COMPETITION LAW & POLICY DEBATE

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Competition Law & Police Debate (CLPD) is a quarterly journal focusing on major developments in Mergers, Cartels, Antitrust (Art.101/102 other than cartels) and State Aid. CLPD contains articles of academic value but written in an approachable style to address practical questions and suggest solutions to new issues. Its focus will be on dissecting, analyzing and criticizing the most recent and important legislation and case law, as well as on discussing questions faced by enforcers and practitioners but neglected in the existing literature. The idea is for CLPD to become an important platform for lawyers and economists to express conflicting views and, in particular, encourage the debate on new developments in all areas of competition law. In this way the journal wants to contribute to debates on policy – or even start them.

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Interleuvenlaan 62
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Phone 0031 570 606100
Fax 0031 570 606769
info@claeys-casteels.com
www.claeys-casteels.com
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Dear Reader,

Competition Law and Policy Debate is starting into its second year. Thank you for your support in year one!

In our first issue in 2016 we are looking at a topic that has been "hot" for decades and that is increasingly discussed in decisions and judgments in the area of competition law -- in spite of the fact that it does not appear to have been decisive in determining the outcome of cases very often. The topic of the symposium, which is introduced by Jorge Padilla, is "Efficiency claims in antitrust and merger control: new developments" and brings together a number of very interesting articles relating to the analysis and effects of efficiency defenses in merger control (Thomas Ross, Benno Buehler and Guilio Federico), Article 101 TFEU (Urs Haegler and Krishna Nandakumar) and Article 102 TFEU (Gianluca Faella) procedures and their non-EU equivalents. Overall, while all of the authors seem to find an increasing use of efficiency defenses by the parties in a case, their analysis also indicates that the framework for taking into account efficiencies is still in a process of being clarified: what types of efficiencies should be taken into account, at what stage of the analysis, with what elements having to be proven and with what type of evidence and level of proof being considered sufficient. Clearly the latter question, lack of sufficient proof, is one raised again and again by agency representatives and courts. A recent example is that of Sysco, which, in its planned USD 8.2 billion takeover of US Foods, had argued that the merger could lead to USD 1 billion in cost savings and synergies but did not manage to convince a Federal judge that these synergies could not be realized without the merger.

Interestingly, as Thomas Ross points out, the only recent judgment where efficiency arguments appear to have been decisive for the outcome of the case, the *Terwita* judgment of the Canadian Supreme Court, seems to be based on an analysis that may well decrease the "efficiency" of merger control procedures.

In addition to our symposium, our first issue in 2016 also contains an article by Nicholas Petit that continues the debate on the effect of the *Intel v Commission* and *Post Danmark II* judgments that different authors had raised in previous issues of CLPD. The author concludes that if the Commission wants to depart from the "As Efficient Competitor" test, it will have to withdraw its Guidance on the Commission's enforcement priorities in applying Article [102 TFEU] to abusive exclusionary conduct by dominant undertakings. We would be interested in hearing whether you agree.

Finally, this issue contains a review of developments in EU merger control from November 1, 2014 to December 31, 2015. Cormac O'Daly's thorough analysis focuses on Phase II decisions but also picks out the most interesting Phase I and referral decisions and highlights the key messages of the General Court's judgments in the appeal of two Commission decisions.

As usual, enjoy reading CLPD – and let us know if you have comments or suggestions.

Annette Schild
Annette.Schild@alschild.com

Rebates and article 102 TFEU: The European Commission's duty to apply the guidance paper

Nicolas Petit
Professor, School of Law of the University of Liege (ULg) and Liege Competition and Innovation Institute ("LCII")

1. Overview

The judgments handed down by the General Court ("GC") in *Intel v Commission*[1] and the Court of Justice of the European Union ("CJEU") in *Post Danmark II*[2] have brought to the fore an important question for the antitrust policy of the European Commission ("Commission") under Article 102 of the Treaty on the Functioning of the European Union ("TFEU"): can the Commission apply the As-Efficient Competitor ("AEC") test in enforcement proceedings brought against rebates – and in particular loyalty rebates – granted by dominant firms, in line with the principles enshrined in its 2009 Guidance Communication on Enforcement Priorities in Applying Article 102 TFEU ("Guidance Paper")?[3]

This question arises because in *Intel v Commission* and *Post Danmark II*, the EU Courts affirm from the side-lines a standard of antitrust liability that is manifestly different from the substantive provisions of the Guidance Paper on loyalty rebates. In *Intel v Commission*, a case initiated prior to the adoption of the Guidance Paper, the GC held that loyalty rebates ought to be scrutinised under a modified *per se* prohibition rule.[4] In *Post Danmark II*, a case about standardised rebates, the CJEU suggests *obiter dictum* that loyalty rebates given in exchange for an obligation or a promise of exclusivity tend to limit access to competitors and thus "*amoun[t] to an abuse*" without the need for further consideration.[5]

In essence, both judgments embrace the "*inhospitality tradition*" of antitrust, described by Judge Easterbrook in 1984 in his article, "The Limits of Antitrust".[6] The inhospitality tradition means that a type of business conduct is viewed with suspicion by courts and agencies, unless the defendant offers a convincing economic justification.[7] The references in *Intel v Commission* and *Post Danmark II* to the strict standard of liability set by the CJEU in *Hoffmann La Roche*[8]

1 *Intel Corp. v European Commission* (T-286/09) June 12, 2014.
2 *Post Danmark A/S v Konkurrenceradet* (C-23/14) October 6, 2015.
3 Guidance Communication on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] OJ C45/7 ("Guidance Paper"). For a comprehensive description of the Guidance Paper and of the AEC test, *see* N. Petit, "From Formalism to Effects? The Commission's Communication on Enforcement Priorities in Applying Article 82 EC" (2002) 32 World Competition 4, 485.
4 N. Petit, "Intel, leveraging rebates and the goals of Article 102 TFEU" (2015) 11 European Competition Journal 1, 26.
5 *Post Danmark II*, paragraphs 27 and 28.
6 Frank H. Easterbrook, "Limits of Antitrust", (1984) 63 Texas Law Review 1.
7 For a similar analysis, *see* P. Ibanez "Post Danmark II, or the Quest for Administrability and Coherence in Article 102 TFEU" (2015) LSE Legal Studies Working Paper No. 15/2015. Available at SSRN: http://ssrn.com/abstract=2636407 or http://dx.doi.org/10.2139/ssrn.2636407.
8 *Hoffmann-La Roche* v *Commission* (85/76) [1979] E.C.R. 461, paragraph 90, referred to in *Intel v Commission*, paragraph 81.

and *Michelin I*[9] underline the influence of the inhospitality tradition in positive EU competition case-law.[10] Paragraph 81 of *Intel v Commission* states explicitly that "*that type of rebate constitutes an abuse of a dominant position if there is no objective justification for granting it*".

With its Guidance Paper, the Commission departs from the inhospitality tradition in relation to loyalty rebates. The Guidance Paper explains that in matters concerning "*price-based exclusionary conduct*", a category that seems to include loyalty rebates, the Commission

> "*will normally only intervene where the conduct concerned has already been or is capable of hampering competition from competitors which are considered to be as efficient as the dominant undertaking.*" (*AEC test*).[11]

It adds that

> "*In order to determine whether even a hypothetical competitor as efficient as the dominant undertaking would be likely to be foreclosed by the conduct in question, the Commission will examine economic data relating to cost and sales prices, and in particular whether the dominant undertaking is engaging in below-cost pricing.*"[12]

After *Intel v Commission*, some Commission officials commented on the judgment and its possible incompatibility with the Guidance Paper's AEC test for loyalty rebates.[13] In an article, the Hearing Officer Wouter Wils suggested that the GC in *Intel v Commission* had considered the AEC test irrelevant.[14] Wils eventually "*commended*" the Court for this. Luc Peeperkorn, a principal expert with the Commission noted the existence of an inconsistency, and found the judgment "*wrong*" from a normative standpoint.[15]

What those comments do not address, however, are the concrete and necessary consequences of *Intel v Commission* and *Post Danmark II* for the applicability of the Guidance Paper's AEC test in loyalty rebates cases investigated by the Commission. It is this specific issue that we now address. We conclude that *Intel v Commission* and *Post Danmark II* do not alter the obligation of the Commission to apply in full its own Guidance Paper, including the AEC, test, in loyalty rebates cases.

2. The Unimportance of *Intel v. Commission for the Positive Applicability of the AEC Test in Loyalty Rebates Cases before the Commission*

Some of the early literature on *Intel v Commission* airs the idea that after the judgment, the AEC test should no longer be applied by the Commission to loyalty rebates cases.[16] That claim relies on a

9 *NV Nederlandsche Banden Industrie Michelin v Commission ('Michelin I')* (322/81) [1983] E.C.R. 3461, paragraph 71, referred to in *Post Danmark II*, paragraph 27.

10 By "*positive*" I mean the existing, man-made law currently in force and positively affirmed by the law makers through cases or legislation, as opposed to the prospective or normative law (law that one believes should exist) or the natural law that pre-exists by nature or reason.

11 Guidance Paper, paragraph 23.

12 *Id.*, paragraph 25.

13 W. P.J. Wils, "The Judgment of the EU General Court in Intel and the So- Called 'More Economic Approach' to Abuse of Dominance" (2014) 77 World Competition: Law and Economics Review 4, 405; in contrast with L. Peeperkorn, "Conditional pricing: Why the General Court is wrong in Intel and what the Court of Justice can do to rebalance the assessment of rebates", (2015) 1 Concurrences – Doctrines 43.

14 Wils, "The Judgment of the EU General Court in Intel and the So- Called 'More Economic Approach' to Abuse of Dominance" (2014) 77 World Competition: Law and Economics Review 4, 405: text accompanying fn. 34 "*The fact that the General Court in the Intel judgment confirmed the established case-law, and thus considered the as-efficient-competitor test irrelevant, has been a major disappointment for those who had hoped that the EU Courts would change their case-law and adopt the test set out in the Priorities Paper as a new test for assessing the legality of exclusionary conduct under Article 102 TFEU.*"

15 L. Peeperkorn, "Conditional pricing: Why the General Court is wrong in Intel and what the Court of Justice can do to rebalance the assessment of rebates", (2015) 1 Concurrences – Doctrines, 43: "*the GC rules that a price-cost test in general and the "as efficient competitor test" (AEC test) in particular are not only not necessary for the assessment of conditional rebates (whether exclusivity or other rebates), as the GC considers it sufficient to demonstrate the existence of a loyalty mechanism to establish a potential anticompetitive effect (§ 145), but would also be erroneous as "an AEC test only makes it possible to verify the hypothesis that access to the market has been made impossible and not to rule out the possibility that it has been made more difficult" (§ 150).*" On the basis of economic and legal arguments, Peeperkorn invites the CJEU to affirm the relevance of the AEC test in loyalty rebates cases, in line with the philosophy of *Post Danmark I*. Readers with an antitrust background will recognise here the enduring, though not unprecedented, disagreement between the Commission's Legal Service (LS) on the one hand, and the Chief Economist Team and Policy Units of the Directorate General for Competition (COMP) on the other. As is well-known, antitrust agencies are social organisations that contain groups with distinct agendas. A commonly heard rumour in the Brussels antitrust community is that the LS would have given instruction to its officials to avoid any reference to the Guidance Paper in documents subject to disclosure.00

16 For instance, P. Nihoul, "The Ruling of the General Court in Intel: Towards the End of an Effect-based Approach in European Competition Law?", (2014) 5 *Journal of European Competition Law & Practice* (8), 521: "*[T]he 'as-efficient-competitor' test, which seeks to determine whether a competitor must sell at a loss to match rebates provided by the dominant firm, is considered useless by the GC in the rebate context. It purports to measure a reality that does not have to be*

mistaken premise. That premise is that the AEC test was the standard of liability applicable to the proceedings commenced by the Commission against Intel's loyalty rebates.[17]

From a positive law standpoint, but only from this standpoint, this premise is specious because it disregards the legal nature of Article 263 TFEU annulment proceedings before the GC. The most important thing to understand is that actions for annulment are time-specific, unlike perhaps other judicial proceedings such as Article 267 TFEU preliminary references before the CJEU. Under Article 263 TFEU, the GC reviews the legality of the Commission's decision against the background of the law applicable at the time of the proceedings. One thus cannot read anything about the Guidance Paper in *Intel v Commission*, which concerns a case commenced in the early 2000s, well before the Commission announced, in 2009, an official change to its enforcement policy of Article 102 TFEU.

This was the position adopted by the Commission in its *Intel* decision.[18] As the Commission had made clear, the Guidance Paper could "*not apply to proceedings that had already been initiated before it was published*".[19] And this approach was the sole possible, explained the Commission, because the Guidance Paper had been published only after Intel "*had been given the opportunity to make its views known*" regarding several documents conveying the Commission's objections, including the formal Statement of Objections.[20]

Interestingly, *Intel v Commission* confirms this idea. It recognises that the "*Article 82 Guidance was not applicable in the present case*".[21] Before this, the CJEU had reached the exact same conclusion in *Tomra v Commission*, where it noted that the Guidance Paper had "*no relevance to the legal assessment of a decision, such as the contested decision, which was adopted in 2006*".[22]

> The most important thing to understand is that actions for annulment are time-specific, unlike perhaps other judicial proceedings

In the scholarly literature, some commentators of the case-law seem to be of the same opinion. Professor Whish, for example, disputes that *Intel* is an "*implied rejection*" of the Guidance Paper, because it was initiated before the adoption of the Guidance Paper.[23]

In reality, the only potentially sound basis to argue that the Guidance Paper was retroactively applicable to the *Intel* proceedings would be to rely on the time overlap between the publication of the Guidance Paper on 24 February 2009 and adoption of the *Intel* decision on 13 May 2009.[24] This position corresponds to that of Wils, who stresses that:

> "*The Commission adopted its decision in the Intel case shortly after it had published, at the end of 2008/ beginning of 2009, its Guidance on its enforcement priorities in applying Article 102 TFEU to exclusionary abusive conduct.*"[25]

demonstrated for the prohibition to apply".

17 Wils, "The Judgment of the EU General Court in Intel and the So-Called 'More Economic Approach' to Abuse of Dominance" (2014) 77 World Competition: Law and Economics Review 4, 405: this position seems to correspond to that carefully implied by Wils, who suggests that the AEC test has been on the cards since the mid-2000s, text accompanying fnn. 18 to 20: "*This Priorities Paper was the end-product of a review process announced by the then Competition Commissioner, Neelie Kroes, in a speech in New York in 2005, and was presented as a 'more economic' and 'effects-based' approach to Article 102 TFEU*". Additionally, Wils offers support for this contention by quoting early commentators who had perceived the *Intel* case as a "*test case*" for this new approach.

18 Decision relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (COMP/C-3/37.990-*Intel*), paragraph 916. Wils recognises this but notes that the Commission included in its analysis a "*150 pages long as efficient competitor analysis*".

19 *Id.*

20 *Id.*

21 *Intel v Commission*, paragraph 158.

22 *Tomra Systems ASA and others v Commission* (C-549/10 P) [2012] E.C.R. 2012-0000, paragraph 81.

23 R. Whish, "Intel v Commission: Keep Calm and Carry On!" (2014) 5 Journal of European Competition Law & Practice, 603: "*Both Tomra and Intel were initiated before the adoption of the Guidance, and so it is irrelevant to the selection of those cases for investigation*".

24 Wils, "The Judgment of the EU General Court in Intel and the So-Called 'More Economic Approach' to Abuse of Dominance" (2014) 77 World Competition: Law and Economics Review 4, 405: Wils discretely seems to be alluding to this possibility in fn. 18, where he stresses that "*While the publication of the Priorities Paper in the Official Journal took place only on 24 February 2009, the Commission had already published the Priorities Paper on its website on 3 December 2008*".

25 *Id.*, text accompanying fnn. 18 to 20

If this argument were to be followed, however, this would mean that the Commission could – within its margin of discretion – change its interpretation of the law applicable in competition proceedings weeks before the adoption of an infringement decision and after a hearing had taken place, as was the case in *Intel* – in whatever way it sees fit. This would allow the Commission to *de facto* negate the defendant's right to a fair trial, which is fundamentally at odds with the rights of defence and to good administration enshrined in the EU Treaties and protected in administrative proceedings before the Commission.[26]

Moreover, this would be a temerarious claim to make on legal grounds. The case-law of the CJEU has consistently ruled that "*…the principle of legal certainty precludes a Community act from taking effect as from a point in time before its publication…*".[27] To be sure, the Court has accepted exceptional derogations to the non-retroactive application of EU law. In the same line of case-law, the Court systematically adds that "*…it may exceptionally be otherwise where the purpose to be achieved so demands and where the legitimate expectations of those concerned are duly respected*".[28] In the present case, however, there are doubts that Intel could entertain legitimate expectations vis-a-vis the application of the Guidance Paper AEC test. It is not us who say this, it is AG Kokott who had been confronted with a similar argument in *British Airways*. At the time, the CJEU AG rebuffed the claim, noting that: "*it is immaterial how the Commission intends to define its competition policy with regard to Article [102 TFEU] for the future*".[29]

And whilst in *Hoechst v Commission*, the GC contemplated the possibility of retroactive application by analogy of a Notice to situations that commenced before its publication, it noted that this can only be the case in situations "*which were not governed by any other legal rule*".[30] Given the amount of clear case-law precedents governing the issue of loyalty rebates, this did not seem to be the situation that prevailed in the *Intel* case.

With this, the bottom line is that *Intel v Commission* is immaterial in terms of the positive applicability of the AEC test to loyalty rebates cases investigated by the Commission.

3. *Post Danmark II* and the Optional Application of an AEC Test in Loyalty Rebates Cases under Article 102 TFEU

A similar problem seems to beset the relevance of *Post Danmark II*. The case before the referring court concerned alleged abuses committed in 2007 and 2008, which pre-dated the Guidance Paper. By applying the above logic, the judgment would not be of any interest as regards the positive applicability of the AEC test. Moreover, the questions referred by the national court to the CJEU were essentially seeking an interpretation of the Treaty rule found in Article 102 TFEU,[31] and not of the applicability of the Guidance Paper which seemed only to be mentioned in passing.[32]

The problems with this analysis are twofold. First, it is settled case-law that in proceedings under Article 267 TFEU "*the interpretation which […] the Court gives to a rule of Community law clarifies and defines, where necessary, the meaning and scope of that rule as it must be, or ought to have been, understood and applied from the time of its coming into force*" (emphasis added).[33] Accordingly, the *Post Danmark II* findings on the relevance of the AEC test for loyalty rebates under Article 102 TFEU must be deemed to pre-exist to the Guidance Paper, and therefore can have a possible impact on the applicability of the Guidance Paper in general and

26 And this would make EU competition proceedings look like Franz Kafka's trial.

27 *A. Racke v Hauptzollamt Mainz* (98/78) [1979] E.C.R. 69, paragraph 10; *Crispoltoni* (C-368/89) [1991] E.C.R. I-3695, paragraph 17. In several competition cases concerning draft notices, the Court held that the Commission was under no obligation to apply the upcoming policy on cooperation with the Commission – a draft was available – in ongoing proceedings before official publication of the final version of the notice on immunity from fines and reduction of fines in cartel cases. *Tokai Carbon v. Commission* (joined Cases T-236/01, T-239/01, T-244/01 to T-246/01, T-251/01 and T-252/01) [2004] E.C.R. II-1181, paragraph 273; *Union Pigments v. Commission* (T-62/02) [2005] E.C.R. II-05057, paragraph 140; *ThyssenKrupp v. Commission* (joined Cases C-65/02 and C-73/02) [2005] E.C.R. I-06773, paragraph 59; *Roquette Frères v. Commission* (T-322/01) [2006] E.C.R. II-3137, paragraph 224.

28 *Id.*

29 Opinion of AG Kokott, *British Airways v Commission* (C-95/04) [2007] E.C.R. I-233, paragraph 28. In *British Airways v Commission*, an applicant in review proceedings had sought to rely on the foreseeable adoption of the Guidance Paper to benefit from certain of its provisions.

30 *Hoechst v. Commission* (T-410/03) [2008] E.C.R. II-881, paragraph 507.

31 *Post Danmark II*, paragraph 20. They talked of the "*relevance, if any, [of] the dominant undertaking's prices and costs [in] the evaluation pursuant to Article 102 TFEU*" of the rebate scheme and of the "*relevance of an as efficient competitor test*" under Article 102 TFEU.

32 *Id.*, in the fourth subparagraph of Question 1.

33 *Willy Kempter KG v Hauptzollamt Hamburg-Jonas* (C-2/06) [2008] E.C.R. I-411.239, paragraph 35; *see* also *Denkavit Italiana* (61/79) [1980] E.C.R. 1205, paragraph 16.

on its AEC test in particular. Second, the Court is the sole EU institution with definitive authority to interpret the Treaty provisions, and in particular Article 102 TFEU. The Commission is thus bound by the CJEU's pronouncements under Article 267 TFEU when it defines its enforcement policy in 'soft law' instruments.

With this, it can be considered that unlike the first instance *Intel v Commission* judgment of the GC, the *Post Danmark II* judgment does impact the Guidance Paper. But what sort of impact does it have? This issue, which is not a positive law issue but instead a substantive one, consists in determining whether the standard of antitrust liability affirmed in *Post Danmark II* contradicts or differs from the one affirmed in the Guidance Paper's section on loyalty rebates, with the result that the Commission should revise or rescind its Communication in relation to loyalty rebates. This risk is not unprecedented. In *Expedia*, the CJEU affirmed *obiter dictum* that restrictions by object were presumed to appreciably affect competition,[34] discarding the laxer principle affirmed in the Commission's 2001 De Minimis Notice (and its own earlier case-law).[35] Following the judgment, the Commission had no other choice but to revise its De Minimis Notice in order to remove the conflict with the substantive principle subsequently established by the *Expedia Inc.* court.[36]

The answer to the question before us therefore hinges on determining whether *Post Danmark II* embraces a standard of antitrust liability for loyalty rebates that refutes the Guidance Paper's AEC test. Fortunately, the Court addresses this question. After having explained that the AEC test is not a compulsory method to make a finding of Article 102 TFEU liability,[37] the Court moves on to embrace the proposition that the AEC test nonetheless remains a possible option to establish antitrust liability under Article 102 TFEU.[38] It is, says the Court, "*one tool amongst others*".[39]

Some might object that the Court's statements concern rebates other than loyalty rebates, which would remain subject to the inhospitality tradition pursuant to paragraph 27 of the judgment.[40] It may additionally be argued that the rebates in the main proceedings were not individualised loyalty rebates, but standardised ones. Both arguments fail for a simple reason: the precedent selected and cited on two occasions by the Court to contend that the AEC test is an option and not an obligation is *Tomra v Commission*, which is a well-known loyalty rebate case. Moreover, the wording of paragraph 27 is not inconsistent with the optionality of an AEC test. To the contrary, an AEC test allows to verify whether the rebates under consideration are indeed loyalty (or exclusivity) rebates "*which by offering customers financial advantages tends to prevent them from obtaining all or most of their requirements from competing manufacturers, [and] amounts to an abuse*" within the meaning of paragraph 27.[41] And this question of exclusivity, which precedes in the analysis the distinct question of whether the rebates can give rise to anticompetitive exclusion, cannot be answered in the abstract[42] and can be adequately addressed with an AEC test.[43]

34 *Expedia, Inc. v. Autorité de la concurrence and Others* (C-226/11) [2012] E.C.R. 0000, paragraph 36.

35 *Franz Völk v. S.P.R.L. Ets J. Vervaecke* (C-5/69) [1969] E.C.R. I-00295.

36 As recognised by the Commission, see MEMO 25 June 2014 "Antitrust: Commission adopts revised safe harbours for minor agreements ("De Minimis Notice") and provides guidance on "by object" restrictions of competition". Some scholars convincingly argue that the laxer principle set out by the Court was nothing novel. *See* S. King, "How appreciable is object? The de minimis doctrine and Case C-226/11 Expedia Inc v Autorité de la concurrence" (2015) 11 European Competition Journal 1, 1. More generally, see G. Bushell and M. Healy, "Expedia: The de minimis Notice and 'by object' Restrictions" (2013) 4 Journal of European Competition Law & Practice 3, 224.

37 *Post Danmark II*, paragraph 57: "*it is not possible to infer from Article 82 EC or the case-law of the Court that there is a legal obligation requiring a finding to the effect that a rebate scheme operated by a dominant undertaking is abusive to be based always on the as-efficient-competitor test*". After having recalled at paragraph 52 that the Guidance paper is not binding on national courts and agencies: "*administrative practice followed by the Commission is not binding on national competition authorities and courts*". What this implies is well-known from European lawyers. In *Pfleiderer* and *Expedia*, the Court had already held that Commission notices were "*not binding on Member States*". *Pfleiderer* (C-360/09) [2011] E.C.R. I-5161, paragraph 21; *Expedia*, paragraph 29.

38 *Post Danmark II*, paragraph 58: "*that conclusion ought not to have the effect of excluding, on principle, recourse to the as-efficient-competitor test in cases involving a rebate scheme for the purposes of examining its compatibility with Article 82 EC*".

39 *Id.*, paragraph 61.

40 *Id.*, paragraph 27.

41 *Tomra v Commission*, paragraph 70.

42 The Court itself explicitly recognizes this, when it distinguishes between formal loyalty rebates where there is an "*obligation for, or promise by, purchasers to obtain all or a given proportion of their supplies*" and which can be subject to the inhospitality tradition under paragraph 27 and *de facto* loyalty rebates, for which an exclusivity effect cannot be presumed. *See Post Danmark II*, paragraph 28. For *de facto* loyalty rebates, an assessment of "*all the circumstances*" is requested. *See Post Danmark II*, paragraph 29. I am grateful to Vincent Verouden who brought this important point to my attention.

43 As is well known indeed, if a dominant firm A tells X that it will get a rebate of 100€ *if* it purchases exclusively from it, it cannot be assumed that X will procure solely from A. It depends on whether alternative suppliers (B, C, D, etc.) can also give a 100€ rebate. Similarly, if A tells X that it will get a rebate of 0,5€ per unit above 80%

4. The EU Courts' Case Law and the Commission's Duty to Apply the Guidance Paper AEC Test in Loyalty Rebates Cases

CJEU precedent recognises that 'soft law' instruments adopted by the Commission have "*self-binding effects*" which limit its discretion in the day-to-day enforcement of the antitrust prohibitions.[44] In a book, Oana Stefan has tracked the cases where the EU courts held that the Commission was bound by 'soft law' instruments. They cover substantive, punitive and procedural instruments as diverse as the Communication on market definition,[45] the Notice on turnover calculation in merger cases,[46] the Notice on procedural alignment,[47] and the Guidelines on fines,[48] amongst others. Against this background, there should be little hesitation that the Commission is bound by the Guidance Paper in general, and thus also by the AEC test outlined at paragraphs 23 to 27 and 37 to 39 of the Guidance Paper.

Notwithstanding this, doubts have been cast in relation to the binding nature on the Commission of the Guidance Paper's AEC test. The main argument against the binding effect of the Guidance Paper is built on a two steps logic, which must be disentangled. At its heart, the argument is based on the text of the Guidance Paper, which states that it formulates enforcement "*priorities*",[49] whilst at the same time disclaiming that it "*is not intended to constitute a statement of the law*".[50] In his *Intel* paper, Wils explains that:

> "*The Priorities Paper clearly states that it is not meant to provide a test for assessing whether or not exclusionary conduct violates Article 102 TFEU (legality test), but only a test to be used by the Commission to determine, in the context of its priority setting, whether or not a case would be a priority case (prioritisation test)*".[51]

> There is no compelling reason ... to consider that the Guidance Paper AEC test does not articulate a classic "rule of practice" which fetters the margin of discretion enjoyed by the Commission

In turn, the argument – which is often implicit in form – seems to be that even if the Commission makes use of its broad discretion to publish precise guidance on its prioritisation policy, it must remain, on a case-by-case basis, able to depart from its own guidance. Wils, in a 2011 paper on prioritisation in competition enforcement, came close to this proposition, suggesting that the Commission could freely depart from the Guidance Paper in each case subject to its scrutiny:

> "*Because the Commission cannot regard as excluded in principle from its purview certain situations which come under its task of enforcing Articles 101 and 102 TFEU, such guidance must not be treated as rules to be applied automatically, but must allow consideration of the merits of each case.*"[52]

of its requirements; of 1€ per unit above 90%; and of 1,5€ per unit if it buys 100%, it cannot be conjectured that X will concentrate all or most of its purchases with A (or buy from B, C, D, etc.).

44 For a complete review and use of the expression, *see* O. Stefan, *Soft Law in Court – Competition Law, State Aid and the Court of Justice of The European Union*, (Alphen aan den Rijn, Kluwer, 2013), in particular Chapter 6; N. Petit and M. Rato, "From Hard to Soft Enforcement of EC Competition Law - A Bestiary of Sunshine Enforcement Instruments", in C. Gheur and N. Petit (Eds.), *Alternative Enforcement Techniques in EC Competition Law*, (Brussels: Bruylant, 2008), p.264.

45 Commission Notice on the definition of relevant market for the purposes of Community competition law *,OJ C 372, 9.12.1997, p. 5–13; see General Electric Company v Commission* (T-210/01) [2005] E.C.R.II–5575.

46 Commission Notice on calculation of turnover OJ C 66, 02.03.1998, p. 25; see*Endesa v Commission* (T-417/05) [2005] E.C.R. II-18.

47 Commission Notice concerning alignment of procedures, OJ C 66, 02.03.1998, p.36, see *Verband der freien Rohrwerke and others v Commission* (T-374/00) [2003] E.C.R. II-2275.

48 Guidelines on the method of setting fines, OJ C 210, 01,09,2006, p. 2; see Stefan, *Soft Law in Court – Competition Law, State Aid and the Court of Justice of The European Union* (2013), in particular Chapter 6 and case law cited therein.

49 Guidance paper, as suggested in its title and at paragraph 2.

50 *Id.*, as expressed at paragraph 3.

51 Wils, "The Judgment of the EU General Court in Intel and the So-Called 'More Economic Approach' to Abuse of Dominance" (2014) 77 World Competition: Law and Economics Review 4, 405, text accompanying fnn. 26 and 27. The author hammers the point on several occasions: "*…the Priorities Paper itself clearly states that the test set out in it is not intended to constitute a statement of the law (legality test), but is merely to be used for prioritisation purposes (prioritisation test)*". See also fn. 125 and 141.

52 W. P. J. Wils, "Discretion and Prioritisation in Public Antitrust Enforcement", (2011) 34 *World Competition* 3, p. 353-382.

This intellectual construct fails, however, for two self-evident, and related, reasons.

First, it must be recalled that a general principle of EU (and of international) law is that the denomination of an act is not decisive with regard to the determination of its legal effects. As is well known, "*the choice of form cannot alter the nature of a measure*",[53] and this applies equally to 'soft law' instruments.[54] The various disclaimers and prioritisation language used in the Guidance Paper cannot be a pretext to dispense with an inquiry into its content, which is a prerequisite to understand its effects.[55] As noted by Scott:

> *"As disclaimers increasingly included in the text of guidance suggest these measures are non-binding and operate without prejudice to the interpretative autonomy and authority of the European Court. However, non-binding should not be equated with an absence of (legal) effects and careful, contextual analysis is required to assess and evaluate their nature and extent."*[56]

Second, 'soft law' instruments adopted by the EU institutions do not – and cannot possibly – prescribe rules of "*law*" with general binding effects, as this would violate Article 288 TFEU (and the procedures for the adoption of secondary legislation).[57] Recalling that the Guidance Paper is not a statement of the law and arguing that it does not convey a "*test of legality*" is thus pushing an open door.[58] And this moot point obscures a somewhat more important point on the nature of 'soft law' instruments, which was first vindicated in the competition field in the *Dansk Rørindustri* case. Here, the Court explained, in relation to Commission Guidelines, that

> *"although those measures may not be regarded as rules of law which the administration is always bound to observe, they nevertheless form rules of practice from which the administration may not depart in an individual case." (emphasis added).*[59]

As Stefan notes, this principle is nothing new and originates from the case-law dealing with staff regulations.[60] Its underlying rationale includes the principles of equal treatment, legitimate expectations, and estoppel.[61]

There is no compelling reason – and, to our knowledge, no such reason has been advanced – to consider that the Guidance Paper AEC test does not articulate a classic "*rule of practice*" which fetters the margin of discretion enjoyed by the Commission.[62] To the contrary, the Press Release adopted on the day of initial publication of the Guidance Paper expressly embraced the language of a "*rule of practice*", noting that "*The Commission will fully apply the approach set out above to future cases*".[63]

Even more importantly, the fact that the Guidance Paper concerns prioritisation issues is irrelevant in this assessment. If the Commission affirms a given

53 *Binderer v Commission* (147/83) [1985] E.C.R. 257, paragraph 11. *See* also, in international law, *Case Concerning Maritime Delimitation and Territorial Questions between Qatar and Bahrain*, ICJ Reports 1994, p. 6.

54 *Salvatore Grimaldi v Fonds des maladies professionnelles* (322/88) [1989] E.C.R. 4407.

55 See, in the sense of this argument, P. Nihoul, "The Ruling of the General Court in Intel: Towards the End of an Effect-based Approach in European Competition Law?" (2014) 5 *Journal of European Competition Law & Practice* (8), 521: "*But one should not be naïve. A realistic interpretation would be to consider that, through the Guidance paper, the Commission was willing to bring European competition policy closer to economic theories currently dominating the debates in the USA*".

56 J. Scott, "In Legal Limbo: Post-legislative Guidance as a Challenge for European Administrative Law" (2011) *Common Market Law Review* 48, 329 (noting also: "*while it is accurate to claim that guidance may never detract from or narrow the scope of a binding provision laid down in law, its existence may operate to shape the Commission's approach to the enforcement of EU law. The underlying legal obligation remains unchanged, but the perception and practice of one of the primary agents of enforcement may be altered in profound and consequential ways*"). The author in turn laments that the Union Courts refuse to consider such guidance to be judicially contestable, despite their practical effects on the administration and third parties. Guidance thus eschews judicial review on grounds of inadmissibility.

57 The Commission Guidelines do not (and cannot) prescribe legal rules, but describe what the Commission believes the legal rules are.

58 True that the point may not be that obvious, given that the Guidance Paper appears on the Commission website under a heading "*Legislation in force*", see http://ec.europa.eu/competition/antitrust/art82/ consulted on 10 November 2015.

59 *Dansk Rørindustri and Others v Commission* (joined Cases C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P) [2005] E.C.R. I-5425, paragraph 209.

60 Stefan, *Soft Law in Court – Competition Law, State Aid and the Court of Justice of the European Union* (2013), p. 139.

61 *Dansk Rørindustri*, paragraph 211: "*In adopting such rules of conduct and announcing by publishing them that they will henceforth apply to the cases to which they relate, the institution in question imposes a limit on the exercise of its discretion and cannot depart from those rules under pain of being found, where appropriate, to be in breach of the general principles of law, such as equal treatment or the protection of legitimate expectations*".

62 Opinion of AG Kokott, *Post Danmark II*, paragraph 59: which employs the expression "as *a rule*" seems to support this interpretation. She writes, "*the Commission undertook to carry out, as a rule, an AEC test in connection with price-based exclusionary conduct*".

63 Commission Press Release, IP/08/1877, Brussels, 3rd December 2008, "Antitrust: consumer welfare at heart of Commission fight against abuses by dominant undertakings".

rule of practice in relation to priority setting, then it willingly narrows the range of tools available to it to select a case – the very tools that the Court talked about in its ruling in *Post Danmark II* (“*tool amongst others*”).[64] The upshot of this is that the Commission should be deemed, in positive law, to be under a duty to apply the chosen Guidance Paper AEC tool prior to deciding whether or not to pursue a pricing abuse.

We note rather ironically that if the reading of the Guidance Paper AEC test as a prioritisation instrument is right, then it makes it immune to any future pronouncement that the EU courts may make

Granted, some flexibility exists. In *Dansk Rørindustri* and subsequent case-law, the Court acknowledged that the binding effect of rules of practice on the Commission is not absolute, and it tolerated a certain margin of discretion. The Commission may exceptionally depart from a rule of practice, but it is bound to give reasons and the Court will verify if they are justified and supported by sufficient legal reasoning,[65] and if those reasons are in line with legitimate expectations, equal treatment, foreseeability and legal certainty.[66] In the Guidance Paper, the Commission has, for instance, reserved the possibility to depart from the AEC test if there is proof that “*a less efficient competitor may also exert a constraint which should be taken into account when considering whether particular price-based conduct leads to anti-competitive foreclosure*”.[67] In addition, in *Post Danmark II*, the CJEU explained that Commission recourse to the AEC test was of “*no relevance*” in legacy markets where the dominant firm has a “*very large market share*” and “*structural advantages*” conferred, inter alia, by a “*statutory monopoly*”.[68] Outside of those circumstances, the Commission is bound to apply the Guidance Paper's AEC test.

We certainly acknowledge that the implication that the Commission can, in principle, not avoid applying an AEC test in loyalty rebates cases may be liable to consume a large amount of resources at early stages of certain proceedings.[69] But this is the inescapable consequence of the combination of the abovementioned case-law with the prioritisation language contained in the Guidance Paper. Recognising that the AEC test is a standard of antitrust liability, instead of a prioritisation test, would have likely proven more efficient from a resource standpoint, because the resource intensive AEC test would only be applied to a subset of cases which have been deemed to merit further antitrust scrutiny, and not to all the cases that reach the docket of the competition agency.

Moreover, we note rather ironically that if the reading of the Guidance Paper AEC test as a prioritisation instrument is right, then it makes it immune to any future pronouncement that the EU courts may make on the legality test that applies to loyalty rebates.[70] In particular, it can be argued that

64 All the more so given that the Guidance Paper does not enshrine priority *targets* (*e.g.* practice or sector) but merely acts as a prioritisation device.

65 Stefan, *Soft Law in Court – Competition Law, State Aid and the Court of Justice of The European Union* (2013), p. 187. Note also that if the Commission wants to amend the AEC test, it cannot do this by individual decisions, *see* p. 173.

66 This is the point generally made in *Dansk Rørindustri. See* also *Expedia,* paragraph 28 in relation to the De Minimis Notice which is quite comparable to the Guidance Paper in that it describes, to some extent, non-priority cases (“*by the de minimis notice, the Commission imposes a limit on the exercise of its discretion and must not depart from the content of that notice without being in breach of the general principles of law, in particular the principles of equal treatment and the protection of legitimate expectations*”).

67 Guidance Paper, paragraph 24. This hypothesis has been confirmed by the CJEU in *Post Danmark II*, paragraph 60.

68 *Post Danmark II,* paragraph 59. Note that this does not seem confined to loyalty rebates. That idea had already appeared before in *Konkurrensverket v TeliaSonera Sverige AB* (C-52/09) [2011] E.C.R. I-00527, paragraph 45.

69 Because in some cases, the calculations necessary to apply the AEC test are rather simple. *See* L. Peeperkorn, “Conditional pricing: Why the General Court is wrong in Intel and what the Court of Justice can do to rebalance the assessment of rebates”, (2015) 1 Concurrences – Doctrines 43.

70 Some scholars have made the point that the Guidance Paper in fact enshrines “*substantive guidelines*”. And given that the substantive tests of liability herein affirmed go beyond the case-law, the Commission would be under the obligation to withdraw the Guidance Paper. *See* L. Lovdahl Gormsen, “Why the European Commis-

even if the CJEU was ever to affirm a stricter test of liability in the forthcoming *Intel* appeal, this would not, and could not, have any possible effect on the applicability and validity of the AEC prioritisation test.[71]

5. Conclusion

In positive law, the Guidance Paper AEC test remains unscathed by *Intel v Commission* and *Post Danmark II*. Instead, *Post Danmark II* has confirmed that the Guidance Paper AEC's test is a valid option in loyalty rebates cases dealt with by the Commission. In other words, this means that the Commission can set for itself stricter standards than those found in the Article 102 TFEU case-law.[72] Moreover, this finding, coupled with the traditional case-law on the self-binding effect of soft law instruments, implies that the Commission is, in positive law, under a duty to apply the AEC test to all price-based abuses, including loyalty rebates cases, opened since the adoption of this document. More generally, the same self-binding effect should apply to the other "*rules of practice*" found in the Guidance Paper, such as the requirement to establish anticompetitive foreclosure and consumer harm in all exclusionary conduct cases.[73]

With all this, if the Commission wants to keep the ability to discretionarily depart from those rules of practice, its sole exit option is a bold (and complex) one: officially withdrawing its Guidance Paper. What does not kill you makes you stronger ...

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sion's enforcement priorities on article 82 EC should be withdrawn" (2010) 31(2) *The European Competition Law Review*, 45: "*As it stands, the Commission is acting outside its remit by going beyond the law set by the Community Courts by means of soft law. Thus, it is respectfully suggested that the Commission withdraws the Guidance Paper*". See *contra* N. Petit, "From Formalism to Effects? The Commission's Communication on Enforcement Priorities in Applying Article 82 EC" (2002) 32 World Competition 485.

71 In proceedings before the EU Commission, of course.

72 In the latest edition of their book, Whish and Bailey note that an interesting question is what the legal position would be if the Commission were to refuse to consider a complaint about conduct that clearly infringes Article 102 TFEU according to the case law of the EU courts on the basis that it does not comply with the Guidance Paper. *See* R. Whish and D. Bailey, *Competition Law* (Oxford: Oxford University Press, 2015), p.187, fn. 17. In our opinion, the Commission can perfectly do this, much as it can decide to shelve complaints related to vertical restraints, and prefer to focus on hardcore horizontal cartels. All the more so in a world where there is a wealth of national venues to bring competition cases, and where remedies for such obvious cases will be easily administered by national agencies and courts without much error risks. In addition, the Commission's focus on the cases with the greatest potential of anticompetitive foreclosure and consumer harm does not imply any violation of the case law, because any suspicion of abuse under the sophisticated detailed effects-based analysis would, *a fortiori*, imply a similar suspicion of abuse under a summary forms-based approach. N. Petit, "From Formalism to Effects? The Commission's Communication on Enforcement Priorities in Applying Article 82 EC" (2002) 32 World Competition 485.

73 Guidance Paper, paragraph 19 and following.

Major developments in EU Merger Control, 2014-2015

Cormac O'Daly
WilmerHale, London and Brussels

Summary

This is an overview of the main developments in EU merger control from 1 November 2014 to 31 December 2015. This period coincided with the 25th year of merger control in the EU[1] and the first year of Commissioner Vestager's mandate. A summary of the main developments is followed by discussion of these developments in more detail.

Unquestionably, the most interesting developments in the last 14 months have been a number of noteworthy European Commission ("EC") decisions. Neither of the court judgments is ground breaking and there have been no significant legislative developments.

While all the EC decisions take account of specific facts, two general trends stand out. First, a number of the decisions focus on dynamic competition and potential threats to innovation and R&D – see, for example, *Novartis/GSK Oncology*, *GE/Alstom* and *Zimmer/Biomet*, which is not yet published.[2] Second, the number of cases that are conditional on an up-front buyer remedy continues to increase.[3]

Phase II Decisions[4]

The trend towards greater consolidation in telecommunications markets continued with the EC approving concentrations on Spanish and Belgian markets subject to remedies. However, the planned joint venture between Telenor and TeliaSonera in Denmark was withdrawn following the EC issuing a Statement of Objections.

In other Phase II decisions, the EC approved the creation of a multi-territorial online music licensing and copyright administration services JV subject to implementation of remedies; it approved General Electric ("GE's") acquisition of Alstom's energy business subject to divestment to a named buyer; in a decision containing an interesting discussion of primary and secondary markets, the EC authorised the creation of a coffee JV subject to divestment of brands and licensing of a brand; and it unconditionally cleared Siemens' acquisition of Dresser-Rand.[5]

1 See e.g. SPEECH *Merger review: Building a global community of practice*, 24 September 2015, available on DG COMP's website, in which Commissioner Vestager notes the "ability of the system to develop" as "the most striking element" of EU merger control in the last 25 years.

2 See also the remarks of Director General Laitenberger, *Competition and Innovation*, Brussels 9 December 2015 and the remarks of Carles Esteva Mosso, *EU Merger Control: The Big Picture*, Brussels 12 November 2014, both available on DG COMP's website.

3 See, for example, *GE/Alstom*, *Holcim/Lafarge*, *IMS/Cegedim*, *Zimmer/Biomet infra* and Case COMP/M.7435, *Merck/Sigma-Aldrich* (which is discussed in the EC's Competition Merger Brief Issue 3/2015, which is available on DG COMP's website, at p. 9). This trend has been noticeable in the last two years. See, for example, Case COMP/M.6905, *Ineos/Solvay/JV*; Case COMP/M.7018, *Telefonica Deutschland/E-Plus*; Case COMP/M.6992, *Hutchison 3G UK/Telefonica Ireland*; and Case COMP/M.7061, *Hunstman Corporation/Rockwood Holdings*. Previous to that, there were only five up-front buyer requirements between 2008 and 2013 – see Cook, Frisch and Novak, *Recent Developments in EU Merger Remedies*, Journal of European Competition Law & Practice, OUP, 2015, Vol. 6, No. 5, 351 at 352.

4 See Section A below.

5 This decision is not discussed in detail since it has not yet been published.

Phase I Decisions[6]

A number of Phase I clearances were authorised subject to creative remedies. In *Novartis/GSK (Oncology)*, the EC was concerned that Novartis would no longer continue to develop a potentially innovative treatment. The EC required divestment of two compounds to a third party and required that entity to enter into a partnership agreement; the EC will have to approve both the partner and the terms of the partnership agreement. The EC approved the concentration between Holcim and Lafarge subject to extensive divestments.[7] *Airbus/Safran* is unusual in that the EC required a structural remedy to address a vertical concern. IMS Health committed to license its "brick structure" to third parties as well as divesting an overlapping business when it acquired Cegedim businesses. The EC approved IAG's acquisition of Aer Lingus subject to sale of slots and a commitment to continue to carry passengers on certain routes to enable them to connect to rivals' long-haul flights. This was the fourth notified concentration involving Aer Lingus; on two previous occasions, the EC had prohibited Ryanair from acquiring it and on the third, Ryanair had withdrawn its notification.

Referrals[8]

In the last 14 months, the EC rejected three requests (*Orange/Jazztel*, *Altice/PT Portugal* and *Hutchison/Telef nica UK*) for referral of transactions under Article 9 of the EU Merger Regulation ("EUMR") to national competition authorities ("NCAs"). The transactions all concerned telecommunications markets. In *Danish Crown/Tican* meanwhile, the EC referred part of a transaction to the Danish NCA. This year has also seen a request from the UK NCA under Article 22 EUMR for the EC to assume jurisdiction over a concentration; such requests are rare.

6 See Section B below.

7 The EC's Competition Merger Brief Issue 1/2015, which is available on DG COMP's website, notes that this decision involved "a structural remedy of an unprecedented size", see p. 20.

8 See Section C.1 below.

European Court[9]

The General Court ("GC") rejected Deutsche Börse's appeal against the EC's 2012 prohibition of its planned concentration with NYSE Euronext. The GC also rejected Niki Luftfahrt's appeal against the EC's clearance of the *Lufthansa/Austrian Airlines* concentration.

Legislative[10]

There have been no significant legislative developments in the last 14 months.

1. Selected EC Phase II Decisions

In an overview of this type, it is not possible to cover all of the EC's merger decisions, or even all of its Phase II decisions.[11] Below we report on the most noteworthy ones.

9 See Section D below.

10 See Section E below.

11 In addition to the Phase II decisions discussed here, the EC approved, subject to divestment to a suitable purchaser and conclusion of a licence, Zimmer's acquisition of the orthopaedic implants producer Biomet (Case COMP/M.7265, *Zimmer/Biomet*); the decision has not yet been published but, according to the EC's press release, the potential negative effect on innovation and R&D was central to this investigation, see IP/15/4727 and see also the EC's Competition Merger Brief Issue 3/2015, which is available on DG COMP's website, at p. 6. Following a Phase II investigation, the EC approved Cargill acquiring ADM's industrial chocolate business subject to the sale of a plant in Germany (Case COMP/M.7408, *Cargill/ADM*); the decision has not yet been published but see the EC's Competition Merger Brief Issue 3/2015, at p. 13, which discusses, in particular, the EC's reconstruction of market shares "based on a customer- and plant-based definition of the geographic market" and its analysis of competitors' future and current capacity levels). The EC cleared Siemens' acquisition of rotating equipment manufacturer Dresser-Rand without requiring remedies after a Phase II investigation (Case COMP/M.7429, *Siemens/Dresser-Rand*); among other things, the EC's press release indicates that the companies focussed on different oil and gas technologies for aero-derivative gas turbines for compressor trains and that the companies rarely bid against each other, see IP/15/5272. As of 31 December 2015, there are six Phase II investigations ongoing: Case COMP/M.7095, *Socar/Defsa*; Case COMP/M.7567, *Ball/Rexam*; Case COMP/M.7630, *Fedex/TNT Express*; Case COMP/M.7555, *Staples/Office Depot*; Case COMP/M.7637, *Liberty Global/Base Belgium*; and Case COMP/M.7612, *Hutchison 3G UK/Telefonica UK*. In December 2014, Mondi announced that it was withdrawing the notification of its plan to purchase assets from Walki due to not having reached agreement on a remedy with the EC, see http://www.londonstockexchange.com/exchange/news/market-news/market-news-detail/MNDI/12563313.html and OJ C430/3, 22 Dec 2015 (Case COMP/M.7566, *Mondi/Walki Assets*). In addition to the decisions that the EC took during the last 14 months, it also published a number of older decisions on its website. These include Case COMP/M.6410 *UTC/Goodrich*; Case COMP/M.6905, *INEOS/Solvay*; Case COMP/M.7054, *Cemex/Holcim Assets*; Case COMP/M.6796, *Aegean/Olympic (II)*, Case COMP/M.7061, *Huntsman/Rockwood*; Case COMP/M.7018, *Telefónica Deutschland/E-Plus*; Case COMP/M.6576, *Munksjö/Ahlstrom* and Case COMP/M.7000, *Liberty/Global Ziggo*.

Main Phase II Decisions

- *Orange/Jazztel*
    - Sale of fibre network to new entrant
    - Wholesale access to ADSL network
    - Access to mobile network
- *Liberty Global/De Vijver*
    - Commitment to license channels and ancillary rights on FRAND terms
    - Anti-circumvention measures and commitment to maintain channels' quality
- *Collecting Societies JV*
    - Commitment not to use leverage to bundle and to license on FRAND terms
    - Rights on termination for customers to avoid lock-in
    - Commitment not to enter into sole or exclusive mandates to license repertoires
- *GE/Alstom*
    - Divestment to avoid creation of a dominant position and to preserve innovation
- *DEMB/Mondelēz*
    - Discussion of primary and secondary markets even though neither party active on primary market
    - Competition in differentiated and branded product markets

1.1. Orange/Jazztel

In May 2015, the EC conditionally approved Orange's acquisition of the telecommunications company Jazztel.[12] This followed a Phase II investigation in which the EC examined the concentration's effects on the retail market for fixed internet access services in Spain and on markets for multiple-play services, including fixed internet access services.[13]

The EC analysed the concentration's effects on the market for multiple-play services as well as on the markets for the separate components of multiple-play services. It concluded that the concentration would reduce competition regardless of whether the correct market definition comprised the multiple-play services bundle or, as the parties submitted, its individual components. Since the EC concluded that the transaction would reduce competition regardless of the chosen market definition, it left open the question of market definition.[14]

Although the planned concentration would not have resulted in Orange acquiring a dominant position, it would have reduced the number of major nationwide fixed internet access providers in Spain from four to three and given rise to non-coordinated anti-competitive effects.[15] Telefónica would have had a market share of some 42 to 45%, Orange/Jazztel some 30% and Vodafone/ONO some 18%.[16]

Orange and Jazztel were the most dynamic fixed internet providers on the market.[17] Since 2010, both had increased their market shares, based on number of subscribers, by around 50% (largely at the expense of Telefónica's Movistar brand). Jazztel had focused on lower cost triple-play offers and had exerted price pressure on its competitors. Orange meanwhile had launched a number of innovative and aggressive tariffs since 2012.

The EC concluded that removing the horizontal competition between Orange and Jazztel would have removed the incentives of the merged entity and its main competitors to compete aggressively post-merger. This conclusion was based largely on a review of Orange's internal documents.[18] Using a

12 Case COMP/M.7421, *Orange/Jazztel*, available on DG COMP's website. See IP/15/4997, MEMO/15/4998, and the EC's Competition Merger Brief Issue 3/2015, which is available on DG COMP's website, at p. 1.
13 Fixed internet access services are offered separately to customers and also as part of "dual-play", "triple-play" or "quadruple-play" bundles. These bundles combine fixed internet access services with other telecommunications services, such as fixed telephony, mobile telephony and television.
14 Case COMP/M.7421, *Orange/Jazztel*, para. 91.

15 *Ibid.*, paras 375 to 403.
16 *Ibid.*, paras 129 to 135, 187 and 197.
17 *Ibid.*, para. 244 *et seq.*
18 There are numerous references to Orange's documents throughout the Decision. See e.g. paras 257, 262, 268, 292 *et seq.*, 302, 335 *et*

calibrated merger simulation model, the EC found that higher prices would be likely.[19]

The EC found that high entry barriers existed due to the significant investments needed to develop a broadband network. The EC was also concerned by the high barriers to entry into multiple-play markets involving a mobile component since it was difficult for a new entrant to obtain reasonable wholesale prices for mobile telecommunications services.[20] Multi-play offers had become, and were projected to remain, very popular in Spain.

Finally, the EC considered that the transaction would not produce material efficiencies that would benefit consumers.[21] The EC found no credible evidence that there would be increased high-speed fibre network coverage since Orange and Jazztel separately were likely to achieve the same or greater coverage as the merged entity.[22] While the merger would produce some efficiencies in relation to multiple-play services including a mobile component, these were deemed insufficient overall to counter the harm that consumers would suffer from the elimination of competition.[23]

To address the EC's concerns that the proposed acquisition would have significantly reduced competition, the parties proposed remedies aimed at enabling the entry of a fourth nationwide competitor on the retail markets involving fixed internet access services in Spain.

First, Orange committed to sell part of Jazztel's FTTH ("fibre-to-the-home") network to a new entrant.[24] To continue to serve current customers, in exchange for a one-time fee and a recurrent fee covering maintenance costs, Orange will be entitled to use up to 40% of the divested network's capacity for 35 years.[25]

While every transaction and its market context is different ...
"The more structural the remedy, the better"

Second, the purchaser of the FTTH network will be granted wholesale access to Jazztel's ADSL network for a minimum of four years, with the possibility of extending that period by another four years.[26] Using this ADSL network, the new entrant will be able to access 78% of the Spanish territory.

Finally, if the purchaser does not already have access to a mobile telecommunications network, Orange committed to provide it with wholesale access to mobile services on competitive terms that were at least as favourable as those formerly granted to Jazztel.[27]

The commitments are subject to the supervision of a monitoring trustee and potentially a divestiture trustee if an agreement with a suitable purchaser is not concluded within a defined timeframe.[28]

This concentration is one of a number in Member State telecommunications markets over the last years.[29] In all of Austria,[30] Germany,[31] and Ireland,[32] and now Spain, the EC cleared the concentrations, which reduced the number of players on certain national telecommunications markets from four to three, subject to commitments.

seq., and 380 *et seq.*
19 See Section 7.2.7 and Annex A.
20 See para. 628 *et seq.* and paras 714 to 716.
21 See Section 7.2.10.
22 *Ibid.*, para. 692.
23 These efficiencies would have benefitted Jazztel customers since the mobile component of their bundle is currently procured at wholesale level from Orange. Post-merger, Orange would be able to offer the mobile services direct to these customers and thereby eliminate a double marginalisation. See para. 747.
24 See Commitments at Annex B to decision, paras 5 and 7 to 15.
25 *Ibid.*, paras 16, 17 and Schedule 1.
26 *Ibid.*, paras 18 to 32
27 *Ibid.*, para. 37(c).
28 *Ibid.*, paras 39 and 40.
29 In November 2015, the EC published an ex-post analysis of two older mobile telecom mergers: Case COMP/M.3916 *T-Mobile/tele.ring* and Case COMP/M.4748, *T-Mobile/Orange*. See http://ec.europa.eu/competition/publications/reports/kd0215836enn.pdf. The Study concludes that *T-Mobile/tele.ring* did not lead to price increases but that mobile telecom prices in the Netherlands increased after the *T-Mobile/Orange* merger compared to other countries. However, it was not established that this was exclusively due to the merger.
30 Case COMP/M.6497, *Hutchison 3G Austria/Orange Austria.*
31 Case COMP/M.7018, *Telefónica Deutschland/E-Plus.*
32 Case COMP/M.6992, *Hutchison 3G UK/Telefonica Ireland.*

In September 2015, Telenor and TeliaSonera abandoned plans to create a wireless joint venture in Denmark.[33] The EC took note of this stating that "the discussions with the parties thus far were not able to fully address the Commission's competition concerns".[34]

Hutchison Whampoa meanwhile has notified the EC of its intention to purchase Telefónica UK (O2) and the EC has opened a Phase II investigation.[35] This investigation may show if *TeliaSonera/Telenor* was an exceptional case or whether the Vestager Commission is intent on making telecommunications mergers more difficult.[36] Notably, the Commissioner has stated that, while every transaction and its market context is different, the Austrian, German and Irish concentrations were allowed to proceed conditional on entry of a mobile virtual network operator ("MVNO") into the market.[37] The Commissioner noted that this was a "less structural" remedy compared to creating a fourth independent mobile network operator ("MNO") and she stated, referring to the structural remedy in *Orange/Jazztel* that, as far as she was concerned, "The more structural the remedy, the better". This does not mean that such a remedy will necessarily be required in *Hutchison/Telefónica UK (O2)*; indeed it is arguable that the UK markets are more competitive than others. It has also been suggested that *TeliaSonera/Telenor* was not a four to three deal but a three to two with the EC considering that Hutchison's Danish presence was marginal.

1.2. Liberty Global/De Vijver

In February 2015, the EC authorised Liberty Global's acquisition of joint control over the Belgian media company De Vijver Media ("De Vijver").[38]

The transaction gave Liberty Global joint control over De Vijver, along with De Vijver's existing shareholders, the Belgian companies Waterman & Waterman and Corelio Publishing. De Vijver broadcasts the Dutch language TV channels "Vier" and "Vijf" in Belgium and licenses them to downstream TV distributors. Liberty Global was already the controlling shareholder of Telenet, the owner and operator of a cable network in the Dutch-speaking Flanders region.

The EC's main concerns related to the combination of the companies' TV activities at the wholesale level for the supply of TV channels to distributors and at the retail level for supply of TV services to end users.[39]

The EC found that being able to offer the Vier and Vijf channels was critical to the viability of any retail TV service provider competing in Flanders and to any potential new entrants.[40] The EC found that the merged entity would be able to foreclose input totally or partially by refusing to license Vier and Vijf to other TV service providers other than Telenet.[41] Moreover, it found that the merged entity would have incentives to foreclose input in this manner.[42] Input foreclosure of Vier and Vijf, combined with Telenet's dominant position, would raise barriers to entry, reduce consumer choice, reduce downstream competition and result in higher prices.[43]

The EC's concerns were largely based on the results of responses to its market investigation. Telenet's stable dominant position on the market for the retail provision of TV services within the area covered by its network (i.e. nearly all of Flanders, the Brussels region and two municipalities in the Walloon region) reinforced these concerns. Depending on the criterion used to calculate market shares, be this revenues or number of subscribers, Telenet's market share exceeded 70%.[44]

The EC was also concerned that Telenet could engage in partial customer foreclosure by disadvantaging the channels and programmes offered

33 OJ C316/1, 24 Sep 2015. Case COMP/M.7419, *TeliaSonera/Telenor/JV*.
34 Statement by Commissioner Vestager on announcement by Telenor and TeliaSonera to withdraw from proposed merger, STATEMENT/15/5627.
35 Case COMP/M.7612, *Hutchison 3G UK/Telefonica UK*, IP/15/5956. As noted above at note 11, the EC has also opened a Phase II investigation into Liberty Global's intention to acquire the Belgian mobile operator Base, see Case COMP/M.7637, *Liberty Global/Base Belgium*, IP/15/5774.
36 Hutchison also agreed to form a joint venture in Italy, which would combine the activities of 3 Italia and Wind Telecomunicazioni. This will be subject *inter alia* to approval from the EC.
37 Competition in telecom markets, Speech, 2 October 2015, available on DG COMP's website.
38 Case COMP/M.7194, *Liberty Global/Corelio/W&W/De Vijver Media*, available on DG COMP's website.

39 Para. 132.
40 Paras 235, 240, 263 and 446.
41 Paras 295 and 401.
42 Para. 358.
43 Paras 438-445.
44 Para. 411 *et seq*.

by Medialaan and VRT, two broadcasters that compete directly with De Vijver.[45]

The EC's concerns were somewhat alleviated during the proceedings when De Vijver and Telenet concluded revised agreements with a number of TV distributors to grant access to Vier and Vijf on more secure terms.[46]

To address the EC's remaining concerns, the parties proposed a remedies package, which was revised following market testing. Its main element is a seven-year commitment to offer third party TV distributors access to the Vier and Vijf channels on fair, reasonable and non-discriminatory ("FRAND") terms.[47] This commitment also applies to any new basic pay TV channel that De Vijver launches during the seven-year period. The commitment applies to traditional distributors and to distributors wishing to offer "over-the-top" ("OTT") services via the Internet.

However, the transaction also gave rise to overlaps on the market for copyright administration services

The commitments extend to related ancillary rights or "linked services".[48] A linked service is "any existing or future service, functionality or feature (a) that is designed and offered as part of the broadcast experience of a linear channel, and (b) that is offered to end users simultaneously with the linear transmission of the channel, or shortly before or after the linear transmission of the channel for a period which is customary for such service"[49]. As examples, the decision mentions multiple device services or PVR services (permitting recording and viewing later in time).[50]

45 Paras 530-553.
46 Para. 593 *et seq.*
47 Paras 658 and 664.
48 Para. 660.
49 *Ibid.*
50 *Ibid.*

The commitments contain safeguards to avoid them potentially being circumvented by the merged entity moving more attractive programmes and services from Vier and Vijf to other pay TV channels.[51] In essence, both De Vijver and Telenet commit to licensing all existing or future jointly controlled "basic pay TV" channels. TV distributors are not, however, required to license all covered channels to benefit from the commitments.[52] The merging parties also committed not to degrade the quality of Vier or Vijf.[53]

The commitments are subject to the supervision of a monitoring trustee.

1.3. Collecting societies JV

In November 2014, the national collecting societies of Germany (GEMA), Sweden (STIM) and the UK (PRSfM) notified a full-function joint venture that would be active in multi-territorial online music licensing and copyright administration services. In June 2015, following a Phase II investigation, the EC approved the transaction.[54]

Collecting societies, or collective management organisations ("CMOs"), manage the copyrights of authors, performers and writers of musical works. They also grant licences on their behalf to users of musical works, collect royalties and monitor unauthorised use.

Traditionally, CMOs offered licences for their repertoires on a territorial (Member State) basis but many had also entered reciprocal arrangements authorising other CMOs to license each other's repertoires in their "home" country.[55] These reciprocal arrangements allowed each CMO potentially to license the "world repertoire" (under a "national blanket licence") but only for its own national territory, which meant that online music platforms (such as iTunes, Spotify and YouTube) would have to obtain licences from all the CMOs in the EEA if they wanted to provide online services across the EEA.[56] This traditional licensing model had changed in the last 10 years with a number

51 Para. 668.
52 Para. 662.
53 Para. 634.
54 Case COMP/M.6800, *PRSfM/STIM/GEMA/JV*, available on DG COMP's website.
55 Para. 21.
56 Para. 22.

of CMOs having started to grant multi-territorial licences to their repertoires but this did not make it any easier for online platforms to obtain licences efficiently.[57] The proposed joint venture was intended to make licensing easier for online platforms since it would offer a single licence to the three parent CMOs' repertoires and potentially also to those of other CMOs who would mandate the joint venture to license their repertories.[58]

The EC found that the proposed joint venture would be unlikely to diminish competition in the market for online licensing since being able to offer a wider repertoire of rights on a multi-territorial basis would not enable the joint venture to charge higher royalties compared to the royalties that would be payable to each of the parent companies (and potentially other CMOs) separately.[59]

However, the proposed transaction gave rise to horizontal overlaps between the parties' activities on the EEA-wide market for copyright administration services to other collecting societies and to "option 3 publishers".[60] Option 3 publishers are the major publishers who had previously withdrawn the mechanical rights[61] for online use related to their Anglo-American repertoire from CMOs and had started to license these rights directly, relying on collecting societies only for administrative services.[62] The joint venture would combine three of the four main players in this area and result in two main EEA competitors with respectively 70-80% market share for the merged entity and 20-30% for SACEM, the French CMO.[63]

The EC found that the merger would create high entry barriers and barriers to growth. This would prevent the formation of other cross-border licensing hubs and arrangements that could potentially offer copyright administration services.[64]

57 Para. 23.

58 The parties claimed that the joint venture was in response to, and complied with, Directive 2014/26/EU on collective rights management and multi-territorial licensing of rights in musical works for online use in the internal market, OJ L84, 20 March 2014, p. 72. See para. 34.

59 Paras 228-303.

60 Para. 104, 126 and 143.

61 See para. 6. Mechanical rights are the "rights to reproduce a musical work". Mechanical rights are one of the two types of rights related to a musical work. The other, performing rights, are "the rights to communicate a musical work to the public, which includes the right to make the musical work available to the public".

62 Paras 27-28.

63 Para. 150.

64 Paras 182 and 216.

The EC was particularly concerned that the merged entity could force option 3 publishers to use its copyright administration services exclusively.[65] Even though option 3 publishers themselves license the mechanical rights to their Anglo-American repertoire, the joint venture would (through PRSfM) hold the performing rights corresponding to this repertoire.[66] Therefore, a user of a musical work would have to take a licence both from the option 3 publisher for the mechanical rights and from the joint venture for the performing rights.[67] Due to the increased presence of the joint venture on the market, the EC feared that the joint venture could try to make the licensing of the corresponding performing rights dependent on the option 3 publishers also using its copyright administration services.[68]

The EC considered that the copyright administration services, including its copyright database, offered by the joint venture were essentially a new product, which will likely make the merged entity one of the very few players on the market in the near future.[69] The joint venture's market power could therefore lock customers into using its copyright database by bundling the different types of copyright administration services it offers.[70] This in turn would make it difficult for a customer to switch to other providers of copyright administration services since their data would be held on the joint venture's database.[71]

Finally, the EC had concerns with potential sole or exclusive mandates that could be granted to the joint venture since these would prevent other CMOs and option 3 publishers from using other providers of copyright administration services.[72]

To address the EC's concerns that the proposed joint venture would have significantly impeded competition, the parties proposed a range of commitments.

First, the Performing Rights Society (which owns 100% of PSRfM's shares) committed not to use its control over the performing rights it manages to

65 Para. 212.

66 Para. 207.

67 *Ibid.*

68 Para. 212.

69 Para. 223.

70 *Ibid.*

71 *Ibid.*

72 Para. 215.

force option 3 publishers to purchase copyright administration services from the joint venture.[73] The Performing Rights Society remains entitled to refuse to grant an option 3 publisher a mandate to license its performing rights but any such refusal must be documented in writing and provided to the appointed monitoring trustee.

Second, the joint venture will offer key copyright administration services to other collecting societies on FRAND terms that are comparable to the terms offered to its parent companies.[74]

Third, to avoid potential bundling, the joint venture committed to offer its copyright administration services either separately or as part of an integrated set of back-office services.[75]

Fourth, the joint venture will allow customers to terminate their service agreements subject to a six month notice period.[76] Moreover, on termination, customers will be entitled, in return for a reasonable fee, to obtain an extract of the joint venture's database pertaining to them, other customer-specific information that is stored by the joint venture and information to enable testing of interoperability with competitors' copyright or back-office services.

Finally, the joint venture committed to refrain from entering into sole or exclusive mandates to license repertoires.[77]

1.4. GE/Alstom

In September 2015, the EC approved GE's acquisition of Alstom's energy business after a Phase II investigation.[78]

Most of Alstom's relevant activities – such as power generation equipment for nuclear, coal, wind and hydro power plants and electricity transmission equipment – were complementary to and did not overlap to any significant extent with GE's activities.

However, the EC identified a significant overlap in the EEA-wide markets for the sale and servicing of heavy duty gas turbines. Worldwide, there are only four significant competitors in this area, the parties; Siemens; and Mitsubishi Hitachi Power Systems ("MHPS") with the fifth, Ansaldo, having a more limited product range, geographic reach and R&D activities. The EC found that MHPS focused on different technology, which was not used in the EEA so the transaction would effectively have reduced the number of significant competitors in the EEA to two (GE/Alstom and Siemens). GE/Alstom would have had a market share of over 50%.

The EC examined bidding data and this confirmed the extent to which Alstom competed with GE and indicated likely price increases post-merger.

The EC was also concerned about the elimination of Alstom's innovation and R&D from the market. In particular, it believed that GE would discontinue products, including Alstom's most technologically advanced heavy duty gas turbine model. It noted that Alstom had some of the most advanced, flexible and cleanest technology available.

To address the EC's concerns and enable the rest of the transaction to proceed, GE offered to divest the main and technologically most advanced parts of Alstom's heavy duty gas turbine business and key personnel. GE proposed that Ansaldo, the fifth competitor in the market, would purchase the divestment business. The EC approved GE's acquisition of Alstom's energy business subject to approving the finalized divestiture to Ansaldo.

1.5. DEMB/Mondelēz/Charger OpCo

In May 2015, following a Phase II investigation, the EC cleared the proposed creation of a full function joint venture between two of the world's leading coffee manufacturers, DEMB (D.E. Master Blenders) and Mondelēz.[79]

73 Paras 367-369 and Commitments, Section B.
74 Para. 350 and Commitments, Section C para 1 and Section D.
75 Commitments, Section C, paras 2-9.
76 Commitments, Section C, para. 14 *et seq* and Section D, para. 2.
77 Para. 362 and Commitments, Section E.
78 Case M.7278, *General Electric/Alstom (Thermal power – renewable power and grid business)*, IP/15/5606. Neither the commitments nor a summary decision has yet been published. The US Department of Justice cleared the transaction on the same day. See SPEECH *Merger review: Building a global community of practice*, 24 September 2015, on DG COMP's website.
79 Case COMP/M.7292, *DEMB/Mondelēz/Charger OpCo*. See EC's Competition Merger Brief Issue 2/2015, which is available on DG COMP's website, at p. 12.

Coffee can be prepared in a variety of ways: using instant coffee; grinding roasted beans; using ground beans; and using consumables (filter pads, capsules and pods etc.) that are designed for making a single cup in a "single-serve machine".[80] All of these products were analysed as separate markets. In line with other fast moving consumer good markets, the relevant geographic markets were found to be national.[81]

> Neither party manufactures or sells coffee machines. Yet the EC analysed primary markets (machines) and aftermarkets (consumables)

The EC's analysis of coffee machines is particularly interesting. Neither of the parties to the joint venture manufactures or sells coffee machines. While DEMB owns the Senseo trademark, Senseo-trademarked machines are made by Philips, and Bosch makes Mondelēz's Tassimo-trademarked machines. However, the EC found that both parties had considerable influence over the promotion, advertising and pricing of machines since, to encourage sales of consumables (coffee pads for Senseo and discs for Tassimo), they frequently gave out coupons or other promotions (e.g. free coffee) effectively to lower the prices of the machines.[82] Therefore the EC engaged in a comprehensive analysis of competition between the EEA's four main brands of single-serve coffee machines in the EEA: DEMB's Senseo; Mondelēz's Tassimo; Nestlé's Nespresso; and Nestlé's Dolce Gusto.[83] These single-serve machines were found to be in a different market to multi-serve machines.[84] Alongside this, the EC analysed the consumables that are used with these machines and "inter-system" (i.e. machines and consumables together)[85] competition. This is effectively an analysis of primary markets (machines) and aftermarkets (consumables).

As regards the consumables that are used with coffee machines, these are of several types: roast and ground coffee for multi-serve machines; and sealed coffee pads, capsules and pods for single-serve machines. The EC found that each single-serve machine requires its own specific format of consumable. Each type of consumable therefore constitutes its own separate product market.[86] The EC distinguished between closed systems (such as Dolce Gusto and Tassimo), which require the use of consumables that are only offered by one company and open systems (such as Senseo), which can be produced by any company.[87]

As regards machines, the EC found that Senseo and Tassimo were not each other's closest competitor since all four of the main brands compete with each other.[88] Indeed, on "the continuum of single-serve systems", Tassimo and Dolce Gusto were found to be closer to each other.[89] These conclusions were based on analysis of the parties' internal documents, answers to the EC's market investigation (which took account of the views of machine manufacturers, retailers and competitors) and quantitative analysis.

The EC also considered whether post-transaction the joint venture could raise prices or reduce consumer choice by, in particular, trying to move customers from the open Senseo system to the closed Tassimo system.[90] The EC concluded that this would not be possible in particular because the machines were manufactured by third parties (so the parties could not unilaterally remove them from the market). It was also found that the parties in any event would likely not have the incentive to increase Senseo machine prices since, if this happened, only some customers would switch to Tassimo (and it was more likely they would switch to Dolce Gusto). As for the possibility of increasing the prices of Senseo consumables, this was not likely to be viable given Senseo is

80 See paras 16-22.
81 Para. 157.
82 Section 9.4.2.
83 In addition, there are brands that have a more regional presence but these are fringe players.
84 See paras 62-69.
85 See para. 124 *et seq*.
86 Para. 93.
87 Nespresso was classified as a semi-open system since, pending the resolution of legal disputes, any company that can develop the relevant technology can manufacture and sell Nespresso-compatible capsules. See paras 95 and 96.
88 Para. 244 *et seq*.
89 Para. 269.
90 Paras 288 to 297.

an open system and customers could therefore purchase their pads from another supplier. The EC also concluded that the market for single-serve machines was dynamic and still nascent; it would therefore be irrational for the joint venture to compete less aggressively. Furthermore, given projected market growth, both new entry and expansion were likely.[91] For these reasons, the EC found that the concentration would not reduce effective competition on the markets for single-serve coffee machines.

Turning to the markets for roast and ground coffee, the EC found that a dominant position would be created in France, Denmark and Latvia and that this would hinder effective competition.[92] The EC also analysed the closeness of competition between the parties and found that they were close competitors.[93]

Finally, on the markets for filter pads, the EC concluded that effective competition would be reduced due to the creation of a dominant position in France and Austria.[94] The EC found that the parties had high combined market shares (60% in France and 70% in Austria) and that they were close competitors in these countries.[95]

To address all of the EC's concerns regarding France, the parties committed to sell Mondelēz's Carte Noire business across the EEA (initially they proposed only to sell brands in France).[96] To address the concerns regarding roast and ground coffee in Denmark and Latvia, the parties committed to sell DEMB's Merrild EEA business.[97] Alongside the Merrild and Carte Noire divestments, the parties agreed to enter a licence for transitional services to enable rebranding; following the market test, it was agreed that these services should be charged on a cost basis.[98] To address the concern raised regarding the Austrian filter pad market, DEMB agreed to license its Senseo brand in Austria for five years and not to use the brand in Austria thereafter for a further five years.[99] The EC found that this licensing remedy would remove the overlap and address its concerns; the EC considered that requiring divestiture of the brand would be disproportionate since it is also widely used in other countries. The EC must approve the purchasers of the divestment businesses and the Austrian licensee.

91 Para. 312.
92 Para. 352. See also paras 358, 387 and 409.
93 Paras 366, 391 and 413.
94 Para. 499.
95 Paras 500-505, 511, 549-554 and 559.
96 Paras 661-663 and 670-695
97 Paras 635-637 and 644-653.
98 Para. 715(a).
99 Paras 638-640, 654-658, 664-666 and 696-714.

Main Phase I Decisions[*]

- *Novartis/GSK (Oncology)*
    - Potential reduction in incentives to innovate
    - Potential competition from pipeline products, including those in earlier stages of development
    - Third party must obtain approval from EC to enter partnership agreement
- *Holcim/Lafarge*
    - Extensive remedies proposed early by the parties enabled Phase I clearance
    - Divestments to eliminate overlaps in Member States
    - Up-front buyer clause
- *Airbus/Safran*
    - "Non-contribution" commitment to avoid input and customer foreclosure
    - Structural remedy for vertical issue
    - Other behavioural commitments
- *IMS Health/Cegedim*
    - Commitment to license and divestiture
- *IAG/Aer Lingus*
    - Divestment of slots
    - Commitment to continue to carry passengers wishing to connect for rivals' long-haul flights

2. SELECTED EC PHASE I DECISIONS

2.1. Novartis/GSK Oncology

In January 2015, the EC approved two concentrations involving Novartis and GSK after Phase I investigations.[100] From a competition perspective, the analysis of innovation and the potential effect of the proposed concentration on pipeline products in the decision authorising the transfer of GSK's cancer treatments to Novartis is the more interesting.[101]

Both Novartis and GSK had developed, and were continuing to develop, targeted therapies for treatment of advanced cancers. Among the products Novartis was acquiring were potential blockbuster drugs that could, especially when used in combination, possibly treat advanced cancers.

More specifically, both Novartis and GSK were engaged in clinical trials using a combination of B-Raf and MEK inhibitors (these are intended to inhibit the reproduction of cancerous cells) to treat a variety of cancers. Roche was also trialing clinical research based on B-Raf and MEK inhibitors so the planned concentration would reduce the number of such research programmes from three to two.

In other decisions, the EC had analysed potential competition between pipeline products that were relatively near being commercialised. Here, however, the EC went further and analysed potential competition from products that were still in Phase I and II clinical trials.[102] In particular, the EC wanted to determine if Novartis would still have incentives to continue its research in this area. Analysing the potential impact of products that are in early stages of development is somewhat difficult since it is uncertain whether these products will prove successful.[103] However, as the EC notes, if Novartis were to abandon its research, this would certainly mean that its product would not come to market.[104] One feature that facilitated the EC's analysis here is that information on clinical trials in the pharmaceutical area is public.

Referring to the results of its market test, the EC found that both Novartis and GSK's research was based on the same mechanism of action and that GSK's research was more advanced. In these circumstances, the EC concluded that Novartis's incentives to continue its research would be lowered and that, post-transaction, it would be more likely to abandon its own research and focus on GSK's.[105] This would lead to a significant reduction in competition in innovation.

Novartis proposed to divest its B-Raf and MEK inhibitors, provide support to ensure the completion of Phase III trials for these drugs' use in skin and ovarian cancer and to ensure broader worldwide research into and development of these drugs' potential use to treat other cancers and, if successful, to ensure their EEA-wide commercialisation.

A potential complication here was that Novartis's MEK inhibitor belonged to a third-party, Array BioPharma Inc., which had licensed it exclusively to Novartis. While Novartis and Array agreed that Novartis would "return" the MEK inhibitor to Array,[106] the EC considered it essential that both the MEK and B-Raf inhibitors should be developed together. Array, however, appeared to lack the skills and scale to conduct research into the two drugs on its own and it also appeared it would be unable to commercialise them in the EEA.

In the end, therefore, Novartis and Array committed (1) that Novartis would return the MEK inhibitor to Array; (2) that Novartis would divest the B-Raf inhibitor to Array; (3) that Array would enter a partnership agreement with a suitable partner, who the EC would have to approve, to continue the clinical research (the EC would also

* Notable Phase I decisions that are not discussed here include Case COMP/M.7449, *SNCF Mobilities/Eurostar International Limited*. See EC press release IP/15/4976, available on DG COMP's website. The EC authorised SNCF acquiring sole control over Eurostar subject to behavioural commitments designed to enable fair and non-discriminatory access to *inter alia* ticket offices, passenger information services, maintenance centres and train paths currently used by Eurostar at peak times (if the new entrant is not able to obtain such access through the usual path allocation procedure).

100 Case COMP/M.7275, *Novartis/GlaxoSmithKline Oncology*. See generally the EC's Competition Merger Brief 2/2015, which is available on DG COMP's website, at p. 1 and the EC's press release IP/15/3842. See also Case COMP/M.7276, *GlaxoSmithKline/Novartis Vaccines Business (ex Influenza)/Novartis Consumer Health Business* and the EC's press release IP/15/3841.

101 The EC also found that, as notified, the transaction would have led to a significant reduction in effective competition in the markets of B-Raf and MEK inhibitors for the treatment of both ovarian and skin cancers.

102 Paras 96 and 97.

103 See para. 99 *et seq*.

104 Para. 108.

105 Paras 104-107 and 109-114.

106 Para. 268.

approve the terms of the partnership agreement, which should cover worldwide development and EEA-wide commercialisation of the drugs); and (4) that Novartis would provide transitional support to Array.[107] If Array fails to conclude an agreement with a suitable purchaser, the commitments foresee that some rights over the compounds would be sold by a divestiture trustee to a suitable purchaser.

2.2. Holcim/Lafarge

In December 2014, the EC approved Holcim's acquisition of Lafarge subject to extensive divestments.[108]

The parties to this enormous transaction both manufacture cement, ready-mix concrete, aggregates and other building materials. The EC had previously cleared two concentrations involving exchanges of assets between Holcim and Mexico's Cemex after Phase II investigations so it was familiar with the relevant markets.[109]

Much of the EC's decision focuses on the parties' overlap in the manufacture of grey cement in numerous Member States. In line with previous decisions, the EC concluded that grey cement was a separate product market to other building materials[110] and that the geographic market comprised an area of some 150 to 250 kms around the relevant cement plants (this being the area within which cement can economically be sold).[111]

When they notified the transaction to the EC, Holcim and Lafarge simultaneously also presented a formal set of remedies, which they had already discussed with the EC's case team.[112] Recognising the extent of the overlap between their activities and that the transaction would lead to a reduction in competition in many markets, the parties proposed far-reaching remedies, which were then refined and expanded following market testing. The final commitments require divestment of the entire activities (i.e. in white and grey cement, ready-mixed concrete, aggregates and any upstream or downstream business) of one of the parties in each Member State where their activities overlap subject only to limited exceptions.[113]

The parties also agreed to an up-front buyer obligation under which the EC would have to approve the buyer of the divested assets before the parties could close their transaction.[114] This meant that the remedy's implementation risk lay with the parties.[115]

The EC decided that the final remedies were sufficiently extensive and, since they eliminated almost all overlaps, were a clear-cut solution to all the potential competition concerns that it had identified.[116] The EC therefore approved the transaction without opening a Phase II investigation. The parties' pro-active proposal of remedies clearly enabled this outcome but it appears that it was also facilitated by the EC already knowing the relevant markets well after its two aforementioned Holcim Cemex investigations. This enabled "dual track" parallel assessment of both potential competition concerns and remedies in Phase I.[117]

> The parties' pro-active proposal enabled this outcome but it was facilitated by the EC already knowing the relevant markets well

Interestingly, the EC left the parties flexibility regarding the remedy's implementation in so far as (a) they could decide to sell to a single purchaser or multiple purchasers and (b) they could sell to a

107 Paras 281 - 282, 289, 303 and 307 *et seq*.
108 Case COMP/M.7252, *Holcim/Lafarge*. See the EC's Competition Merger Brief Issue 1/2015, which is available on DG COMP's website, p. 20.
109 Case COMP/M.7009, *Holcim/Cemex West* and Case COMP/M.7054, *Cemex/Holcim Assets*.
110 *Ibid.*, para. 56.
111 *Ibid.*, para. 68.
112 See *ibid.*, para. 478 and the EC's Competition Merger Brief Issue 1/2015, p. 21.
113 Decision, paras 483 and 484.
114 *Ibid.*, paras 479, 489 and 490 and see Commitments paras 8 and 14.
115 *Ibid.*, para. 579. In April 2015, the EC approved CRH's acquisition of divested Holcim and Lafarge assets (Case COMP/M.7550, *CRH/Holcim Lafarge Divestment Business*). See IP/15/4854.
116 See Decision, para. 562 *et seq*.
117 See the EC's Competition Merger Brief Issue 1/2015, p. 21.

traditional purchaser (company) or, using a "Hybrid Option", sell part of the divestment business to an "Anchor Investor" in the capital markets.[118] This flexibility probably was necessary given the scale and value of the assets being divested and the fact that assets were also being divested in non-EEA countries. The requirement, under the up-front buyer clause, that the EC pre-approve the buyer (or the Anchor Investor) also enabled the EC to grant this flexibility while at the same time allowing it to continue to oversee and control the remedy's implementation.

2.3 Airbus/Safran/JV

In November 2014, the EC approved the creation of a joint venture between Airbus and Safran for space launchers, satellite subsystems and missile propulsion.[119]

While the EC examined horizontal overlaps in the parties' activities, its main concerns were of a vertical nature. In particular, the EC was concerned that the joint venture would have both the ability and the incentive to engage in input[120] and customer[121] foreclosure regarding Safran's electric plasmic propulsion systems (known as Hall-effect thrusters). It also was concerned that the joint venture would have the incentive and the ability to engage in input foreclosure in relation to the supply of carbon-carbon cylinders for optical instruments for space application,[122] supply of pressure sensors[123] and supply of thermal protection systems for vehicles re-entering the earth's atmosphere.[124] In addition, the EC was concerned that the joint venture could share confidential information relating to third party competitors of Airbus with Airbus.[125]

To address the EC's concerns, the parties offered a mix of structural and behavioural remedies.[126] First, the parties made a "non-contribution" commitment under which Safran's activities in electric satellite propulsion will be excluded from the joint venture and maintained separately.[127] This commitment is for 10 years[128] and the parties also agreed to refrain from giving the joint venture the possibility of exercising any influence over the retained Safran business.[129] This aspect of the remedy is interesting since, in effect, it is a structural remedy designed to address a vertical concern. The EC's Competition Merger Brief notes that the non-contribution commitment was necessary given that the EC was concerned about both input and customer foreclosure; an access remedy (like the one discussed below) would not have been sufficient.[130]

Second, the parties committed to conclude a framework supply agreement with Safran's main customer for the supply of carbon-carbon cylinders, pressure sensors and thermal protection systems.[131] Other entities can also request supply on non-discriminatory terms. Again, this commitment is valid for 10 years.[132] The framework agreement contains confidentiality provisions to address the concern that the joint venture would share information with Airbus.

Interestingly, the European Space Agency was appointed as monitoring trustee for the framework contract part of the commitment.

2.4. IMS Health/Cegedim

In December 2014, the EC approved IMS Health's proposed acquisition of part of Cegedim's customer relationship management and strategic data business.[133]

The parties had a number of overlapping activities but the EC's horizontal concerns were limited to the market for standardised primary market research services. In particular, the EC's market investigation indicated that if the market was split into markets for customised and syndicated primary market research (syndicated being more general and regular market research that is not

118 *Ibid*, p. 22 to 24 and Decision paras 488 to 492.
119 Case COMP/M.7353, *Airbus/Safran/JV*. See also the EC's Competition Merger Brief Issue 2/2015, available on DG COMP's website, at p. 9 and IP/14/2164.
120 Para. 301 *et seq*.
121 Para. 357 *et seq*.
122 Para. 378 *et seq*.
123 Para. 406 *et seq*.
124 Para. 478 *et seq*.
125 Para. 453 *et seq*.
126 Timing was of the essence in this case. One week after the EC's clearance, the European Space Agency met to decide on the development of a new generation of Ariane space launchers. See Decision paras 52 to 54.
127 Para. 553 *et seq*.
128 Para. 561.
129 See Commitments, para. 4.
130 EC's Competition Merger Brief Issue 2/2015, available on DG COMP's website, at p. 11. See also Decision, para. 558.
131 *Ibid*.
132 Commitments, para. 25.
133 Case COMP/M.7337, *IMS Health/Cegedim Business*.

conducted in response to a specific request), then the merged entity would have market shares in excess of 25% at EEA level, 40 to 50% in each of France and Italy and some 70-80% in Spain in syndicated primary market research.[134] The EC found that the parties were close competitors, the only credible suppliers of certain data and that there were barriers to entry.[135]

In addition, the EC believed that IMS would have the ability and incentive to refuse to grant Cegedim's competitors (providers of healthcare professional databases and customer relationship management ("CRM") and master data management ("MDM") software) access to its "brick structure" sales tracking data system.[136] The brick structure is a *de facto* standard and Cegedim's competitors would no longer have been able to compete effectively if they were denied the access that they had previously enjoyed. As the decision notes, this is a classic case of the merged entity controlling key technology or IP rights that can foreclose competitors.[137]

The parties submitted two commitments.[138] First, to remove the concerns related to standardised primary research services, IMS committed to divest its syndicated promotional audit business in the EEA and Switzerland.[139] The EC must approve the purchaser. Second, IMS committed to continue to grant the target's competitors access to its brick structure, including to the future brick structure (if changed) for a period of 10 years.[140]

2.5. IAG/Aer Lingus

In July 2015, the EC approved IAG's acquisition of Aer Lingus.[141] IAG is the holding company of British Airways, Iberia and Vueling while Aer Lingus was a publicly listed Irish airline.[142]
The parties had overlapping activities in a number of areas but the only one that gave rise to any concerns was the air transport of passengers on several routes (London-Dublin, Belfast-London and Dublin-Chicago).[143] In addition, the EC identified a risk that IAG could prevent Aer Lingus from continuing to provide connecting flights to the long-haul flights of competing non-IAG (and non-oneworld alliance[144]) airlines. The EC analysed this latter risk akin to input foreclosure with connecting passengers being an input for a downstream market for long-haul flights to and from particular airports.[145] The EC considered that IAG would have both the ability[146] and the incentive[147] either to deny or, by raising prices, reduce the ability of Aer Lingus passengers to connect with non-IAG long-haul flights.[148] In the EC's opinion, this would have led to foreclosure of a significant percentage of total passengers carried on some flights and foreclosure of all rivals on relevant downstream markets.[149]

The parties offered two remedies. First, IAG committed to release five daily slot pairs at London Gatwick airport. These slots are to be used on the London-Dublin and Belfast-London routes.[150] Given the conditions attached to the slot release and the congestion at Gatwick, the EC concluded that this would be effective to maintain competition on these routes.

Second, IAG committed, subject to some exceptions, to enter into agreements with competing airlines which operate long distance flights out of Amsterdam, Dublin, London-Gatwick, London-Heathrow, Manchester and Shannon.[151] The agreements are intended to guarantee that Aer Lingus can continue to provide these airlines with connecting passengers for their long-haul flights operating out of these six

134 Para. 183.
135 Paras 185 - 186.
136 Para. 239 *et seq* and para. 252 *et seq*.
137 Para. 314.
138 Para. 276.
139 Para. 278.
140 Paras 283, 317 and 321 and Commitments, para. 5.
141 Case COMP/M.7541, *IAG/Aer Lingus*. In another decision in the airline sector, the EC cleared the creation of a joint venture between Etihad and Alitalia subject to sale of slots and an undertaking to enter a special prorate agreement, a fare combinability agreement and an interline agreement with new entrants on relevant routes. See Case COMP/M.7333 *Alitalia/Etihad*.
142 The EC had already examined three unsuccessful attempts by Ryanair to acquire Aer Lingus.
143 Paras 219-311 and paras 381-404. The EC used its now established Origin and Destination city-pair approach to market definition, see paras 14 to 19. On short-haul flights, the EC considered that it was not appropriate to distinguish between time sensitive and non-time sensitive passengers. Whether it was appropriate to distinguish between these two groups on longer flights was left open since either way the EC's conclusions would not have changed, see paras 20-29.
144 Para. 456.
145 See paras 442 - 443.
146 See para. 467 *et seq*.
147 See para. 482 *et seq*.
148 See para. 443.
149 See paras 513 and 514.
150 Paras. 560-567 and paras. 595-617. See also Commitments, paragraph 2.
151 Paras. 568-583 and paras. 618-636. See also Commitments, paragraph 4.

Other EC Decisions

- Referrals
  - EC refused to refer *Orange/Jazztel*, *Altice/PT Portugal* or *Hutchison/Telefónica UK* to NCA
  - EC referred part of concentration to Danish NCA in *Danish Crown/Tican*
  - UK's CMA requested that EC take jurisdiction in *Amadeus/Navitaire* and EC accepted
- Article 6(1)(a) decision in Knorr Bremse/Vossloh

airports. The commitment covers defined routes that are currently offered by Aer Lingus; the agreements would initially last for five years but they would be renewable for further periods of two years on the same conditions.

3. Other EC Decisions

3.1 Referrals

(a) Orange/Jazztel

Orange's acquisition of Jazztel has been discussed above.[152] In November 2014, the Spanish NCA requested that the EC transfer review of the case to Spain under Article 9 EUMR.

In January 2015, the EC decided not to refer the case to Spain.[153] Its press release noted the need to ensure consistency in the application of merger control rules in the fixed and mobile telecommunications sector and the EC's prior experience in this area (among these the 2014 clearance of Vodafone's acquisition of ONO[154]). Thus, the EC considered that it was the better placed authority.

(b) Altice/PT Portugal

Similarly, the EC rejected a request under Article 9 EUMR from the Portuguese NCA that Altice's acquisition of PT Portugal be referred to it. Again, the EC emphasised its experience in analysing mergers in the telecommunications sector and the need for EU-wide consistency in this area.[155]

(c) Hutchison/Telef nica UK

Citing similar reasons, the EC also rejected the UK's Competition and Markets Authority's ("CMA") request for the EC to transfer review of the above-mentioned *Hutchison 3G UK/Telef nica UK* concentration to the UK.[156]

(d) Danish Crown/Tican

In July 2015, the EC agreed to partial referral of the concentration between Danish Crown and Tican to the Danish NCA, which resulted in it being reviewed by both the EC and the Danish NCA.[157] Both companies operate slaughterhouses and process meat and the EC considered that the concentration threatened to affect competition significantly in Denmark. The EC cleared the transaction outside Denmark. At the start of November, Danish Crown announced that the transaction would not go ahead because the Danish NCA would not be able to approve the transaction within the required timeframe.[158]

(e) Amadeus/Navitaire

In September 2015, the UK's CMA requested that the EC assume jurisdiction and review Amadeus's proposed acquisition of Navitaire under Article 22 EUMR.[159] Both companies supply IT systems for air passenger services. The EC agreed to the request and the concentration was notified to it in December.[160]

3.2. Other

In May, the EC adopted a decision under EUMR Article 6(1)(a) finding that a transaction between Knorr Bremse and Vossloh fell outside the EUMR. The transaction was cleared in September after it was renotified.[161]

152 Case COMP/M.7421, *Orange/Jazztel*.
153 See IP/15/3680.
154 Case COMP/M.7231, *Vodafone/ONO*.
155 Case COMP/M.7499, *Altice/PT Portugal*, see IP/15/4805.
156 Case COMP/M.7612, *Hutchison 3G UK/Telefonica UK*, see IP/15/6251.
157 Case COMP/M.7565, *Danish Crown/Tican*, see IP/15/5401.
158 See http://www.danishcrown.com/page7451.aspx.
159 https://www.gov.uk/government/news/cma-asks-ec-to-examine-airline-passenger-service-systems-merger.
160 See https://www.gov.uk/cma-cases/amadeus-navitaire-merger and Case COMP/M.7802, *Amadeus/Navitaire*.
161 Case COMP/M.7538, *Knorr Bremse/Vossloh*.

European Court Cases

- GC rejected Deutsche Börse's appeal against EC's prohibition of planned concentration with NYSE Euronext
- GC rejected Niki Luftfahrt's appeal against EC's clearance of *Lufthansa/Austrian Airlines*

4. European Court Judgments

4.1. Deutsche Börse v Commission

In February 2012, the EC prohibited the concentration between Deutsche Börse and NYSE Euronext.[162] Arguing that the EC should have cleared the concentration, Deutsche Börse appealed the EC's decision to the GC.[163]

The EC argued that Deutsche Börse's three pleas were ineffective since the contested decision could not be annulled even if all of the pleas were upheld because the decision still contained findings that were not disputed by Deutsche Börse and which justified the decision's operative part.[164] The Court agreed in principle that when only some of the grounds provide a sufficient legal basis for the decision, any error in other grounds has no effect on the decision's operative part.[165] However, the Court concluded that, in this particular case, some of Deutsche Börse's pleas might result in the annulment of the decision.[166] Notably, Deutsche Börse had raised rights of defence as part of two of its pleas and, if successful, it was not inconceivable that this could lead to the entire decision being annulled.[167]

The Court recalled the general principles for its assessment. First, when the EC finds that a concentration should be prohibited, particularly when this is because of a potential effect on competition, it has to produce convincing evidence.[168] Second, although the EC has a margin of discretion regarding economic assessments, this does not mean that the Court must refrain from reviewing the EC's interpretation of economic evidence.[169] Finally, where the EC has discretion, respect for the rights guaranteed under the EU's administrative procedure is of fundamental importance.[170]

The first plea alleged that the EC did not take sufficient account of horizontal competitive constraints and demand-related constraints.[171] The Court, however, found that the EC had correctly concluded that exchange-traded derivatives ("ETDs") and over the counter ("OTC") derivatives belong to separate markets and that the applicant's arguments did not call this conclusion into question.[172] The GC therefore rejected Deutsche Börse's claim challenging the existence of a category of customers that trade only ETDs.[173]

The second plea alleged errors of law and assessment regarding the alleged efficiencies that would be produced.[174] Again, the GC rejected all the arguments put forward by Deutsche Börse. The Court notably disagreed with the argument that the Horizontal Merger Guidelines[175] require only that efficiencies must be shown to benefit customers and that it is therefore irrelevant if the merged entity could later claw back some of the efficiencies from customers.[176]

In its third plea, Deutsche Börse alleged errors of law and assessment regarding the commitments that the EC had rejected.[177] Deutsche Börse essentially alleged that the rejection was insufficiently reasoned.[178] The GC disagreed.[179]

162 Case COMP/M.6166, *Deutsche Börse/NYSE Euronext*.
163 Case T-175/12, *Deutsche Börse v Commission*, ECLI:EU:T:2015:148.
164 Para. 43.
165 Para. 47.
166 Para. 54.
167 Para. 55.
168 Para. 63.
169 Para. 66.
170 Para. 67.
171 Para. 69.
172 Para. 106.
173 See, for example, paras 92 and 119.
174 Para. 235.
175 Commission Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C31, 5 February 2004.
176 Para. 273.
177 Para. 376.
178 Para. 383.
179 Paras 389, 394, 400 and 414.

Following the judgment, Deutsche Börse decided not to appeal the GC's ruling.[180] This therefore closes one of the most complex EU merger control cases of recent years.

4.2. Niki Luftfahrt v Commission

In August 2009, the EC conditionally cleared Lufthansa's acquisition of Austrian Airlines after a Phase II investigation.[181] At the same time, the EC also issued a decision finding that restructuring aid granted by the Republic of Austria in favour of Austrian Airlines was compatible with the internal market.[182] Niki Luftfahrt, a competing Austrian airline, initiated applications to annul both the merger clearance[183] and the state aid decision.[184] In both cases, the GC dismissed the applications.

The GC summarised the extent of its judicial review when considering challenges to merger decisions.[185] This has been discussed above in relation to the *Deutsche Börse* case.

Niki Luftfahrt notably alleged that the EC had failed to state reasons regarding its conclusions on the competitive situation on air routes between Central and Eastern Europe.[186] In line with established case-law, the GC noted that the extent of the reasoning obligation in Article 296 TFEU depends on the circumstances of each case, and that sometimes it is not necessary to go into all the relevant facts and points of law, as not only the wording of the reasoning but also its context and applicable legal rules can serve to fulfil Article 296 TFEU's requirements.[187]

Niki Luftfahrt also maintained that the EC had not sufficiently established the facts in its investigation.[188] In particular, it argued that the EC did not have enough time to analyse responses to certain questionnaires between the submission of revised commitments and the EC's decision to prepare a conditional authorisation decision.[189]

The GC ordered measures of organisation requiring the EC to produce copies of the relevant responses and the draft commitments.[190] The GC reviewed these documents and concluded that changes to the draft commitments were "slight" and that analysing the responses to the EC's questionnaire "does not appear to have been an impossible task for the Commission's staff to have completed" during the relevant time period.[191]

Among other things, Niki Luftfahrt also argued that the EC's approach to market definition in the state aid decision did not correspond to its approach in the merger decision, that the EC had made manifest errors of assessment regarding market definition, regarding the concentration's effects on certain routes and when analysing the adequacy of Lufthansa's commitments. The GC rejected all these arguments.

5. Legislative Developments

In contrast to the previous 12 months, during which the EC revised its notice on the Simplified Procedure and initiated a wide-ranging consultation on minority shareholdings, referrals and other issues, there have been no legislative developments in the mergers area during the last 14 months.

In a speech in March, Commissioner Vestager remarked that replies to the EC's consultation on minority shareholdings showed that there was "widespread concern regarding the proportionality" of the EC's proposals.[192] In the same speech, Commissioner Vestager also suggested the possibility of amending the EUMR's notification thresholds to enable the EC to review deals with a high transaction value even if the parties' turnovers do not meet the EUMR's thresholds.

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180 MLex, "*Deutsche Börse abandons legal fight to overturn EU's NYSE merger block*", 12 May 2015.
181 Case COMP/M.5440 *Lufthansa/Austrian Airlines*.
182 Commission Decision 2010/237/EC (ex NN 663/08) *Austria Austrian Airlines – Restructuring Plan*, 28 August 2009, OJ 2010 L59.
183 Case T-162/10, *Niki Luftfahrt v Commission*, ECLI:EU:T:2015:283.
184 Case T-511/09, *Niki Luftfahrt v Commission*, ECLI:EU:T:2015:284.
185 Case T-162/10, paras 86 - 87.
186 Para. 91 *et seq.*
187 Para. 99.
188 Para. 103 *et seq.*
189 Para. 111.
190 Paras 112-114.
191 Para. 116.
192 SPEECH *Thoughts on merger reform and market definition*, 12 March 2015, available on DG COMP's website.

Efficiencies in Antitrust and Merger Control

Jorge Padilla
Economist, Compass Lexecon

Efficiency considerations are at the heart of the economic assessment of market performance. They are the main reason why economists endorse free competitive markets and consider the exercise of market power a market "failure". Competition is worth protecting because competitive markets deliver efficient outcomes. A competitive market ensures that products and services are allocated efficiently and, therefore, that all gains from trade are exhausted. A competitive market is also efficient from a productive perspective, since only those firms with the lowest costs can survive in such a market. A competitive market will also be dynamically efficient: competition fosters creativity, promotes investment and innovation, and forces idle incumbents out of the market. Efficient markets are good for consumers in the short and the long term.

One would expect, therefore, that the assessment of efficiency played a central role in the design and enforcement of competition law; that competition authorities assessed the unilateral conduct of firms with market power, or cooperative agreements between firms, whether or not they involved a full merger, in terms of their implications for market efficiency. But that is not often the case. Or, more precisely, insofar as competition authorities focus on efficiency, they do so almost exclusively in connection with allocative efficiency. That is, with the price implications of unilateral actions, agreements or market concentration.

Cost efficiencies are typically neglected unless they translate into lower prices, which means that fixed cost reductions are not taken into account because they are presumed to benefit shareholders only. Rebutting that presumption has proven impossible in practice, even when there is a well-established body of economic literature clarifying the circumstances when that presumption is incorrect. It is well-known that company initiatives that increase a firm's cash flows tend to be invested in part. This is because companies find it cheaper to fund their investments, especially when those investments concern risky and innovative projects, with their own cash as opposed to raising the required amounts in capital markets.

Dynamic efficiencies are also typically neglected because they are hard to quantify and, more generally, hard to verify. This sort of efficiency effect is by its very nature speculative as we know that forecasting is a hard exercise. Competition authorities have, in my experience, rejected dynamic efficiency arguments even when companies manage to quantify them, arguing that some of the benefits resulting from, for example, the launch of a new product or service by a firm would be "clawed back" by the innovator rather than appropriated by its customers. Competition authorities are right in noting that some of the efficiencies generated by the launch of new products will be appropriated by the firms which commercialise them and not by consumers. Yet, it is also well-known in economics that the proportion of those efficiencies that could be clawed back is necessarily limited. In other words, the mere reference to a claw back effect should not be sufficient to dismiss dynamic, demand-side efficiencies that have been documented and quantified.

In my opinion, the negative attitude of competition authorities around the world towards efficiency arguments in all sort of competition cases is due to, first, the fact that they are at an informational disadvantage vis-à-vis the company or companies claiming those efficiencies. Competition authorities are typically unable to measure those efficiencies by themselves; they must rely on the information provided by the companies under investigation. They may not be able to rely on the collaboration of third parties either, whether consumers or competitors, for confidentiality reasons. Understandably, they find it difficult to accept propositions that they are unable to verify. As Nobel Prize Winner Ronald Coase once stated:

"if an economist finds something—a business practice of one sort or other—that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of un-understandable practices tends to be very large, and the reliance on a monopoly explanation, frequent."[1]

Secondly, companies asserting efficiencies have often failed to provide the sort of evidence that competition authorities would regard as sufficiently credible. This is because the efficiency analyses that are used in business to justify strategic decisions - such as mergers - and commercial decisions - such as the adoption of a new pricing policy - are very often aspirational, based on commercial intuition and soft evidence, at best, and gut feeling, very often. Competition authorities require a level of precision that companies operating under the fog of war that sets in actual markets are frequently unable to deliver.

Finally, I believe competition authorities are unwilling to entertain the efficiency arguments made by defendants because that would force them to balance those efficiencies against their own estimates of the competitive effects of the conduct under investigation. And that is anything but simple. Business initiatives that are acknowledged to produce efficiencies should not be categorised as restrictions by object or per se illegal. Instead, their procompetitive and anticompetitive effects should be investigated and compared. Oftentimes, however, competition authorities do not have quantitative estimates of the likely competitive effects of unilateral or collective actions of firms under investigation, and their qualitative assessments are vague and imprecise. In those instances, acknowledging potential efficiencies would rule out intervention, whether or not the intervention was justified.

While the overall picture is rather bleak, the scope for arguing efficiencies in competition cases is greater in some jurisdictions than in others and also varies from one area of competition law to another within a given jurisdiction. Thus, in particular, it appears that the willingness of the European Commission and Courts to consider efficiency justifications in abuse of dominance cases is fairly limited, despite the promising statements made by the General Court in *Intel*[2] and the European Court of Justice in *Post Danmark I*[3] and *Post Danmark II*.[4] In those cases, the European Courts opened the door to efficiency arguments in abuse of dominance cases but required four conditions: (i) verifiability, (ii) indispensability, (iii) pass on and (iv) no elimination of competition. This development is discussed in great detail by **Gianluca Faella** in his contribution.[5] He is however less optimistic than I am regarding the abovementioned cases. He concludes that efficiency arguments are de facto impossible under the straitjacket of the four-leg test and considers that, to be viable, the analysis of efficiencies must be part of an integrated assessment of the implications of the practice under scrutiny rather than postponed to the last stage of the analysis and subject to strict requirements, as the European courts required in *Intel*, *Post Danmark I* and *Post Danmark II*.

Haegler and Nandakumar explain how the Commission's four-leg efficiency test has been applied by the European Commission to assess the efficiency effects of agreements among competitors (under Article 101(3)). They focus in particular on the assessment of A++, a revenue-sharing JV between four members of Star Alliance.[6] The Commission treated this agreement as a

1 Ronald H. Coase, "Industrial Organization: A Proposal for Research," in Victor Fuchs, ed., *Policy Issues and Research Issues in Industrial Organization*, 1972, p. 69.

2 Case T-286/09 *Intel Corp v Commission*, 2014.

3 Case C-209/10, *Post Danmark A/S v Konkurrencerådet*, 2012.

4 Case C-23/14, *Post Danmark A/S v Konkurrencerådet*, 2015.

5 Gianluca Faella, "The Efficient Abuse: Reflections in the EU, Italian and UK Experience", 2016/1 CLPD (33-46)

6 Urs Haegler and Krishna Nandakumar, "Efficiencies under 101(3) TFEU – did the Commission go far enough in A++?", 2016/1 CLPD (47-53)

restriction by object but limited its intervention to just one overlap route because it concluded that efficiencies were likely to outweigh the potential anticompetitive effects of the JV for all other overlap routes. The Commission considered each of the elements of the four-leg test laid out above and, importantly, it was prepared to consider some out-of-market efficiencies generated by the JV provided they benefitted the same consumers who would be harmed in the overlap routes covered by the JV.

Ross,[7] for Canada, and **Buehler and Federico**, for the EU,[8] discuss the role of efficiencies in merger control. Ross describes the two welfare standards economists use to assess the competitive effects of mergers: the *consumer welfare standard* and the *total welfare standard*.[9] Under the consumer welfare standard, a merger which is likely to increase prices absent efficiencies is only cleared without conditions if the efficiencies it creates and which accrue to consumers are sufficiently large to cause prices to fall. Instead, a merger which raises prices could be cleared under the total welfare standard if it generates sufficient efficiencies for the shareholders of the merging parties.

The welfare standard applied in Canada is total welfare, while in the EU mergers are assessed under the more restrictive consumer welfare standard. Ross critically reports the outcome of the recent *Tervita* decision in Canada, whereby the Canadian Supreme Court found that, absent any quantification of anticompetitive effects that were indeed quantifiable, the Canadian Competition Bureau had failed in establishing that there were any anticompetitive effects at all. Given this result, and the fact that the Competition Bureau had accepted that the merger produced some (albeit small) efficiencies, the Supreme Court allowed the merger to proceed. Ross argues that this decision will have profound implications for merger control in Canada; in particular, the parties will be in a position to force the Competition Bureau to undertake costly quantitative assessments of the price effects of proposed transactions by presenting evidence of some efficiencies, irrespective of their size.

7 Thomas W. Ross, "Competitive Effects and Efficiencies: The Canadian Supreme Court's Decision in *Tervita*", *2016/1* CLPD (54-63)

8 Benno Buehler and Giulio Federico, "Recent Developments in the Assessment of Efficiencies of Mergers in the EU", 2016/1 CLPD (64-75)

9 See Alison Oldale and Jorge Padilla, "For Welfare's Sake?, Balancing Rivalry and Efficiencies in Horizontal Mergers", *Antitrust Bulletin*, 2010.

Buehler and Federico provide an overview of the role played by efficiency claims in the assessment of merger cases examined by the Commission during 2012-2014. The paper focuses on those cases where an efficiency assessment has played a prominent role. It identifies three overarching issues: whether efficiencies should be distinguished from other types of procompetitive effects; the assessment of pass-on to consumers and the balancing of this against any competition harm; and the relevance and implications of the distinction between static and dynamic efficiencies. The authors note that the prominence of efficiency arguments has risen in recent cases. They believe that this is largely because the merging parties have relied on such arguments more often in merger proceedings. While they acknowledge that efficiency arguments have so far not persuaded the European Commission to clear a merger which was found to increase prices in the absence of efficiencies, they point to the *UPS/TNT Express* merger case[10] as an example of how efficiencies were used to narrow down the number of relevant markets where the Commission concluded the merger was anticompetitive.

The four papers collected in this issue provide a factually rich and conceptually rigorous review of some of the salient issues concerning the role of efficiencies in antitrust and merger control. The topics covered are not easy but the authors deal with them elegantly, succinctly and rigorously. After reading these papers, I better understand the conceptual and political challenges that those of us who consider efficiencies should play a much bigger role in competition law are likely to encounter. And yet I found reasons for optimism in these papers, since they make it clear that efficiency considerations are at least no longer kept outside of the narrative employed by competition authorities and courts in their decisions and rulings.

Besides the work at Compass Lexecon, Jorge Padilla is teaching competition economics at the Barcelona Graduate School of Economics and the Toulouse School of Economics. The opinions in this paper do not necessarily represent the views of Compass Lexecon or its clients; they are the author's sole responsibility. Please send your comments to jpadilla@compasslexecon.com

10 Case No COMP/M.6570 – ***UPS/ TNT EXPRESS***. See Enrique Andreu, Jorge Padilla, and Nadine Watson, "The Economics of the UPS/ TNT Case Revisited: Implications for the Future", ***Competition Policy International***, 2015.

The Efficient Abuse: Reflections on the EU, Italian and UK Experience

Gianluca Faella
Associate, Cleary Gottlieb Steen & Hamilton, Rome

1. Introduction

Unlike other areas of competition law, which explicitly incorporate a theory of efficiencies, in many jurisdictions antitrust rules on abuse of dominance and monopolization do not provide for an efficiency justification. In the EU, restrictive agreements may be exempted if they satisfy the conditions laid down in Article 101(3) TFEU, and recital 29 of Regulation No. 139/2004 states that a merger leading to anticompetitive effects can proceed if the efficiencies it brings about counteract the potential harm to consumers. However, Article 102 TFEU seems to establish an absolute prohibition of abuses of dominance. The same is true in many Member States, whose substantive law is generally modelled on EU rules, and in jurisdictions outside the EU, such as the United States and Canada,[1] even though the antitrust laws of some States provide for an efficiency defence of unilateral practices.[2]

Notwithstanding the lack of an explicit exception in many jurisdictions, most policy makers and commentators agree that, even in abuse and monopolization cases, efficiency considerations should form an essential part of the analysis. In the EU, the Commission and EU Courts have explicitly accepted the availability of an efficiency defence under Article 102 TFEU. However, efficiency claims have not played an appreciable role in decision practice and case law at the EU and national level, and many aspects relating to their assessment remain open to question.

This paper focuses on the role and limits of the efficiency defence in abuse cases. In particular, after some preliminary remarks on the role of efficiencies in the assessment of abuse cases (section 2), this paper analyses the evolution of the EU approach (section 3) and the experience in Italy and the UK (section 4). The analysis of the EU, Italian and UK experience will provide the basis for some remarks on the reasons for the very limited use of the defence (section 5), the stage of antitrust analysis where efficiency considerations should play a role (section 6), and their relevance in an effects-based approach (section 7). Section 8 draws some conclusions.

2. The Role of Efficiencies in Abuse Cases

Antitrust analysis frequently involves a trade-off between different values and economic effects. This is also true for the assessment of efficiencies in abuse cases. Economists usually distinguish between different types of efficiencies, namely allocative, productive and dynamic efficiencies. Commercial practices that increase one type of efficiency may lead to a loss of another type of

1 See Section 2 of the Sherman Act and Section 79 of the Canadian Competition Act.

2 For example, in France, under Article 420-4 of the Commercial Code, agreements and unilateral practices are lawful if the firms concerned can prove that: (i) the conduct ensures economic progress; (ii) it does not eliminate competition in a substantial part of the relevant market; and, (iii) a fair share of the resulting profit is transferred to consumers. Under Article 10 of the Mexican Competition Act, the antitrust authority has to examine whether the efficiency gains resulting from the conduct concerned favourably affect the competitive process. Similarly, pursuant to Section 8 of South Africa's Competition Act, efficiencies may justify an otherwise potentially anticompetitive practice, if the dominant firm is able to show technological efficiency or other pro-competitive gains which outweigh the anticompetitive effects of its conduct.

efficiency. A practice that enables a dominant firm to save costs, or to launch new or better products, may increase productive or dynamic efficiency, respectively, but may also allow the firm to strengthen its market power, thus leading to an increase in price and reducing allocative efficiency.

Different types of efficiencies are heterogeneous and often difficult to measure. Furthermore, different scholars and policy-makers may have different views as to the type of efficiency that should prevail in the case of conflict. Many scholars deem that dynamic efficiency is crucial to foster economic development. However, antitrust enforcers tend to focus on short-term allocative efficiency, on the assumption that short-term anticompetitive effects and price increases can hardly be justified by long-term and less certain dynamic efficiencies that may result from investments in new products and improvement of existing ones.

The question of the weight to be given to different types of efficiencies in antitrust cases is closely related to the never-ending debate on the objectives of antitrust law. If the objective pursued by competition policy is the promotion of total welfare, a commercial practice that reduces costs but leads to higher prices would be unobjectionable as long as the welfare of the society as a whole is increased. In contrast, if antitrust rules aim at protecting consumer welfare, productive efficiency gains would only count if they are so significant that prices will not increase.

Article 101(3) TFEU and the EU merger regulation support the view that the primary economic objective of EU competition law is the protection of consumer welfare. Indeed, they clarify that productive and dynamic efficiency gains can justify negative effects on competition, and the ensuing allocative inefficiency, only if consumers are not harmed. Although the text of Article 102 does not provide a clear indication of the type of welfare that it seeks to ensure, it is commonly accepted that Articles 101 and 102 pursue the same objective,[3] as they both aim at protecting consumers by means of undistorted competition.[4]

This also implies that efficiency gains can hardly justify serious harm to the competitive process. Indeed, the incentive of firms to pass possible cost efficiencies on to consumers depends, to a significant extent, on the intensity of competitive pressure from the remaining firms in the market and potential entrants.[5] Furthermore, pursuant to Article 101(3) TFEU, to invoke an efficiency defence, firms have to prove, *inter alia*, that the agreement does not eliminate effective competition. EU case law and decision practice confirm that, under EU law, the protection of the competitive process is a fundamental value, which may prevent the application of the efficiency defence.[6]

The adoption of a consumer welfare standard and the emphasis on the protection of the competitive process put significant limits on the role and availability of the efficiency defence, especially in abuse cases. The defence is not absolute, as efficiencies may justify an anticompetitive practice only if they counteract the possible negative effects on consumers, and the competitive process is not compromised.

3. The Evolution of the EU Approach

Efficiencies have traditionally played a very limited role in EU decision practice and case law on unilateral conduct. The notion of abuse inherited from the Ordoliberal school, focusing on the deviation from a virtuous model of competition on the merits, did not leave much scope for efficiency arguments. In principle, efficiency gains were taken into account only to the extent that the dominant firm's practice merely reflected lower costs or other efficiencies, so that the conduct concerned could be considered a form of competition on the merits, which does not fall, by definition, within the notion of abuse.

Moreover, the absence of an explicit exception in the wording of Article 102 TFEU has provided arguments supporting the view that there is no efficiency defence in abuse cases. It has been

3 See Case 6/72 *Europemballage and Continental Can v Commission* [1973] ECR 215, para. 25.

4 See, *e.g.*, Joined Cases C-468/06 to C-478/06 *Sot. Lélos kai Sia and Others* [2008] ECR I-7139, para. 68; Case C-95/04 *British Airways v Commission* [2007] ECR I-2331, para. 110; Case C-52/09 *Konkurrensverket/TeliaSonera* [2011] ECR I-00527, para. 76; Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (2009/C 45/02), paras. 5 and 6.

5 See, *e.g.*, Guidelines on the application of Article 81(3) of the Treaty (2004/C 101/08), para. 92; Commission decision of 4 July 2007, Case COMP/38.784 *Wanadoo España/Telefónica*, paras. 655-657.

6 "Ultimately, the protection of rivalry and the competitive process is given priority over possible short-term efficiency gains". *Id.*, para. 657.

argued that the differences in the wording of Articles 101 and 102 TFEU are justified because an already existing sub-optimal structure of the market differentiates abuse cases from restrictive agreements.[7] If the degree of competition is already weakened as a result of the presence of a dominant firm, and the latter's behaviour hinders the maintenance or growth of competition, the practice would be unlikely to enhance efficiency to the benefit of consumers, as a competitive market environment ensures that firms have sufficient incentive to operate efficiently and to pass efficiency gains on to consumers.[8] Furthermore, it has been argued that an efficiency defence in abuse cases contradicts the requirement of non-elimination of competition provided for by Article 101(3) TFEU, which is linked to the existence of dominance, as confirmed by the fact that, in principle, restrictive agreements entered into by dominant firms cannot be exempted.[9]

> The emphasis on consumer welfare and the competitive process limits the availability of the efficiency defence

In the past, some rulings of the EU Courts seemed to exclude the possibility of relying on efficiencies once a practice engaged in by a dominant firm is found to restrict competition. In 1983, in *Michelin I*, the European Court of Justice (ECJ) held that neither the intent to increase sales nor the objective of spreading production more evenly could justify a target rebate scheme capable of hindering access to the market.[10] In 1989, in *Ahmed Saeed Flugreisen*, the ECJ stated that "no exemption may be granted, in any manner whatsoever, in respect of abuse of a dominant position", as such abuse is "simply prohibited by the Treaty".[11] In 1990, the General Court (GC) held that Article 102, "by reason of its very subject-matter (abuse), precludes any possible exception to the prohibition it lays down".[12] In 2003, in *Atlantic Container*, the General Court stated that, as Article 102 does not provide for any exemption, abusive practices are prohibited "regardless of the advantages which may accrue to the perpetrators of such practices or to third parties."[13] In 2007, in *France Télécom*,[14] the General Court refused to accept that economies of scale and learning effects could justify predatory pricing.

However, in other cases, such as *Michelin II*,[15] *British Airways*[16] and *Microsoft*,[17] the EU Courts endorsed the idea that unilateral conduct may be objectively justified if the exclusionary effects are outweighed by efficiency gains to the benefit of consumers. In these cases, the EU Courts also clarified that the defence would fail if the exclusionary effect bears no relation to the benefits for the market and consumers, or if it goes beyond what is necessary to attain those benefits.

At the time of the adoption of the 2005 Discussion Paper and the 2009 Commission Guidance on exclusionary conduct,[18] the treatment of the efficiency defence under Article 102 TFEU arose as a topic of great importance. The introduction of an effects-based approach, focusing on the impact of the contested practice on consumer welfare, resulted in a change of perspective. The framework set out by the Guidance made it necessary to analyse possible redeeming virtues even if the contested conduct falls within the scope of Article 102 TFEU. Once the notion of abuse is framed in terms of foreclosure leading to consumer

7 See, *e.g.*, V. Mertikopoulou, "Evolution of the objective justification concept in European competition law and the unchartered waters of efficiency defences", Concurrences (2014), No. 2-2014.
8 See, *e.g.*, Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (2011/C 11/01), para. 103; Guidelines on the application of Article 81(3) of the Treaty (2004/C 101/08), para. 92.
9 *Id.*, para. 106.
10 Case 322/81 *Michelin v Commission* [1983] ECR 3461, para. 85.
11 Case 66/86 *Ahmed Saeed Flugreisen* [1989] ECR 803, para. 32. See also Joined Cases T-191/98, T-212/98 to T-214/98 *Atlantic Container v Commission* [2003] ECR II-3275, para. 1109; Joined Cases T-24/93 to T-26/93 and T-28/93 *Compagnie maritime belge transports and others v Commission* [1996] ECR II-1201, para. 152.
12 Case T-51/89 *Tetra Pak Rausing v Commission* [1990] ECR II-309, para. 25.
13 Joined Cases T-191/98, T-212/98, and T-214/98 *Atlantic Container Line v Commission* [2003] ECR II-3275, para.1112.
14 Case T-340/03 *France Télécom v Commission* [2007] ECR I-107; on appeal, Case C-202/07 P *France Télécom v Commission* [2009] ECR I-2369.
15 Case T- 203/01 *Manufacture française des pneumatiques Michelin v Commission* [2003]ECR II-4071, para. 98.
16 Case C- 95/04 *British Airways v Commission* [2007] ECR I- 2331, paras. 84-86.
17 Case T-201/04 *Microsoft Corp. v Commission* [2007] ECR II-3601, para. 1114 et seq.
18 Guidance, *supra* note 4.

harm (anticompetitive foreclosure),[19] antitrust authorities and courts can hardly refrain from the difficult and challenging task of balancing negative and positive effects on economic efficiency and consumers.

> The Guidance and some recent EU rulings clarified the conditions to benefit from the defence

However, instead of analysing the efficiencies in the context of an overall assessment of the impact of the conduct on the market, the Guidance stated that they should be taken into account as a possible justification subject to stringent conditions. According to the Guidance, dominant firms have to demonstrate with a sufficient degree of probability, and on the basis of verifiable evidence, that four cumulative conditions are fulfilled: (i) the efficiencies have been, or are likely to be, realized as a result of the conduct; (ii) the conduct is indispensable to the realization of those efficiencies; (iii) the likely efficiencies resulting from the conduct outweigh any likely negative effects on competition and consumer welfare in the affected markets; and (iv) the conduct does not eliminate effective competition, by removing all or most existing sources of actual or potential competition. In essence, the efficiency defence under Article 102 TFEU is modelled on the exemption of restrictive agreements provided for by Article 101(3) TFEU. While the first three conditions may be found in earlier rulings on abuse of dominance, the requirement that effective competition is not eliminated was introduced by the Guidance.

A few years later, in *TeliaSonera*, the ECJ confirmed the need to take into account efficiency gains to the extent that they benefit consumers.[20] However, it did not make reference to the four cumulative conditions provided for in the Guidance. In 2012, in *Post Danmark I*, the ECJ endorsed for the first time the attempt to introduce a test akin to that provided for by Article 101(3),[21] as it stated that the efficiency defence is subject to four cumulative conditions, identical to those set out in the Guidance. Thus, the requirement of non-elimination of effective competition appeared in EU case law for the first time.

In two recent rulings, the EU Courts adopted a rigorous approach to the analysis of rebate systems, but confirmed that dominant firms may justify an anticompetitive practice by proving efficiency gains capable of counterbalancing or outweighing its negative effects.

In particular, in the *Intel* judgment, delivered in 2014,[22] the GC stated that exclusivity rebates granted by a dominant firm are by their very nature capable of restricting competition and foreclosing competitors.[23] The GC held that, for a finding of abuse, it is sufficient to demonstrate a loyalty-inducing mechanism. According to the Court, a price-cost test is not only not necessary, but would also be erroneous, because it "only makes it possible to verify the hypothesis that access to the market has been made impossible and not to rule out the possibility that it has been made more difficult".[24]

However, the Court added that it is open to the dominant firm to justify the use of an exclusivity rebate system by showing that its conduct is objectively necessary or that the potential foreclosure effect may be counterbalanced or outweighed by advantages in terms of efficiencies that also benefit consumers.[25]

In 2015, in *Post Danmark II*,[26] the ECJ analysed the retroactive quantity rebate system implemented by the Danish incumbent in the postal sector. The Court stated that the as-efficient competitor test is not a prerequisite for a finding of abuse, but

19 *Id.*, para. 19.
20 Case C-52/09 *Konkurrensverket v TeliaSonera* [2011] ECR I-527, para. 76.
21 Case C-209/10 *Post Danmark* ECLI:EU:C:2012:172, paras. 40-43.
22 Case T-286/09 *Intel v Commission* ECLI:EU:T:2014:547.
23 *Id.*, paras. 85 and 87.
24 *Id.*, para. 150.
25 In the case concerned, the GC noted that the dominant firm had put forward no argument in that regard. *Id.*, para. 94.
26 Case C-23/14 *Post Danmark v Konkurrencerådet* ECLI:EU:C:2015:651.

only "one tool amongst others".[27] A tendency to remove or restrict the buyer's freedom to choose is sufficient for a finding of abuse. In the case in question, the as-efficient competitor test was "of no relevance" because: (i) given the characteristics of the market, the emergence of as-efficient competitors was not credible; and (ii) less efficient competitors could exert a useful constraint on the dominant firm.[28]

However, even in this case, the ECJ added that it is open to a dominant firm to provide justification for behaviour liable to be caught by Article 102 TFEU, by demonstrating that the exclusionary effect may be counterbalanced or outweighed by advantages in terms of efficiencies that also benefit consumers. The Court confirmed that, in order to benefit from the defence, the dominant firm has the burden of proving that the four cumulative conditions set out in the Guidance and *Post Danmark I* are met.[29]

Even though the availability of an efficiency defence under Article 102 TFEU is now unambiguously accepted by the EU institutions, efficiency claims have been addressed in a specific and transparent way only in a very few cases, and have always been rejected by the Commission.[30]

4. The Experience at the National Level: Italy and the UK

The experience in Italy and the UK provides interesting indications on the role of efficiencies in abuse cases. In both systems, competition authorities and courts apply not only EU, but also national rules that (i) are heavily modelled on Articles 101 and 102 TFEU,[31] and (ii) must be interpreted and applied in a manner that is consistent with the principles established by EU case law and decision practice.[32] Thus, it should be expected that the internal practice promptly reflects developments at the EU level. However, even at the national level, the explicit acknowledgement of the efficiency defence by the EU institutions does not seem to have had a significant impact on decision practice and case law.

4.1. The Italian experience

In Italy, decision practice and case law still reflect, to a large extent, the traditional form-based approach of the EU institutions. The delay in the transition towards a more effects-based approach has resulted in a very limited application of the efficiency defence in abuse cases. Efficiency claims have so far been put forward by dominant firms only in a few cases and, even in these cases, they have not played a significant role in the analysis of the contested practice, which has focused on actual or potential foreclosure.

In *TNT Post Italia/Poste Italiane*, the Italian Competition Authority (ICA) held that Poste Italiane, the incumbent in the postal sector, had offered below-cost prices for a new certified date delivery service in order to protect its dominant position in the traditional market for bulk mail from the competitive pressure exerted by the certified date and time delivery service launched some years before by TNT Post Italia.[33] Bulk mail and certified delivery services were considered separate, albeit related, relevant product markets. In the market for certified delivery services, TNT was by far the leading firm, with a share exceeding 90%, and offered prices lower than those charged by the incumbent. Indeed, in the period under investigation, TNT had continued to grow more than the incumbent.

On appeal, the Regional Administrative Court of Lazio (TAR) held that the ICA had not adequately

27 *Id.*, para. 61.
28 *Id.*, paras. 59-62.
29 *Id.*, paras. 47-49.
30 In particular, in *Intel*, the dominant firm argued that its rebate system was necessary to achieve several efficiencies in terms of lower prices, scale economies, other cost savings, risk-sharing and marketing efficiencies. The Commission held that the alleged efficiencies related to rebates, and not to the exclusivity condition. Furthermore, the dominant firm had not provided sufficient evidence supporting its claims and excluding less restrictive means. See Commission decision of May 13, 2009, Case COMP/37.990, *Intel*, paras. 1617-1639. In *Réel /Alcan*, the dominant firm tried to justify tying by arguing for product-related efficiencies due to joint development and production, operational efficiencies, and reputational efficiencies arising from avoiding the use of its product with an inferior product. The Commission rejected these claims on the grounds that: (i) the joint development and production would not require contractual tying; (ii) customers strongly requested unbundled products; (iii) the prices of the combined products were higher. See Commission Decision of 20 December 2012, Case COMP/39230, *Rio Tinto Alcan*, paras. 86-84. On the EU decision practice, see H.W. Friederiszick and L. Gratz, "Hidden Efficiencies: The Relevance Of Business Justifications In Abuse Of Dominance Cases", 11(3) Journal of Competition Law & Economics, 671 (2015).
31 See Article 3 of Law No. 287/1990 and Section 18 of the UK Competition Act 1998.
32 See Article 1(4) of Law No. 287/1990 and Section 60 of the UK Competition Act 1998.
33 Decision of 14 December 2011, No. 23065, Case A413, TNT Post Italia/Poste Italiane, Bulletin No. 48/2011.

proved that the prices offered by the incumbent were predatory.[34] *Inter alia*, the Court found that: (i) the ICA had erroneously identified the long-run average incremental cost (LRAIC) borne for the provision of the new service, as it had qualified as incremental some resources that would have been in any case used for the provision of other services; (ii) the ICA had verified whether the prices offered covered costs only with regard to the first full year of activity, without taking into account the likely reduction in unit costs resulting from the increase in sales in the following years; (iii) the absence of a predatory strategy was confirmed by the fact that TNT had maintained its preeminent position in the market for certified delivery services.

During the administrative proceedings and the subsequent judicial phase, the incumbent argued that, even if its commercial practice had had exclusionary effects, it would have been justified. The prices offered for the certified delivery service represented a proportionate reaction to the competitor's commercial policy, as they were higher than those charged by TNT for a service characterized by a better performance level. Furthermore, the contested conduct was justified by the efficiencies realized to the benefit of customers because the offer of competitive prices had enabled the incumbent to achieve a minimum scale in the relevant market, so as to spread the initial investment over a higher volume of mail and to reduce unit costs. Indeed, even assuming that the LRAIC calculated by the ICA was correct, the increase in sales had made it possible to achieve a positive margin starting in the second full year of activity. This had enabled the incumbent to offer a new service, which exerted a competitive constraint in a market almost monopolized by TNT.

Even though it was not necessary, the TAR also upheld the grounds of appeal based on the existence of business justifications. However, it did not analyse in depth the efficiency claim, as it focused on the errors committed by the ICA in the analysis of the alleged predatory prices. The TAR ruling was confirmed by the Supreme Administrative Court, which did not specifically address the issue of the efficiency defence.[35]

Efficiency arguments were raised also in *Viaggiare/Ryanair*.[36] Viaggiare, an online travel agency (OTA), brought a damages action for breach of Article 102 TFEU against Ryanair before the Court of Milan. Viaggiare offered online services that allowed for the comparing of flights and prices of various airlines and the purchasing of tickets. In order to carry out its activity, it needed information on flights and prices of different airlines. The OTA claimed that Ryanair had abused its dominant position by refusing to grant access to up-to-date information on its flight tickets and by hindering its intermediation activity.

The Court of Milan assessed Ryanair's conduct under the essential facility doctrine. The Court found that Ryanair was dominant in upstream markets for air transportation services, given its *de facto* monopoly in 49 intra-EU routes and its share exceeding 50% in 19 routes. As a consequence, the activities performed by the OTAs in the downstream market largely depended on access to information on Ryanair flight tickets, which was considered an essential facility for OTAs seeking to offer their services.

Ryanair argued, *inter alia*, that the decision to prevent the OTAs from selling its tickets had resulted in lower prices for consumers. The fact that Ryanair's tickets were sold only on the airline's website allowed collecting additional revenues through the sale of advertising spaces and ancillary services (such as insurance, local transport and car rental). In turn, these additional revenues made it possible to lower the prices offered to passengers.

The Court of Milan accepted that it was necessary to verify whether: (i) Ryanair's conduct could be considered justified in light of ancillary revenues and their alleged positive effects on flight ticket prices; or (ii) the interest of the OTA should prevail due to the need to provide consumers with a different and more complete service. In this respect, however, the Court limited itself to making reference to the standard established by EU case law for the assessment of refusal to license intellectual property rights. According to this standard, such a refusal may be abusive if, *inter alia*, it prevents the emergence of a new product or service for which there is potential demand.[37]

34 TAR Lazio, Judgment of 25 June 2012, No. 5769.
35 Council of State, Judgment of 6 May 2014, No. 2302.
36 Judgment of 4 June 2013, No. 7825.
37 See, in particular, Joined Cases C-241/91 P and C-242/91 P *RTE and ITP v Commission ("Magill")* [1995] ECR I-743, para. 54; and Case C-418/01 *IMS Health v NDC Health* [2004] ECR I-5039, para. 38.

In the case at hand, Ryanair's refusal to allow the consultation of its website was capable of hampering the development of different and more complete services provided by the OTAs, consisting of consultation of multiple flights, intermediation and sale of tickets. On this basis, the Court concluded that Ryanair's conduct was not justified by possible benefits for consumers[38].

> In Italy, efficiency claims have not played a significant role in the analysis of unilateral practices

4.2. The UK experience

Even in the UK, there have been very few decisions that discussed efficiency defences under Article 102 TFEU or the prohibition laid down in Chapter II of the UK Competition Act.[39]

Efficiencies were discussed in the 2002 decision of the Director General of Fair Trading in *The Association of British Travel Agents and British Airways*.[40] The complainant (ABTA) alleged that British Airways was abusing its dominant position by making excessively low booking payments to travel agents, which did not allow agents to cover their costs.[41]

The Director General considered that BA was not obliged to make booking payments covering the full cost incurred by agents in issuing the tickets. Travel agents could supplement the booking payment by charging passengers a service fee, given that they provided a service that was useful to passengers.[42] Competition between agents and other distribution methods would not be eliminated if BA were to sell tickets through its website at prices lower than those available through agents, as there were "*significant differences*" in the nature of the two channels.[43] Furthermore, there was an objective justification for tickets being available through BA's website at a lower price than through travel agents, in so far as online distribution costs were lower than those of the traditional channel. The price difference could simply reflect the additional costs and services relating to distribution through travel agents.[44]

Instead of accepting a true efficiency defence, the decision appears consistent with the traditional approach of the EU institutions, according to which pricing practices that reflect different cost levels are in principle compatible with antitrust rules.

Efficiency arguments were rejected in two cases concerning alleged anticompetitive practices in the pharmaceutical sector. In *Genzyme*,[45] the OFT found that Genzyme, holding a dominant position in the market for the supply of drugs used to treat a rare disease, had imposed a margin squeeze on a provider of homecare services, Healthcare at Home (H@H), by offering to provide H@H with the drug at the same price offered to the National Health Service (NHS) for supply of the drug together with its own newly launched homecare service.

Genzyme argued, *inter alia*, that its own method of distribution was the most cost-effective and, therefore, the best option for the NHS. However, the OFT noted that no document submitted by Genzyme during the investigation supported its argument.[46] The OFT added that, in any case, it was not for Genzyme to determine what is in the best interest of the NHS or other purchasers, while denying them the option of obtaining a better deal through competition. The NHS should have the possibility to decide whether it would be more cost-effective for it to purchase the drug

38 In 2015, the finding of abuse was annulled by the Court of Appeals of Milan, according to which the plaintiff had not adequately proved that Ryanair was dominant and its conduct was capable of restricting competition. The Court of Appeals did not address the issue of possible efficiencies. See judgment of 12 October 2015, No. 3900

39 On the UK experience, see C. Brown, "Efficiency defences under the Chapter II prohibition and Article 102 TFEU: The UK experience", Concurrences (2014), No. 2-2014.

40 Decision No. CA98/19/2002 (11 December 2002).

41 According to ABTA, if travel agents charged customers an additional service fee to cover their costs, customers would be encouraged to book their tickets online at British Airways' website instead of through a travel agent.

42 *Id.*, para. 32.

43 *Id.*, para. 42.

44 *Id.*, paras. 44-45.

45 *Exclusionary behaviour by Genzyme Limited*, Decision No. CA98/3/03 (27 March 2003).

46 *Id.*, para. 360.

and homecare services together as a package or separately.[47]

In *Reckitt Benckiser*,[48] the OFT found that Reckitt Benckiser (RB) had abused its dominant position by withdrawing and delisting NHS presentation packs of a drug shortly in advance of the publication of a generic name relevant to the product, which would have facilitated full generic competition. According to the OFT, RB's decision to withdraw and delist NHS packs aimed at hindering the development of such competition.

The OFT did not specifically address the issue of the possible efficiency defence, but it did consider whether RB foresaw pro-competitive gains as a result of the withdrawal of the drug. RB expected that the withdrawal would have ensured higher profitability and revenues, which would have provided, in turn, a viable base to invest in R&D and to preserve much of its specialised workforce. However, the OFT did not regard either of these effects as pro-competitive efficiency gains, since they stemmed from the restriction of competition caused by the conduct, rather than directly from the conduct itself.[49]

Efficiency considerations were more successful in two cases concerning alleged predatory pricing in the transport sector. In *First Edinburgh/Lothian*,[50] Lothian Buses (Lothian) complained that First Edinburgh (FE) had abused its dominant position in the market for commercial bus services by offering predatory prices and increasing the number and frequency of services in the Edinburgh area.

FE held a dominant position in one or more markets in the area surrounding Edinburgh, while Lothian was likely to be dominant in Edinburgh. Lothian argued that FE was using the profits deriving from its operations in the area surrounding Edinburgh to subsidise its expansion within the city, but the OFT held that the contested conduct was not anticompetitive. According to the OFT, even though the prices offered by FE were below average variable cost (AVC) on some routes for some of the time, the evidence collected was consistent with intense competition, instead of anticompetitive foreclosure, because FE was incurring short-term losses in an attempt to establish a more secure commercial basis for its Edinburgh operations.[51] Internal evidence confirmed that the short-term losses incurred by FE were not motivated by an intent to exclude Lothian from the market, but by the future benefits deriving from establishing a more comprehensive network in Edinburgh and rationalising its depots.[52] Accordingly, the ordinary presumption of predation arising from below AVC pricing could be rebutted.[53]

The OFT did not specifically address the issue of the possible efficiency defence, but efficiency considerations and, in particular, the prospect of a pro-competitive outcome seem to have played a significant role in the analysis of whether the conduct was predatory.

> In the UK, efficiency considerations seem to play a role, but in an integrated way

The efficiency defence was explicitly considered by the OFT in the *FlyBe* case,[54] concerning the alleged predatory prices offered by an airline (FlyBe) to establish itself on a new route. The OFT held that FlyBe's entry and low pricing on the Newquay-London Gatwick route did not amount to an abuse, principally because the company was not dominant on that route, and any conduct on that market was not capable of maintaining or strengthening its dominance on other routes.

47 *Id.*, para. 361. On appeal, the Competition Appeal Tribunal (CAT) confirmed the OFT's findings: see *Genzyme Limited v OFT* [2004] CAT 4, para. 592.
48 *Abuse of a dominant position by Reckitt Benckiser Healthcare (UK) Limited and Reckitt Benckiser Group plc*, Decision No. CA98/02/2011 (12 April 2011).
49 *Id.*, para. 6.36.
50 Decision No. CA98/05/2004 (29 April 2004).
51 *Id.*, para. 58.
52 *Id.*, para. 68.
53 *Id.*, para. 75.
54 *Alleged abuse of a dominant position by FlyBe Limited* (5 November 2010).

Nonetheless, for completeness, the OFT proceeded to consider FlyBe's arguments on business justifications. The OFT found that initial losses experienced in the first one or two years after entering a route are the result of normal commercial practice for an airline, and are due to the need to stimulate market demand for the route. Thus, there was an objective justification for FlyBe's decision to enter the route despite the expected initial losses.[55]

In addition, FlyBe argued that efficiencies had been generated as a result of its entry on the route in competition with a small regional airline already active on that route. The alleged efficiencies included: (i) a substantial consumer benefit (of almost £4.5 million) reflecting the fall in prices due to the entry of a new player; (ii) greater choice for consumers; (iii) the offer of direct flights (while the incumbent's flights were indirect); (iv) the possibility to purchase FlyBe's flights as part of a journey comprising several flights through a "Global Distribution System"; and (v) the fact that it had stimulated demand in the south east of England by increasing advertising in the area.[56]

The OFT accepted that some of these possible benefits had been realised, but noted that some of them could also be the result of predatory behaviour. The lower fares since FlyBe's entry and other benefits were an advantage for consumers, but there was no guarantee that they would continue if FlyBe were to become the sole operator on the route. Ultimately, the OFT held that there was insufficient evidence to conclude that the alleged efficiencies would have offset the long-term impact of a predatory strategy on consumer welfare, had FlyBe needed to rely on the defence.[57]

The efficiency defence has not explicitly been considered in the jurisprudence of UK courts.[58] However, in some cases, the courts seem to have integrated efficiency considerations within their analysis of whether conduct is at all abusive.[59]

5. The Limited Use of the Efficiency Defence in Abuse Cases

The assessment of efficiencies has yet to become a significant part of the analysis carried out by the Commission, national competition authorities (NCAs) and national courts under Article 102 TFEU and similar internal rules. Indeed, it is difficult to find any abuse cases closed by a decision finding that an exclusionary practice does not infringe competition rules because of alleged efficiencies. Furthermore, efficiency arguments have been discussed only in a limited number of cases.

Several factors may contribute to explaining why efficiencies have not played an appreciable role in decisional practice and case law despite the Guidance. It has been argued that the paucity of decisions on the efficiency defence may be a sign of maturity of EU competition law enforcement because it may be due to the application of an effects-based approach, which would make efficiency defences unnecessary.[60] Firms may not need to rely on the efficiency defence because the possible benefits have already been taken into account in the assessment of whether the investigated practice raises competitive concerns.

Efficiency considerations may be the reason why the competent authority does not adopt a prohibition decision, or closes its investigation with a decision rejecting a complaint. Efficiency gains may also induce the competent authority to adopt a commitment decision aimed at reducing the possible negative effects, instead of banning the practice altogether, furthermore they may play a role in the assessment of the adequacy and proportionality of the offered commitments. In these cases, efficiencies are not formally treated as a defence, but they play a role in the reasoning at an earlier stage, possibly even before a competition authority decides to open proceedings.[61]

55 *Id.*, paras. 6.98-6.99.
56 *Id.*, para. 6.102.
57 *Id.*, paras. 6.104-6.108. In its analysis, the OFT made explicit reference to the Commission Guidance. However, in view of its finding that FlyBe's conduct did not amount to an abuse, the OFT did not address the efficiency arguments advanced by FlyBe in much detail.
58 See C. Brown, *supra* note 38.
59 For instance, in the *Attheraces v British Horseracing Board* case, [2007] EWCA Civ 38, the Court of Appeal considered whether the pricing of pre-race data, required *inter alia* by bookmakers, at levels significantly above the production cost was unfairly high. It held that a simple "cost +" approach was not appropriate, since pre-race data was not a standalone product, but a by-product of British horseracing. The existence and value of the by-product depended on the existence, quality and integrity of the primary activity. The Court found that, as the economic value of the pre-race data was much greater than its production cost, the use of a simple "cost +" approach was not appropriate.
60 See, *e.g.*, E. Rousseva, "Efficiency defence under Article 102 TFEU: Retrospective and Prospective", Concurrences (2014), No. 2-2014.
61 *Id.*

A more comprehensive and detailed assessment of the existence of a material adverse effect on competition implies that there is less need to rely on the efficiency defence. At the same time, the emphasis on material anticompetitive effects means that firms wishing to invoke the efficiency defence have to overcome a high hurdle to prove that the alleged benefits of the contested conduct outweigh its negative impact on competition and consumers. Accordingly, firms under investigation may have little incentive to advance the defence.

This view may be supported by the experience of some Member States. In the UK, the adoption of an effects-based, rather than a formalistic, approach to Article 102 and the Chapter II prohibition seems to have led in many cases to findings of non-infringement or "no grounds for action" decisions. Efficiency considerations seem to play a role in competition law enforcement, but more in an integrated way, at the stage of the analysis of whether a given conduct is anticompetitive in the first place.[62]

However, the tendency to anticipate the analysis of efficiency considerations in an integrated effects-based approach is not the only factor explaining the limited use of the defence. Indeed, it is open to question whether the effects-based approach has fully established itself in EU case law and throughout the European competition network. The EU Courts have rejected some of the most innovative aspects of the Guidance.[63] Even the Commission adopted an ambiguous attitude towards the effects-based approach. Indeed, in some cases it continued to rely on the traditional approach of EU decision practice and case law, which implies a much lower standard of proof and guarantees a wider margin of manoeuvre and discretion in the assessment of unilateral conduct.[64] The contrary views expressed by EU Courts on some aspects of the Guidance and the ambiguous attitude of the Commission have not encouraged the transition towards a more economic approach at Member State level.

In some States such as Italy, the NCA's reluctance to embrace a full effects-based approach in abuse cases may have limited the scope for the analysis of possible efficiencies. This may also have had a bearing on the defensive strategy of firms concerned. Given the limited economic analysis of exclusionary effects carried out by some authorities in abuse cases, it seems even more unlikely that they will take into account alleged efficiencies. As a consequence, firms tend to focus their defence on the finding of an exclusionary practice.[65]

Furthermore, some NCAs may still be sceptical about the fact that an exclusionary practice implemented by a dominant firm does not harm consumers. After all, competition stimulates economic performance, increases consumer choice and induces firms to offer competitive prices.

> Several factors may explain the limited role of efficiencies in decisional practice and case law

Agreements between parties holding low levels of market power may be considered efficiency-enhancing even if they have some restrictive effects. However, when the degree of competition is already weakened as a result of the presence of a dominant firm, a practice that further hinders the development or maintenance of competition is much less likely to be considered capable of benefiting consumers.[66] In addition, in some cases, the competent authority may consider that the efficiencies arising from an anticompetitive practice may strengthen its exclusionary impact, if they result in a competitive advantage for the dominant firm. Thus, efficiencies may be considered an offence rather than a defence.

62 Furthermore, efficiency considerations may have affected the OFT's decisions to close certain investigations and give priority to other cases that could have a more significant impact on consumer welfare. See C. Brown, *supra* note 38.

63 For instance, in *Intel* and *Post Danmark II*, the GC and the ECJ, respectively, held that a properly defined price-cost test is not a necessary step for a finding of abuse in the case of loyalty-inducing discounts. In *TeliaSonera*, the ECJ stated that a price squeeze may be abusive even though the requirements for the application of the essential facility doctrine are not met.

64 See, *e.g.*, Case COMP/37.990, *Intel*, *supra* note 30.

65 See G. Faella and A. Schettino, "The efficiency defence in abuse cases: some reflections on the Italian experience", Concurrences (2014), No. 2-2014.

66 See, *e.g.*, V. Mertikopoulou, *supra* note 7.

Finally, a central reason for the very limited use of the efficiency defence in abuse cases is the fact that the conditions for a successful defence are very stringent and the burden of proof is extremely high. In a dominated market it is very difficult to meet the requirement that the conduct does not eliminate effective competition. This requirement increases the risk that efficiencies may be treated as an offence rather than as a defence,[67] to the extent that they contribute to reinforcing the position of the dominant firm and the exclusionary impact of the practice. Furthermore, it is very difficult to prove that efficiency gains are sufficient to outweigh any negative effects on competition and consumers. Quantifying dynamic efficiencies and the long-term effect of the lessening of competition on consumers may be extremely complex. In many cases, dominant firms may be able to provide qualitative arguments, but a balance between different effects may well require quantitative evidence, which may not be available. In addition, it is very difficult to prove that efficiency gains will be passed on to consumers in markets where competition is already weakened by the presence of a dominant position.[68]

In many cases, the burden of proof on dominant firms may amount to a *probatio diabolica*. This may be the case, for instance, with price abuses. Most competition authorities and courts seem willing to accept that bearing short-term losses to enter a market is normal commercial practice. However, if the product concerned is already marketed, proving that the benefits of below-cost pricing outweigh the possible long-term negative effects requires a forward-looking assessment of variables that could hardly be quantifiable even in a limited time-span.

The main efficiency gain that may arise from below-cost pricing is the achievement of economies of scale. However, these economies are extremely difficult to estimate. As the decrease in unit costs due to an increase in output depends on total volumes, economies of scale may be ascertained only *ex post*, and may significantly vary over the years depending on the level of sales. Estimating the impact of the possible economies of scale on the price level is even more difficult. Based on economic theory, there is no clear link between a decrease in fixed cost and a reduction in prices, as the price level is influenced mainly by marginal cost.

Similar difficulties arise when estimating the possible negative effects on price levels and consumer welfare. In a predatory pricing scenario, such effects materialize only in a subsequent phase, when the anticompetitive strategy leads to the exclusion of competitors, thus strengthening the dominant firm's market power. It is very difficult, or even impossible, to estimate the negative impact that predatory pricing may have, in the future, on the price level, which depends on a number of factors, including demand elasticity, entry, and the number and importance of competitors remaining in the market after the implementation of the predatory strategy.[69]

As dominant firms bear the burden of demonstrating, on the basis of verifiable evidence, that the cumulative conditions provided for by the Guidance and EU case law are fulfilled, the fact that, in most cases, efficiencies and negative effects cannot be precisely measured and balanced against each other inevitably restricts the scope for the use of an efficiency defence. Indeed, it has been argued that, due to its "difficult, almost impossible, evidentiary threshold", the efficiency defence remains "a mere theoretical possibility".[70]

6. Integrated versus Two-Step Approach

The limited role of efficiency arguments reflects the lack of a clear and consistent theoretical framework for the assessment of efficiencies under Article 102 TFEU. In principle, antitrust authorities and courts can analyse efficiencies as a part of an overall assessment of the effects of the investigated practice or in a subsequent phase, as a

67 See, *e.g.*, D. Waelbroeck, "The assessment of efficiencies under Article 102 and the Commission's Guidance Paper", in F. Etro and I. Kokkoris (Eds.), *Competition Law and the Enforcement of Article 82* (Oxford University Press, 2010).

68 See, *e.g.*, J.-F. Bellis and T. Kasten, "Will Efficiencies Play an Increasingly Important Role in the Assessment of Conduct Under Article 102?", in F. Etro and I. Kokkoris (Eds.), *supra* note 66.

69 Actually, some of the few cases in which efficiency considerations have been accepted concerned alleged predatory prices. However, in those cases, competition authorities and courts had already concluded that the practice was not anticompetitive. Accordingly, it was not necessary to precisely estimate the alleged efficiencies nor to balance them against the possible negative consequences on competition and consumer welfare. Indeed, in *FlyBe*, the OFT stated that, had the practice been considered predatory, there would have been insufficient evidence to conclude that the alleged efficiencies would have offset the negative long-term impact of the strategy on consumer welfare. See *supra*, para. 4.2.

70 See V. Mertikopoulou, *supra* note 7.

defence for an alleged anticompetitive behaviour. It is still open to question whether the two-step approach introduced by the Guidance and endorsed by the ECJ, based on the Article 101(3) model, is the most appropriate way to incorporate efficiency considerations in the analysis of abuse cases.

Some commentators have argued that the assessment of competitive harm and possible advantages under Articles 101 and 102 TFEU should be consistent, also in light of the fact that the two provisions pursue common objectives and may apply at the same time to certain practices.[71] Furthermore, it may not make sense from a practical perspective for enforcers and courts to follow different approaches under the two provisions.

However, most scholars seem to believe that a two-stage approach based on strict conditions, similar to those set out in Article 101(3) TFEU, does not fit abuse cases. Some years before the adoption of the Guidance, some scholars argued that, as Article 102 does not expressly provide for an exception, efficiencies could not be a defence, but only an integral part of the assessment of the abuse.[72] In his opinion in *Syfait*, Advocate General Jacobs held that a two-step analysis of abuse and objective justification is "somewhat artificial". He noted that Article 102 TFEU, in contrast with Article 101 TFEU, does not contain any explicit provision for the exemption of anticompetitive conduct. The very fact that conduct is characterised as an abuse suggests that a negative conclusion has already been reached. Therefore, it would be more accurate to say that certain types of conduct on the part of a dominant firm do not fall within the category of abuse at all.[73]

After the Guidance was adopted, many scholars argued that the introduction of a defence similar to Article 101(3) was the inferior method of dealing with efficiencies, in comparison with incorporating efficiencies in the concept and finding of abuse.[74] Anticompetitive behaviour and justifications are intrinsically linked in Article 102 TFEU cases because positive and negative effects are often "deeply intertwined" and cannot be analysed separately.[75] The Commission should therefore carry out an integrated assessment, through a transparent and detailed analysis of both anticompetitive effects and efficiency considerations.[76]

The artificiality of the separation between the two stages of analysis is confirmed by the fact that the legal standard used for certain categories of abuse already involves an assessment of possible efficiencies. For instance, the standards applicable to refusal to deal and to license intellectual property rights are based on a balance between the preservation of incentives and the protection of competition. In principle, a refusal to deal is unlawful only if the input is indispensable and the practice may eliminate effective competition on a downstream market. EU case law on refusal to license intellectual property rights requires, in addition, that the contested conduct prevents the emergence of a new product for which there is potential consumer demand. The indispensability, elimination of competition and new product requirements are based on efficiency considerations, as they are intended to protect the dominant firm's and its competitors' incentives to invest and innovate. A balance between anticompetitive effects and efficiencies is inherent in the standard used for the assessment of these practices.[77]

At the same time, the analysis of the requirements for a finding of abusive refusal to deal may be sufficient to rule out the conditions to benefit from an efficiency defence. In principle, if the indispensability and the related elimination of competition requirements are satisfied, the

71 See, *e.g.*, E. Rousseva, *supra* note 59; "The Concept of "Objective Justification" of an Abuse of a Dominant Position: Can It Help to Modernise the Analysis under Article 82 EC?", 2(2) Competition Law Review 27 (2005); and "Objective Justification and Article 82 EC in the Era of Modernisation", in G. Amato and C.D. Ehlermann (Eds.), *EC Competition Law: A Critical Assessment* (Oxford: Hart Publishing, 2007), 377.

72 See, *e.g.*, R. Nazzini, "The Wood Began to Move: an Essay on Consumer Welfare, Evidence and Burden of Proof in Article 82 EC Cases", 31(4) European Law Review 516 (2006).

73 See Opinion of AG Jacobs in Case C-53/03 *Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait) and Others v GlaxoSmithKline* [2005] ECR I-4609, para. 72.

74 See, *e.g.*, G. Faella and R. Pardolesi, "Squeezing Price Squeeze under EC Antitrust Law", 6(1) European Competition Journal 255 (2010); P. Akman, *The concept of abuse in EU competition law*, Oxford: Hart Publishing, 2015, p. 282; H.W. Friederiszick and L. Gratz, *supra* note 30.

75 *Id.*

76 *Id.*

77 Indeed, even scholars that defend the use of similar standards under Articles 101 and 102 TFUE note that, at least for certain practices, efficiencies are normally taken into account in the first stage of the analysis. See E. Rousseva, *supra* note 60.

conditions required by the Guidance and the ECJ for a valid efficiency defence (including the non-elimination of competition) cannot be met. Thus, efficiencies can only be taken into account in the first stage of the analysis.

The Italian and UK experiences seem to confirm that efficiencies may play a real role, and are normally analysed, only within an integrated assessment of the effects of the practice.[78] Efficiency arguments have been invariably rejected when the contested conduct has been found to restrict competition in the first place. The only cases in which efficiency considerations have been (explicitly or implicitly) accepted are predatory pricing cases where judges and competition authorities concluded that the contested practice was not exclusionary.[79] There are significant similarities between these cases:

- The firm under investigation was not dominant in the relevant market where it offered allegedly predatory prices;
- The firm intended to increase its sales in order to establish itself on that market, which was dominated by another player;
- The offer of an alternative service at low prices increased, rather than decreased, the degree of competition in the relevant market.

In sum, the practice represented a legitimate form of competition, instead of a predatory strategy. Allocative and productive efficiencies arising from the decrease in price, the increase in consumer choice and the reduction of unit costs seem to have played an important role in the assessment of whether the practice was anticompetitive. At the same time, in *FlyBe*, the OFT deemed it necessary to clarify that, had the strategy been considered predatory, the alleged efficiencies would likely not have prevented a finding of infringement.

An integrated approach seems to be not only more in line with national decision practice and case law, but also theoretically sound. Unilateral conduct that increases efficiency and benefits consumers should be considered, in principle, a legitimate form of competition and not an anticompetitive practice, even though it may have some negative effects on competitors, just like any other legitimate competitive initiative does. One could argue that this is competition on the merits. Ultimately, there is no efficient abuse.

> It is questionable whether a two-step approach based on the Article 101(3) model is appropriate

7. Efficiency Defence and Effects-Based Approach

The question arises as to whether the introduction of a (theoretical) efficiency defence in abuse cases has fostered the transition towards a more sophisticated and economically sound analysis of unilateral conduct.

The answer is probably no. What is necessary to improve the accuracy of antitrust analysis and to reduce the risk of false positives in alleged abuse cases is not an efficiency defence subject to very strict conditions, which are almost impossible to satisfy, but a real effects-based approach. This effects-based approach should integrate the analysis of possible efficiency gains within a comprehensive and detailed assessment of the effects of the practice.

From this point of view, the *Intel* and *Post Danmark II* rulings are worrying. Apparently, they have reinforced the role of efficiencies in abuse cases. In fact, they have restricted the scope for a more economic and effects-based analysis of rebate systems. The Guidance introduced an as-efficient competitor test for rebate systems, which aimed at integrating economic analysis insights and, ultimately, efficiency considerations into the competitive assessment. Contrary to the Guidance, the EU Courts stated that the application of

78 For instance, in *Viaggiare/Ryanair*, the Court of Milan did not carry out a separate analysis of the alleged efficiencies, but seemed to consider that they were outweighed by negative effects because the contested conduct prevented the emergence of a different and more complete product.

79 See the *TNT Post Italia/Poste Italiane*, *First Edinburgh/Lothian* and *FlyBe* cases, discussed *supra*, paras. 4.1 and 4.2.

a properly structured as-efficient test is not a necessary step, as a tendency to remove or restrict the buyer's freedom to choose is sufficient for a finding of abuse. The GC held that a price-cost test would be erroneous, since it would not allow for the detection of practices that make it "more difficult" to enter the market.[80] The ECJ considered that the as-efficient test is only "one tool amongst others", which in many cases may be irrelevant, as less efficient competitors could also exert a useful constraint on the dominant firm.[81]

The *Intel* ruling was criticised because it seemed to endorse an almost per se illegality rule to exclusivity rebates, which seemed difficult to reconcile with the effects-based approach. According to some commentators, much of the criticism of the *Intel* judgment was misplaced because the presumption introduced by the GC is not absolute. The dominant firm has the right to argue that there is a justification for the exclusivity rebate. Accordingly, the *Intel* judgment did not introduce (or perpetuate) a per *se* rule, but simply reversed the evidential burden of proof where exclusivity is practiced by a dominant firm, in that it is for the firm concerned to adduce evidence of the objective justification.[82]

Even though it is open to question whether the EU Courts' approach to certain retroactive rebates amounts to a *per se* illegality rule, in practice the possibility to rely on an objective justification seems to be illusory, as efficiencies are narrowly interpreted by the Commission and EU Courts.[83] A theoretical possibility to advance efficiency claims subject to strict conditions is not an adequate counterweight to a limited analysis of the economic effects of unilateral conduct. In the past, individual and block exemptions under Article 85(3) EC were used to correct the distortions caused by an excessively broad interpretation of the notion of restriction of competition under Article 85(1) EC. The efficiency defence introduced by the Guidance and EU case law cannot play the same role under Article 102.

8. Conclusion

The role of efficiencies in current antitrust practice is far from satisfactory. The distinction between the finding of anticompetitive foreclosure and the subsequent assessment of possible efficiencies is in many cases artificial. Furthermore, the strict conditions identified by the Commission and the EU Courts do not leave much scope for efficiency arguments in abuse cases. The efficiency defence is more a theoretical possibility than a real option.

Reliance on the efficiency defence, as currently structured under EU law, cannot reduce the risk of erroneous condemnations inherent in a form-based approach. Possible counterbalancing efficiencies should be analysed within an integrated assessment of the effects of the practice, rather than postponed to the last stage of the analysis, as a defence subject to strict requirements. Furthermore, efficiency arguments may play a significant role in antitrust enforcement only within the framework of an effects-based approach, which has not yet been fully adopted in EU and national decision practice and case law. A broad and form-based interpretation of the concept of abuse, coupled with a theoretical possibility to justify efficiency-enhancing practices, is undoubtedly a step back in the transition towards the long-awaited effects-based approach.

Gianluca Faella is adjunct professor of Competition Law and Policy at the University of Siena, Law and Economics at the Federico II University of Naples, and Economic and Financial Law (Antitrust and Regulation) at the Luiss University of Rome.

80 Case T-286/09 *Intel v Commission* ECLI:EU:T:2014:547, para. 150.
81 Case C-23/14 *Post Danmark v Konkurrencerådet* ECLI:EU:C:2015:651, paras. 59-62.
82 See R. Whish, "Intel v Commission: Keep Calm and Carry on!", 6(1) Journal of European Competition Law & Practice 1 (2015).
83 See B. Sher, "Keep Calm—Yes; Carry on—No! A Response to Whish on Intel", 6(4) Journal of European Competition Law & Practice 219 (2015).

Efficiencies under 101(3) TFEU – did the Commission go far enough in A++?

Urs Haegler
Vice President, Compass Lexecon

Krishna Nandakumar
Economist, Compass Lexecon

1. Introduction

On 12 May 2015, the European Commission accepted legally binding commitments offered by Skyteam members Air France/KLM, Alitalia and Delta on three of the many transatlantic routes that are covered by a joint venture ('JV') between those carriers.[1] The commitments were designed to address the Commission's concerns that the JV may harm competition for certain passenger groups on the three transatlantic routes.[2]

Two years earlier, the Commission had accepted commitments offered by Air Canada, United Airlines and Lufthansa (members of Star Alliance), to address concerns pertaining to a single route only (Frankfurt-New York) covered by their JV known as A++.[3, 4] Based on the efficiencies put forward by the parties in that case, the Commission decided not to raise concerns on all the other routes covered by the agreement.[5]

As the A++ JV enables the participating carriers to share revenues, jointly fix schedules and coordinate prices, the Commission considered that the agreement restricts competition both by object and by effect within the meaning of Article 101(1) TFEU. Specifically, the Commission deemed the A++ JV to restrict competition by object because the agreement "*by its very nature aimed at, and had the potential of, restricting competition*".[6] According to the authority, there was also a restriction of competition by effect on the Frankfurt-New York route, since the existence of barriers to entry and expansion meant that rivals could not prevent an appreciable reduction in competition.

Whilst Article 101(1) TFEU prohibits all agreements that have the object or effect of restricting competition,[7] according to Article 101(3) TFEU, the provision may be inapplicable where an agreement gives rise to sufficient efficiency gains to compensate for any harm to competition that may be created.[8] This article reviews the key types of efficiencies that the Commission has considered in the context of the A++ JV, including:

1 European Commission, Decision in Case COMP/AT.39964, *Air France/KLM/Alitalia/Delta*, 12 May 2015 (public version available at http://ec.europa.eu/competition/antitrust/cases/dec_docs/39964/39964_1755_5.pdf).
2 The routes include the non-stop services between New York, on the one hand, and Amsterdam, Rome and Paris, respectively, on the other.
3 European Commission, Decision in Case COMP/AT.39595, *Continental/United/Lufthansa/Air Canada*, 23 May 2013 (the 'A++ Commitments Decision').
4 Moreover, in 2010, the European Commission made legally binding the commitments offered by Oneworld carriers British Airways, American Airlines and Iberia in relation to six transatlantic routes, in response to the Commission's concerns about the carriers' transatlantic joint venture.
5 A. Italianer, 'Competitor agreements under EU competition law,' 40th Annual Conference on International Antitrust Law and Policy, Fordham Competition Law Institute New York, 26 September 2013. The analytical framework for the Commission's efficiencies assessment is described in Paras. 55-79 of the A++ Commitments Decision.
6 See A++ Commitments Decision, Para. 37.
7 European Commission, *Guidelines on the application of Article 101(1) TFEU*. OJ 2011 C101/8, Para. 23.
8 According to European Commission (2011) *Guidelines on the application of Article 101(1) TFEU*. OJ 2011 C101/8, Para. 49, such exemption requires that the agreement (i) leads to efficiencies for the consumer, (ii) is indispensable for such efficiencies, (iii) passes on the efficiencies to the consumer; and (iv) does not lead to an elimination of competition.

- Reductions in schedule delay;
- Economies of density; and
- Efficiencies accruing to certain connecting passengers.

The first two types of efficiencies are commonly referred to as 'in-market efficiencies', since they mainly benefit non-stop passengers on a given transatlantic trunk route. Below we identify several sources of schedule delay reductions enabled by the JV, including the carriers' ability to combine their schedules, coordinate departure times, and lay on additional flights in response to increased (feeder) traffic volumes. The latter also give rise to economies of density in the form of higher load factors, aircraft up-gauging and additional frequencies.

The third type of efficiency relates to efficiencies that accrue to passengers outside the relevant market ('out-of-market efficiencies'), i.e., to those whose transatlantic itinerary involves at least one stop behind or beyond the transatlantic trunk route. This article emphasises that a JV, by mitigating the double-marginalisation problem to a considerable extent, leads to large benefits of this kind.

It is important to note that, notwithstanding the conceptual distinction drawn between those two efficiency categories, the Commission acknowledged that in-market and out-of-market efficiencies can interact and reinforce each other.

We largely agree with the approach that the Commission has adopted in relation to the recognition of in-market efficiencies; and the Chief Economist Team at DG Competition, in particular, deserves credit for contributing to the design of the analytical framework discussed in this paper. Furthermore, in our view, the Commission's willingness to broaden the standard for the assessment of out-of-market efficiencies in the context of this JV should also be commended. However, as we argue below, we consider that, with regard to the out-of-market efficiencies, there are good economic reasons as to why the Commission could have gone even further.

The remainder of this article is structured as follows. First, we discuss each of the three aforementioned types of efficiencies in turn. More specifically, Section 2 deals with schedule delay reductions, Section 3 covers economies of density, and Section 4 provides an explanation of the out-of-market efficiencies as well as a discussion of the Commission's approach to quantifying them. Section 5 then briefly reflects on the issue of balancing efficiencies and anticompetitive effects, before Section 6 concludes.

The Commission acknowledged that in-market and out-of-market efficiencies can interact and reinforce each other

2. Schedule delay reductions

By offering a greater number of return flight bundles (departure-time pairs), an airline JV reduces 'schedule delay', which is measured as the minimum difference between a passenger's preferred departure time and the departure times actually available. Thus, following the formation of a JV, the airlines are better placed to meet passengers' departure-time preferences.

Efficiencies relating to schedule delay reductions constitute demand-side benefits that flow directly to consumers, so that the pass-on condition is automatically satisfied (although, at least in theory, the JV might be able to claw back a portion of those benefits by raising fares).

2.1. Sources of schedule delay reductions

The increase in passengers' choice due to a JV stems from three sources, namely the combination of participant airlines' schedules, improved schedule coordination and the increase in frequencies provided as a result of higher feeder traffic volumes.

2.1.1. Schedule combination

Suppose that each of two airlines, labelled 1 and 2, respectively, operates one daily non-stop flight in each direction between two cities, denoted by A and B, respectively. Some passengers planning a round trip on Route A-B will be content with the combination of outbound/inbound departure times offered by either Airline 1 or Airline 2 individually.

However, other passengers may find the departure time offered by Airline 1 on the outbound leg (A-B) particularly convenient, but prefer the departure time scheduled by Airline 2 on the inbound leg (B-A). The reverse preferences may occur as well. Whilst these other passengers are entitled to choose return flight bundles that combine the schedules of the two carriers, doing so will – under pre-JV competition – force them to buy a one-way ticket from each carrier. Two one-way tickets typically cost substantially more than a ticket for a round-trip operated a single carrier only.[9] Therefore, most passengers are likely to opt for an itinerary involving a single carrier in spite of the potentially less favourable departure times and, hence, experience a longer schedule delay.

In contrast, with a JV in place, this state of affairs can be avoided. Passengers obtain more favourable departure times (shorter schedule delay) at 'no extra cost', because the price of the ticket for the return trip will not depend on whether the itinerary involves a single or two distinct carriers.

2.1.2. Schedule coordination

When carriers enter a JV agreement, they typically go beyond simply combining existing schedules. The agreement enables participating carriers to market their services as a single entity and, therefore, to coordinate their schedules with a view to choose departure times across all flights in a way that offers passengers a more comprehensive time-of-day coverage. This contributes further to the reduction in schedule delay.

Under pre-JV competition, each carrier aims at maximising profit individually on the route, rather than bearing in mind joint revenues. As a consequence, there may be little incentive to coordinate schedules. To the contrary, both carriers may vie for the departure time/slots that fit best with the preferences of the majority of passengers,[10] whilst tending to neglect the needs of other passengers who prefer to fly at somewhat 'less popular' times of the day.

With a JV, a wider range of customer preferences can be catered for, as frequencies can be rearranged in a manner that increases the range of preferences covered. Participants of a JV such as A++ become indifferent as to the specific service(s) they are asked to operate, as the overarching objective of the agreement is to increase the participant carriers' joint revenue, which is then split among them.

2.1.3. Increased frequencies

A JV agreement is likely to result in a substantial increase in feeder traffic volumes (i.e., there will be a greater number of connecting passengers).[11] If up-gauging of aircraft used to operate existing transatlantic frequencies is not sufficient to meet the incremental demand, it may be necessary to lay on additional flights. The resulting increased choice in departure times has the effect of aligning the JV's offerings even more closely with passengers' preferences.[12]

2.2. The beneficiaries of schedule delay reductions

Whilst all non-stop passengers that wish to combine the carriers' services benefit from this efficiency, the extent of schedule delay reduction enjoyed by corporate passengers or passengers who are part of a frequent flyer program ('FFP') tends to be particularly large. The reason is that the participants to a metal-neutral JV such as A++ also combine their corporate-customer and FFP schemes:

9 In effect, this situation amounts to double marginalisation, as it is equivalent to one carrier buying a single ticket from the other carrier at retail price and reselling it to the aforementioned passenger at the same price (cost plus mark-up).

10 The existence of 'wing-to-wing' flights is an oft-observed phenomenon in situations without cooperation between carriers. A carrier – operating individually – may not have sufficient incentives to opt for a less attractive departure time, as the lower number of passengers choosing that option would likely entail lower profits for that carrier.

11 This effect, which is acknowledged in the Commission's *A++* Commitments Decision (Footnote 44), is covered in greater detail in the section on out-of-market efficiencies.

12 This aspect highlights the fact that less restrictive and commercially realistic alternative agreements such as, e.g., a pure code-sharing agreement, cannot create the same level of schedule-delay efficiencies as the JV. In a pure code-sharing agreement, a marketing carrier purchases seats on segments that are operated by another carrier, and sells tickets for integrated itineraries to its customers.

- All other things equal, corporate customers tend to prefer to focus most of their air travel requirements on a single carrier, so as to maximise the discounts that can be obtained. A JV facilitates this without limiting those customers' choice over departure times.
- Similarly, FFP passengers have a strong preference for travelling on the airline that operates the FFP of which they are a member, as they seek to increase the number of frequent flyer miles or loyalty points collected. Absent a JV, their choice set tends to be particularly restricted by such considerations. With the JV in place, however, the restrictions are relaxed, as discounts and FFP miles can be earned irrespective of which of the JV airlines operates a given flight.[13]

3. Economies of density

Economies of density in the airline industry can arise from the ability of an operator to carry more passengers on the same aircraft (i.e., to increase load factor), to optimise the size of aircraft deployed (up-gauging), or to increase frequencies of service on a given route.[14] Load-factor increases and optimisation of aircraft usage may reduce incremental or average costs per passenger, and greater frequencies imply capacity increases. Both the cost and the capacity effects may lead to fare decreases that result in increased consumer welfare.

Implementing a JV allows carriers to offer a better schedule on relevant routes, as discussed above, and better fares for certain connecting passengers on other related routes, as will be discussed in the next section.[15] These advantages draw more passengers to the airline and increase the number of passengers, which has three important effects.

- *Firstly*, following the implementation of a JV, carriers may be able to increase the number of passengers flying on existing scheduled services, which – when operated with the same aircraft (capacities) – leads to an increase in load factors and, therefore, per-passenger cost savings;
- *Secondly*, the JV allows carriers to optimise the size of the aircraft used, which is commonly referred to as 'up-gauging'; and
- *Thirdly*, increased traffic volumes provide incentives to the carriers to increase the number of frequencies on the route of concern. Whilst this requires additional investment expenditure, it entails an increase in overall capacity, which in turn may effectuate further cost reductions.

A combination of these effects is likely to lead to a reduction in the incremental or average cost per passenger. It is widely acknowledged in the academic literature and by competition authorities that savings in marginal (or variable) costs are typically followed by reductions in price.[16]

4. Out-of-market efficiencies

Out-of-market efficiencies pertain to so-called behind-and-beyond ('B&B') passengers. These passengers have itineraries that incorporate at least one feeder leg connected to the transatlantic segment, thus involving at least one stop.

As the relevant market in the Commission's A++ investigations was a given transatlantic *trunk* route (e.g., Frankfurt-New York), and the competitive concern related to the non-stop passengers travelling on that route, efficiencies accruing to B&B passengers are, in some sense, 'out-of-market'.[17]

13 It has been argued that passengers can be – and sometimes are – members of multiple FFP programs (which, *prima facie*, appears to mitigate their preference for a particular carrier). However, there are often benefits to collecting points on a single loyalty program. Many FFPs have a tier-based system that allows customers to be promoted to higher tiers once they reach a threshold of points. Reaching a higher tier entails a number of incremental benefits including, among others, collecting more points on the carrier's flights, flexible booking, lounge access and access to more reward flights. Therefore, even passengers who are part of multiple loyalty programs, when faced with a choice, would prefer to fly on the airline on which they have accumulated the highest number of points.

14 Brueckner, J.K. and Whalen, W.T., "The price effects of international airline alliances," The Journal of Law and Economics, 2000, pp.503-554, note that 'high traffic densities allow carriers to operate larger, more efficient aircraft and to disperse fixed costs over more passengers' (p.506)

15 To the extent that economies of density result in lower fares, they amplify the stimulating effect of the JV on demand, thereby generating a positive feedback effect on the schedule delay reductions and out-of-market efficiencies.

16 See, e.g., European Commission, Guidelines on the application of Article 81(3) of the Treaty. OJ C 101, 27.4.2004 (Para. 98). The extent to which those cost savings benefit consumers hinges on the rate of cost pass-through, the determination of which depends on the factors relating to market structure, the nature of competition (i.e., Bertrand vs. Cournot), the elasticities of demand and supply as well as the elasticity of the price elasticity of demand, i.e., the extent to which the price elasticity of demand changes when the price increases.

17 The efficiencies are 'out-of-market' because they may result from lower fares on the behind and beyond legs of a flight involving one or more stops. But they are also 'in-the-market' to the extent that

However, it is well established in the relevant economics literature that B&B passengers generally benefit from JVs through lower fares.[18] In this section, we discuss the extent to which the Commission has taken into account out-of-market efficiencies in the case at hand.

4.1. Mitigating double marginalisation

Out-of-market efficiencies are based on the notion that joint pricing and splitting revenues by the JV carriers eliminates or at least substantially reduces the double-marginalisation problem that typically occurs when they act independently.[19]

To see this, consider, for example, a B&B itinerary from A to C via B, where A to B is operated by Carrier 1 and B to C is operated by Carrier 2, as depicted in Figure 1.

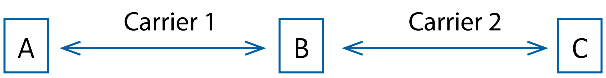

Figure 1 - B&B itinerary involving two carriers

Absent the JV, for Carrier 1 to offer a service from A to C, it has to buy seats on segment B-C from its operator, Carrier 2, as an input. Carrier 2 will charge its marginal cost plus a mark-up. Carrier 1 in turn sets its fare for the A-C service by adding its own mark-up to the sum of (i) the marginal cost of operating the segment A-B and (ii) Carrier 2's *marked-up* marginal cost of operating B-C. This pricing externality between carriers results in an inefficiently high fare for the A-C service that stifles demand for it, a phenomenon that economists refer to as double marginalisation.

A JV between the two carriers allows them to operate the two segments (A-B and B-C) as a single entity and to internalise this mutual marking-up externality. The single, jointly decided mark-up is smaller than the sum of the two individual mark-ups established absent the JV, implying a fare for the A-C service that is lower than under pre-JV competition.[20]

4.2. The criteria for considering out-of-market efficiencies

The central debate surrounding out-of-market efficiencies in the context of airline JVs is the extent to which they should be considered. The guidelines on the application of Article 101(3) TFEU provide that '*where two markets are related, efficiencies achieved on separate markets can be taken into account provided that the group of consumers affected by the restriction and benefiting from the efficiency gains are substantially the same.*'[21]

In its *A++* Commitments Decision, the Commission broadened this test to adapt it to the specific circumstances of the case,[22] which include, *inter alia*, '*considerable commonality between passenger groups travelling on the route of concern and related behind and beyond routes.*'[23]

Considerable commonality between non-stop passengers on the route of concern (potentially harmed by the JV's anticompetitive effects, if any) and B&B passengers (likely to benefit from the JV's efficiency gains) requires that, over the period of investigation, a B&B customer (i) has made at least one non-stop trip on the route of concern; (ii) has used more than one carrier to complete the B&B itinerary ('inter-lining'); and (iii) has completed the B&B itinerary using the route of concern as a segment.[24] A notion apparently underlying the

these fare reductions benefit passengers travelling on the trunk route.

18 See, e.g., Brueckner, J.K. and Whalen, W.T., "The price effects of international airline alliances, "*The Journal of Law and Economics*, 2000, pp.503-554.

19 It is important to note that 'less restrictive' forms of cooperation, such as, e.g., standard code-sharing agreements are unlikely to generate the same level of out-of-market efficiencies as they are less effective at dealing with the double marginalisation problem described above. In a similar vein, it may be tempting for a competition authority to permit in-depth cooperation (such as a revenue-sharing JV) on the B&B itineraries, but to 'carve out' the non-stop traffic on the trunk routes from the agreement, in an attempt to harness the efficiencies on the B&B itineraries whilst avoiding potential anticompetitive effects on the non-stop routes. However, a carve-out approach may defeat the purpose of the JV (network integration), as it provides carriers with an incentive to divert traffic from the routes that are not carved (where they have to share revenues) to those that are (where they do not have to share revenues).

20 Brueckner and Whalen (2000). The authors note that 'joint pricing internalizes the negative externalities from the uncoordinated choice of subfares, leading to lower fares.' (p. 30)

21 European Commission, Guidelines on the application of Article 81(3) of the Treaty. OJ C 101, 27.4.2004 (Para. 43).

22 *A++* Commitments Decision, Para. 57

23 *A++* Commitments Decision, Para. 58

24 To determine the degree of commonality in practice, one may rely on information from corporate accounts, or draw on records from FFP accounts. These accounts allow tracking of the journeys made by registered corporate customers and individuals, respectively, over time. For passengers who do not belong to either of those groups, customer commonality is much harder, if not impossible,

third condition is that passengers have strong preferences over the precise routing of their connecting flights, even for the same origin-and-destination pair.

It follows from these conditions that the Commission has not credited out-of-market efficiencies enjoyed by passengers on B&B itineraries related to (i.e., flowing over) a route of concern, but who have *not* also travelled non-stop on the route of concern itself at some point. This approach leads to the exclusion of two types of 'out-of-market' efficiencies:

- *Firstly*, efficiencies bestowed on B&B passengers on the route of concern that have not, at some point, also completed a non-stop transatlantic itinerary on that route; and
- *Secondly*, efficiencies pertaining to passengers that have made at least one non-stop flight on the route of concern and have also completed one or more transatlantic B&B itineraries, but where the latter did not involve the route of concern as the transatlantic segment.

The Commission explicitly excludes the *first* type on the basis of a Pareto criterion, whereby taking into account such benefits would amount to balancing '*competitive harm to one customer group against benefits to another customer group.*'[25]

The exclusion of the *second* type is implicit, but it cannot be rationalised in the same way as the exclusion of the first type. In other words, the Commission's endeavour to avoid 'inter-personal balancing' of harm and benefits does not explain the requirement that, for a B&B journey to be taken into account, it has to flow over the route of concern (as opposed to any other transatlantic trunk route covered by the JV). After all, the origin and destination of that same B&B journey can also be served by a different itinerary, as the JV at issue typically covers a large number of trunk routes, many of which can be and are used as the transatlantic segment of a given origin-and-destination pair.

The Commission's *A++* Commitments Decision does not put forward a valid reason for disregarding B&B journeys that have been routed over a transatlantic trunk route other than the route of concern.[26] For most connecting passengers travelling between a given origin and destination and, with a given number of stops, the precise routing of connecting passengers does not matter. For example, assuming similar elapsed times across itineraries, a passenger who wishes to fly from Rome to San Francisco will typically be indifferent between possible stop-over points such as, e.g., New York or Atlanta.

To the extent that all relevant routings are covered by the JV agreement at hand, B&B passengers can be expected to enjoy the same efficiency benefits, regardless of the routing. Crediting those efficiency benefits would, therefore, be appropriate. It would also be consistent with the Commission's recognition that, whilst passengers usually travel on a specific route, airlines consider the total network for commercial decisions on a specific route.[27]

> For most connecting passengers [...] the precise routing of connecting passengers does not matter

5. Balancing efficiencies and anticompetitive effects

Under Article 101(3) TFEU, the Commission is required to balance any competitive harm that it has identified on a given route of concern against the total efficiency benefits that flow from the JV on that route.[28] The burden of estimating the

to establish.

25 *A++* Commitments Decision , Para. 61. In this context it is worth noting that the Commission appears to have no issue with making inter-personal comparisons of utility within the confines of a relevant market, but is not willing to do so across markets, despite the absence of a fundamental difference between the two situations.

26 Note that as long as one retains the condition that those journeys have been made by inter-lining passengers with at least one non-stop flight on a route of concern, the balancing of harm and benefits continues to be intra-personal rather than inter-personal.

27 *A++* Commitments Decision, Para. 59. This recognition is also one of the 'specific circumstances' that has motivated the broadening of the 'substantially-the-same' test.

28 European Commission Guidelines on the application of Article 81(3) of the Treaty. OJ C 101, 27.4.2004 (Para. 11).

extent of harm is on the Commission rather than the JV parties.

The Commission has not presented a quantitative assessment of the anticompetitive effects of the JV, but appears to have deemed them to be appreciable on a number of routes, including the route subject to the commitments in the *A++* Commitments Decision, i.e., Frankfurt-New York. The JV generated efficiencies on all routes, but with regard to Frankfurt-New York, the Commission evidently considered the estimated quantum of efficiencies to be insufficient to compensate fully for the presumed anticompetitive effects of the deal.

It is worth pointing out that the remedies set out in the *A++* Commitments Decision did not remove the efficiencies generated by the JV, but only affected the size of its deemed anticompetitive effects. In that regard the remedy was superior to the 'carve-out' remedies previously imposed in similar transactions in the US.[29]

6. Conclusion

This article has reviewed the principal types of efficiencies that arise in the context of revenue-sharing joint ventures set up by airlines. These efficiencies include reductions in schedule delay, economies of density and efficiencies arising to certain connecting passengers. We have also emphasised the there is significant interaction between these efficiency sources.

Reductions in schedule delay are due to the closer alignment between passengers' departure-time preferences and the flight schedules that a JV can offer. The JV carriers are able not only to combine their schedules and coordinate departure times across existing (pre-JV) services, but they may also be able to lay on additional flights as a result of the beneficial effect of the JV on feeder traffic. The benefits from schedule delay reduction are felt particularly strongly by corporate customers and individuals that are members of an airline's FFP.

The increase in the number of connecting passengers implies a higher number of passengers on the transatlantic (trunk) segment, which may give rise to economies of density in the form of higher load factors and opportunities to up-gauge aircraft or to increase frequencies.

In addition to these two types of in-market efficiencies (benefitting primarily non-stop passengers on a given transatlantic trunk route), the article also discusses out-of-market efficiencies, which accrue to connecting passengers as a result of the way in which a JV helps mitigate the double-marginalisation problem.

Whilst the Commission, in the context of its *A++* Commitments Decision, has broadened the applicability criterion to one of 'considerable commonality' between the non-stop passengers that are potentially harmed by the decrease in competition on the trunk routes on the one hand, and the connecting passengers that benefit from the JV on the other, we argue that the Commission did not go far enough. We consider its approach to credit only those out-of-market efficiencies enjoyed by B&B passenger that have also at some point travelled non-stop on the route of concern (rather than on any transatlantic trunk route covered by the JV) as too narrow and not well grounded in the 'network realities' of airline joint ventures.

The authors advised the respective JV partners in both the A++ and the Skyteam cases. The opinions in this paper are the sole responsibility of the authors and do not necessarily reflect the views of other Compass Lexecon experts or of Compass Lexecon's clients. The authors gratefully acknowledge comments received from Jorge Padilla and Enrique Andreu.

29 See, e.g., US Department of Transportation (2009), Final order. In DOT Docket OST-2008-0234 (http://www.regulations.gov/fdmspublic/component/main?main=DocketDetail&d=DOTST-2008-0234).

Competitive Effects and Efficiencies: The Canadian Supreme Court's Decision in Tervita

Thomas W. Ross
Sauder School of Business, University of British Columbia

1. Introduction

On January 22, 2015, the Supreme Court of Canada ("SCC") issued a very significant decision in the *Tervita* matter.[1] The SCC allowed a merger in the hazardous waste landfill market in Northeastern British Columbia to proceed over the objections of the Commissioner of Competition ("Commissioner"). It is rare that a Canadian competition case makes its way to the SCC and its decision in this merger matter – the first relating to the efficiency exception provisions in Canada's *Competition Act ("Act")*[2] -- could have profound implications for the way in which future merger reviews are conducted and for how efficiencies will be evaluated in merger cases in which there is a demonstrated harmful effect on competition.[3]

With the introduction of the merger provisions into the *Act*, Canada became one of the competition law jurisdictions most sympathetic to mergers that generate potential economic efficiency benefits. Indeed, as detailed below, mergers that have been determined to harm competition and raise prices can be permitted if they provide large enough gains in efficiency by, for example, lowering production costs through the realization of economies of scale or other synergies. An earlier merger case, *Superior Propane*, which reached the Federal Court of Appeal, had provided guidance on how the trade-off between efficiency benefits and harm to competition was to be conducted.[4] *Tervita*, however, turned more on the kinds of evidence to be provided by the parties, and the priority to be accorded to quantitative versus qualitative evidence. Beyond this, the *Tervita* judgement touched on a number of other significant issues in merger review including: the proper test in cases that involve a prevention (as opposed to a lessening) of competition; the extent to which the Commissioner can advance his own theories about how the firms would conduct themselves should the merger be prevented; and the proper sequence in which evidence of anticompetitive effects and merger efficiencies should be provided by the parties. While one can appreciate the clarity provided on some important questions, there is much in this decision that is concerning to competition economists. Chief among them is the degree to which the SCC has instructed the Commissioner to provide one type of evidence (quantitative) rather than another (qualitative)

1 *Tervita Corp v Canada (Commissioner of Competition)* 2015 SCC 3 [*Tervita*]. When the Commissioner of Competition filed the original application to block the transaction, the Tervita Corp was known as the CCS Corp, but I will consistently refer to it as Tervita here.

2 RSC 1985 c C-34.

3 The last time a merger case made its way to the SCC was the *Director of Investigation and Research v Southam Inc* [1997] 1 SCR 748. It is something of an irony that such an important case as *Tervita* – going all the way to the Supreme Court – should be about a relatively small merger. The CDN$6 million transaction was small enough as to fall well below the thresholds for mandatory pre-notification.

4 *Canada (Commissioner of Competition) v Superior Propane Inc (CA)*, 2003 FCA 53, [2003] 3 FC 52 [*Superior Propane*].

even in situations in which most economists might find the latter more compelling.

The purpose of this paper is to review key aspects of the SCC's decision and discuss the decision's potential implications for future merger cases in Canada. The focus here will be on the more "economics-related" elements of the decision which are likely to prove the most controversial.[5]

2. Background

The provisions of the *Act* central to this case are found in sections 92 and 96. Section 92 is the core merger provision providing the Competition Tribunal ("Tribunal")[6] with the authority to block mergers that harm competition. Section 96 provides an exception for mergers that harm competition but generate sufficient efficiency benefits.

Specifically, section 92 provides that

> *"Where, on application by the Commissioner, the Tribunal finds that a merger or proposed merger <u>prevents</u> or lessens, or is likely to <u>prevent</u> or lessen, competition substantially ..." (emphasis added),*

the Tribunal may dissolve or order changes to a completed merger or, in the case of a proposed merger, block or attach remedial conditions to that merger. The emphasis added here highlights the fact that the *Tervita* was a "prevent" case. As explained below, the transaction would have prevented increased competition, according to the Commissioner, by blocking the entry of an independent player in the market. It was not argued that the merger would have lessened competition below levels experienced prior to the transaction.

Section 96 provides an exception to section 92 when there are gains in efficiency:

> *"96. (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be <u>greater than, and will offset</u>, 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." (emphasis added)*

Initially most observers of Canadian competition policy (including the Tribunal) believed that the "greater than and offset" condition here suggested that Canadian law mandated a "total surplus" test in merger review.[7] That is, a merger would be permitted if the efficiency gains were larger in dollar value than the dollar value of the deadweight loss attributable to the merger. Admittedly, it was not clear under this interpretation how the term "offset" added to "greater than" since "greater than" would appear to be all one needed to apply the total surplus test. However, in its *Superior Propane* decisions, the Federal Court of Appeal instructed the Competition Tribunal that it must consider other effects beyond those measured by the deadweight loss attributable to the merger, for example the redistributive effects of higher prices.[8]

By deciding that Canadian law did not completely embrace the total surplus standard, *Superior Propane* did open the door to a potentially constructive interpretation of "greater than and offset". In this possible interpretation the term "greater than" would refer to the total surplus calculation; that is, are the efficiencies greater than the deadweight loss? Where the efficiencies are larger, the offset part of the test would then ask if they were enough larger to compensate for any other negative effects, for example from any socially undesirable redistributions of surpluses from consumers to producers. If they were large

5 For example, this paper will not review the decision's sections related to the question of the standard of review to be applied by Courts to decisions by the expert Competition Tribunal.

6 The Canadian Competition Bureau is not a commission in the model of the European Commission or the U.S. Federal Trade Commission. While the Bureau will investigate and prosecute competition cases, adjudication is performed by the separate Competition Tribunal for civil/administrative matters (including mergers) and by regular courts for criminal matters. The Competition Tribunal is composed of judges from the Federal Court of Canada and lay members.

7 For a more complete explanation of the total surplus test and the alternative, consumer surplus test, see the Annex at the end of this article.

8 On this see, for example, Thomas W. Ross and Ralph A. Winter, "Canadian Merger Policy Following Superior Propane", *Canadian Competition Record*, Summer 2003 and Thomas W. Ross and Ralph A. Winter, "The Efficiency Defense in Merger Law: Economic Foundations and Recent Canadian Developments", 72 *Antitrust Law Journal* 471 (2005). This total surplus test is essentially that contemplated by Oliver Williamson in Oliver E. Williamson, "Economies as an Antitrust Defense: The Welfare Tradeoffs", 58 *American Economic Review* 18 (1968).

enough, it could be said that they also offset the anticompetitive effects. Unfortunately, as part of its analysis of quantitative and qualitative effects, the SCC in *Tervita* seems to have blocked this interpretation, a point explained below.

The key facts of the *Tervita* case can be described simply. At the outset of the case, Tervita Corp operated the only two hazardous landfill sites in the northeastern area of the province of British Columbia ("NEBC"). These landfills are specifically designed to permit the permanent disposal of hazardous waste, mostly generated by oil and natural gas firms operating in that region of the province. Securing permitting for such sites involves a costly, uncertain and lengthy procedure. A third site, the Babkirk site, was owned by Complete Environmental Inc. ("Complete") which was planning to develop it as a bioremediation facility. However, Complete did have permitting that would allow the operation of a secure landfill.[9] The Babkirk site was located between the two Tervita sites in Northeastern British Columbia. At some point after securing the regulatory approvals for the Babkirk site in 2010, the owners of Complete began to consider options for selling their company. In January 2011, after unsuccessful negotiations with other parties, it was sold to Tervita. Shortly after the deal closed, the Commissioner of Competition commenced action before the Tribunal to undo the transaction.[10]

The Commissioner argued before the Tribunal that the acquisition of Complete (and the Babkirk site) by Tervita substantially prevented competition and protected Tervita's monopoly position in the market for hazardous waste disposal services in NEBC. Against the argument that, absent the transaction, the owners of Babkirk were not planning on operating a competing secure landfill, the Commissioner advanced the position that a bioremediation facility was unlikely to be successful and that that site would then be available for Complete, or another party, to operate a secure landfill in competition with Tervita's two landfills. Prevention of competition cases are already rare in Canada – but this one had the added twist that the counterfactual to the merger put forward by the Commissioner was not consistent with the business plans of the potential entrant.

On the question of anticompetitive effects, evidence was advanced that suggested that prices would be 10% (or more) lower with competition; however – importantly -- no explicit measurement of deadweight loss attributable to the merger was provided by the Commissioner in her case in chief. It was provided later, in a reply affidavit from her expert.

> The Commissioner argued that the transaction would <u>prevent</u> competition from emerging in the market

In its 2012 decision, the Tribunal largely accepted the Commissioner's positions and found against the merger. It agreed that the relevant product market was that for hazardous waste disposal services and that, but for the transaction, the Babkirk site was likely to be eventually used for hazardous waste disposal in competition with Tervita. With this product market definition, the Tribunal avoided possibly falling victim to the "cellophane fallacy".[11] Looking for substitution possibilities at current (here pre-merger) prices – as in the hypothetical monopolist test for market definition – risks adding substitutes to the market that would not be included at the lower prices expected to follow should the merger be blocked and entry occur. The leading candidate substitutes that might have been included in the relevant product market were (i) bioremediation of the waste, and (ii) storage and risk management. The merging parties argued for their inclusion, but the

9 There was a fourth site, Peejay, with permits for the operation of a secure landfill in Northeastern British Columbia, but this landfill has not yet been constructed and is in a location remote enough that an operation there may not provide a competitive check on pricing at the other sites.

10 *The Commissioner of Competition v CCS Corporation et al*, 2012 Comp Trib 14.

11 On the cellophane fallacy, see, for example, Massimo Motta, *Competition Policy: Theory and Practice* (2004), at pages 105-106. We would normally associate the cellophane fallacy with the problems of market definition in monopolization or abuse of dominance, but it should be clear that similar issues arise in merger cases alleging a prevention of competition.

Tribunal considered and rejected including these alternatives in the relevant product market.

While the Tribunal found that the Commissioner had failed to meet her burden to demonstrate the extent of the quantifiable anticompetitive effects at the appropriate time (in her case in chief), it did agree that there would be at least a minimal amount of deadweight loss.[12] Though the efficiency defense was argued by the merging parties, the Tribunal accepted efficiencies of only a very small amount, concluding then that they could not possibly be greater than and offset the harm to competition.

The Federal Court of Appeal ("FCA") then dismissed Tervita's appeal in 2013.[13] It agreed that a prevention case is necessarily forward-looking with respect to what competition might emerge within reasonable period of time and it provided some guidance regarding what period would be reasonable. While rejecting some elements of the Tribunal's approach to the efficiency defense, it nevertheless agreed that the allowable efficiencies were very limited (even marginal) and therefore not sufficient to overcome the harm to competition, which it determined to be of "undetermined" magnitude.[14] Importantly, the FCA stated that, where the anticompetitive effects and efficiencies can be quantified, they should be.[15]

12 In its decision, the Tribunal acknowledged that the Commissioner's expert did quantify the anticompetitive effects in his reply report, but that this was "made available to CCS two weeks before the hearing. By then, the Tribunal's Scheduling Order did not permit CCS to bring a motion or file a further expert report. In addition, the Tribunal accepts that, in practical terms, there was insufficient time before the hearing to permit CCS to move to strike Dr. Baye's report or to seek leave to file a further report in response to the Commissioner's quantification of the Effects." (paragraph 235) The Tribunal, nevertheless, considered the expert's evidence from his reply report and accepted his "rough estimate" as reliable enough to be considered (paragraphs 300-302).

13 *Tervita Corporation v Commissioner of Competition*, 2013 FCA 28.

14 The FCA concluded at paragraph 130: "In this case, the Commissioner did not discharge her burden to quantify the "deadweight loss" resulting from the merger, and the Tribunal erred by allowing her to correct that failure through a reply report using an admittedly deficient methodology. The Tribunal compounded that error by not allowing Tervita an opportunity to formally respond to that report. As a result, the Tribunal should have concluded that the "deadweight loss" had not been properly quantified, and that consequently the weight to be attributed to it was not zero, as the appellants submit, but was rather undetermined."

15 At paragraph 148 of the FCA decision: " the quantification of both gains in efficiency and anti-competitive effects must be carried out whenever it is reasonably possible to do so."

3. The Supreme Court Decision - Important issues

Tervita appealed the FCA decision to the Supreme Court and its appeal was granted with the SCC's decision in early 2015. The key element of its decision was a finding that, absent any quantification by the Commissioner of anticompetitive effects that were in fact quantifiable, she had failed in her burden under section 96 of establishing that there were any anticompetitive effects at all.[16] While similar in spirit to comments from the Tribunal and FCA, the SCC was drawing a harder line. Given this result, any small amount of efficiencies would be enough to satisfy the greater than and offset test of section 96. As it accepted that there were (very limited but positive) efficiencies, the SCC granted the appeal, allowing the merger to proceed. A key paragraph from the decision that speaks to the point is the following:

> *"[100] The Tribunal should consider all available quantitative and qualitative evidence (Superior Propane I, at para. 461; Superior Propane III, at para. 335). While quantitative aspects of a merger are those which can be measured and reduced to dollar amounts, qualitative elements of a merger, including in some cases such things as better or worse service or lower or higher quality, may not be measurable as they are dependent on individual preferences in the market (see Superior Propane I, at paras. 459-60). Effects that can be quantified should be quantified, even as estimates. If effects are realistically measurable, failure to at least estimate the quantification of those effects will not result in the effects being assessed on a qualitative basis."*

This section then reviews key aspects of this decision.

16 Interestingly, while the SCC's decision indicates that the Commissioner needed to quantify anticompetitive effects as part of her case against the efficiency exemption, under Section 92 the prevention or lessening of competition can be established with only qualitative evidence. As a result, in this case, we have a finding that there was: (i) a prevention of competition that, (ii) had zero anticompetitive effect. The SCC acknowledged that this made this an unusual case, see paragraph 166.

Quantitative vs Qualitative Effects[17]

Given that there were no significant issues of redistribution recognized in this case, the trade-off analysis essentially turned on the application of a total surplus test. Evidence on both the possible efficiencies and anticompetitive effects can come in two forms: quantitative and qualitative. Quantitative evidence could come in the form of, for example, statistical estimates of demand elasticities. Knowing demand elasticities helps us predict the extent to which market power can lead to higher prices and the degree to which higher prices will translate into reduced quantities (and deadweight losses). Qualitative evidence speaks to the size of certain effects, but without providing specific estimates. For example, a survey of buyers indicating that a large majority of them would not have acceptable substitutes to which they could turn if their current supplier increased prices suggests a low elasticity of demand but does not provide a specific value.

There is unfortunate confusion in the decision with regard to the application of the quantitative and qualitative modifiers to both "evidence" (as in the paragraph quoted above) and "effects".[18] In a standard total surplus evaluation there are really only two effects that matter: effects on competition -- as captured for example by deadweight loss but possibly also including effects due to changes in qualities or other factors buyers may care about -- and effects on costs (efficiencies). With respect to these effects there will be two kinds of evidence: quantitative and qualitative. For all effects there will be many different kinds of evidence that can be provided and this evidence will range from the highly quantifiable to the completely unquantifiable (and hence qualitative). There is, in effect, a spectrum of quantifiability for all effects.

The decision unfortunately then treats quantitative effects and qualitative effects as if they are different types of effects, rather than types of evidence about common effects. This is important because we need to recognize that, at the end of the day, we need to be able to sum up the anticompetitive and efficiency effects to determine whether total surplus has risen or fallen. To do this, we must have a sense of the "quantity" of the effects on which we have only qualitative evidence. Treating quantitative and qualitative as if they are themselves different kinds of effects risks taking us down the path of two separate tests – one to see if the quantitative effects on competition favour the transaction and another to do the same with respect to the qualitative effects. What then if the merger passes one test but not the other? Here is where the SCC saw the qualitative/quantitative distinction as a key to understanding what "offset" added to "greater than" in the language of Section 96.

> *"[144] The statutory requirement that the efficiency gains be "greater than" and "offset" the anti-competitive effects imports a weighing of both quantitative and qualitative aspects. The term "greater than" suggests a numerical comparison of the magnitude of the efficiencies versus the extent of the anti-competitive effects. The use of the term "offset" implies a subjective analysis related to the "balancing of incommensurables (e.g., apples and oranges)" (Tribunal decision, at para. 309) — considerations that cannot be quantitatively compared because they have no common measure..."*

This then led the SCC to develop a "two-step inquiry" (with the second step having two parts) that treats quantitative and qualitative as apples and oranges at first, but then combines them:

> *"[147] In light of this recognition, the balancing test under s. 96 may be framed as a two-step inquiry. First, the quantitative efficiencies of the merger at issue should be compared against the quantitative anti-competitive effects (the "greater than" prong of the s. 96 inquiry). Where the quantitative anti-competitive effects outweigh the quantitative efficiencies, this step will in most cases be dispositive, and the defence will not apply. There may be unusual situations in which there are relatively few quantified efficiencies, yet where truly significant qualitative efficiencies would support the application of the defence. However, such cases would likely be rare in view of the emphasis of the analysis on objectivity and the impermissibility of asserting unquantified-but-quantifiable efficiencies*

17 On this particular aspect of the decision, see also the excellent analysis in Ralph A. Winter, "Tervita and the Efficiency Defense in Canadian Merger Law", 28 *Canadian Competition Law Review* 133 (2015).

18 This is not meant to suggest that the SCC created this confusion – it has appeared elsewhere, for example in the Tribunal decision in this case and in the Tribunal's decision in the *Superior Propane* case (though in the latter case, the Tribunal clearly saw that the quantified and qualitative needed to be combined into one test.)

as qualitative efficiencies. Qualitative considerations must next be weighed. Under the second step, the qualitative efficiencies should be balanced against the qualitative anti-competitive effects, and a final determination must be made as to whether the total efficiencies offset the total anti-competitive effects of the merger at issue (the "offset" prong of the inquiry). For the Tribunal to give qualitative elements weight in the analysis, they must be supported by the evidence and the reasoning for the reliance on the qualitative aspects must be clearly articulated."

> The decision treats "quantitative" and "qualitative" as different types of effects, rather than types of evidence

First, quantitative evidence is to be weighed, then qualitative, and finally they are to be combined to make a final determination. As pointed out by Justice Karakatsanis in her dissent, it is not clear why there should be separate treatment of the qualitative and quantitative if they are only to be combined in the third step. It is also far from clear why qualitative evidence would not be relevant to the consideration of whether efficiencies are greater than the anticompetitive effects.

There are aspects of the SCC's decision on these effects that will be of concern for economists. For one, there does not seem to be the recognition that all effects are in principle quantifiable – it is simply a question of the existence of data and techniques to do the job at a high enough level to provide confidence in the measures provided. In some cases we will be forced to rely on qualitative evidence – but evidence about what likely quantities are. To suggest that some effects are inherently qualitative and not at all measurable seems wrong. If we cannot get a sense of the magnitude of effects on which we have only qualitative evidence, how can we possibly consider them in the third (adding up) step?

There is a danger that breaking the analysis into these steps could risk errors if the inquiry can be stopped after the first step, as might be suggested by the sentence: "Where the quantitative anti-competitive effects outweigh the quantitative efficiencies, this step will in most cases be dispositive, and the defence will not apply." This would suggest that if some significant efficiencies had not been quantified – for example, an increased likelihood of greater future innovation – they might never get a chance to be considered. As a result, there is a potential for mergers that would pass a total surplus test to be blocked by this kind of inquiry.

Apart from this over-inclusiveness, the multiple stages may not be a serious problem as, in most cases, the evidence of effects is all properly combined to make the final determination.[19] More problematic is the SCC's implied hierarchy of effects, its confidence in the ability of economists to quantify certain effects and the burden it places on the Commissioner to provided quantitative evidence whenever it is possible -- even if the quality of the evidence may not be high.

As seen in paragraph 100 of the decision, the SCC seems to place a higher value on quantitative evidence and, in fact, requires that if effects can be quantified they should be to, in its view, minimize subjectivity.[20] And, critically, if the Commissioner does not quantify effects that are "realistically measurable", those effects will not be assessed on a qualitative basis.[21] Given the challenges of data availability and assessment in many cases, this will encourage the Commissioner to provide very poor empirical estimates of the magnitudes of effects even when qualitative evidence might be more helpful.[22] Part of the motivation for preferring quantitative evidence seems to lie in the SCC's

19 This does leave us with an unhelpful interpretation of what Parliament may have meant by "greater than and offset" however – one that could have been avoided after the *Superior Propane* decisions as explained above.
20 From paragraph 124 of the decision: "Where effects are measurable, they must be estimated. Effects will only be considered qualitatively if they cannot be quantitatively estimated. .. This approach minimizes the degree of subjective judgment necessary in the analysis and enables the Tribunal to make the most objective assessment possible in the circumstances (*Superior Propane IV*, at para. 38)."
21 Which might seem inconsistent with the statement in the first line of paragraph 100 that the Tribunal should consider all qualitative and quantitative evidence.
22 Section 4 of Winter, supra note 18, has a nice review of some of the challenges of quantifying anticompetitive effects.

desire to minimize the subjectivity of the analysis, however, it is widely recognized that modern empirical techniques can themselves contain a great deal of subjectivity with respect to modelling choices, empirical methods chosen and the interpretation of results. While this may provide more work for economists inside and outside of the Competition Bureau, it will not necessarily improve the information sets on which future decisions will be based.

The Merger Review Process

The SCC also appears to have taken a position on what review process under Section 96 would satisfy procedural fairness.

> *"[131] The Federal Court of Appeal's "undetermined" approach also raises concerns of fairness to the merging parties... The difficulty with assigning non-quantified quantifiable effects a weight of "undetermined" is that it places the merging parties in the impossible position of having to demonstrate that the efficiency gains exceed and offset an amount that is undetermined. Under this approach, to prove the remaining elements of the defence on a balance of probabilities becomes an unfair exercise as the merging parties do not know the case they have to meet."*

This could be read to suggest a procedure in which the Commissioner must first present all her quantified evidence of anticompetitive effects before the merging parties present their evidence on efficiencies.[23] The idea here seems to be that the Commissioner must set the bar (and clearly) so that the merging parties will know how high to jump. It is not obvious why, in an adversarial system that is designed to encourage all sides to present the best possible evidence, this sequencing would be necessary for fairness. Rather the choice of sequence should depend on which will tend to produce the best decisions. On this, two points.

First, there will be cases in which one will need to know the level of achievable efficiencies in order to determine the deadweight loss attributable to the merger. For example, when a merger affects the marginal costs of the merged firm, it will influence the post-merger price and, as a consequence, the deadweight loss resulting from the merger.

Second, and this is also a point made by Winter, better decisions can be made when the party with more qualitative evidence moves second and this is likely to be the Commissioner. If efficiencies can be accurately quantified at some level, say $X, the Commissioner needs only establish that the anticompetitive harm is greater than $X -- precision in this estimate is not required, which will be helpful if much of the relevant evidences is qualitative.

Prevention of Competition Cases

The SCC did provide some guidance with respect to how "prevent" cases are to be reviewed. It agreed that a "but for" test is the right analytical framework under section 92. Just as with the more common "lessening of competition" cases, the need is to conduct a forward looking analysis that considers how competitive the market would be but for the merger. In this, the SCC indicated that a two-step approach should be taken in a prevent case.[24] First, the firm or potential competitor that would be prevented from entry by the merger must be identified. Typically, this will be one of the merging parties. Second, the "but for" market condition must be established. Would the identified firm actually have entered and would this entry have had an effect on market power in the relevant market? The barriers and time to establish effective entry should also be considered.

> The Court grants considerable latitude in considering "but for the merger" scenarios

The SCC, like the FCA, was also prepared to grant the Commissioner and Tribunal considerable authority to consider various but for scenarios. The merging parties argued that, but for the merger, the owners of the Babkirk site would have continued to develop it as a bioremediation facility that would therefore not be competing in the

23 Winter, supra note 18 at page 154, also draws this inference.

24 At paragraph 60 and elaborated upon in subsequent paragraphs.

hazardous waste landfill business. As a result, they contended that the merger would not prevent any additional competition in the relevant market.

The Commissioner argued, with some supporting evidence, that the bioremediation project would ultimately fail and that the site would then likely have been used (by Complete or a subsequent owner) as a secure hazardous waste landfill. The Tribunal accepted that the site would have become a competitor to Tervita by the spring of 2013 at the latest.[25] The FCA also accepted this determination and, while it indicated that the new competition must emerge within a reasonable period of time, it concluded that this would indeed be the case – in part by reference to how much time it would take a completely new entrant to appear in the market. The SCC agreed with the Tribunal and the FCA on these points.

While it might seem extraordinary for a judicial body to second-guess the business judgement of current managers and predict a future for a firm that is not in its current business plans, a generous interpretation might suggest that this case presented an unusual amount of evidence on the reasonableness of different strategies and the extent to which alternatives had been considered. But this approach will certainly make many competition economists nervous. In any case, even if Babkirk were to be run as a bioremediation facility but for the merger, its permitting as a hazardous waste landfill site might have left it as a potential entrant into that market, and a competitive threat, as long as it was owned independently of Tervita.[26] The merger ended any possibility of that asset providing competitive discipline to the market.

4. Final Observations

The *Tervita* decision has quite clearly provided some important interpretations of key sections of the Canadian *Competition Act* that relate to the efficiency exception/defense in merger cases. Some sections of the decision have provided valuable clarity on issues such as the treatment of prevention of competition cases including, the "but for" analysis, and on the importance for the Commissioner of quantifying anticompetitive effects when it is possible.

However, elements of the decision will be troubling for many economists. Chief among these is the hierarchy of evidence that has the potential to place even very low quality quantitative evidence above convincing qualitative evidence in evaluating any anticompetitive effects or efficiencies. The requirement that the Commissioner quantify any quantifiable effects, or they will not be counted at all, is also troubling given the costs of some kinds of quantification and the uncertainty about what will be considered quantifiable. Finally, the required sequencing that has the Commissioner provide her evidence on anticompetitive effects before the parties are required to provide their evidence on efficiencies seems unnecessary on fairness grounds and less likely to generate correct decisions than a sequence that has the efficiency data provided first.

The decision should be expected to lead the Commissioner to conduct more detailed empirical investigations earlier in merger cases and compel merging parties to do the same. While surely positive for the employment of economists, it may lead to a merger review process that is slower, costlier and no more capable of selecting out the right transactions. This is partly because, while mergers in which the efficiency defense is truly important should continue to be rare, the Commissioner may now have to prepare for them in every case. By arguing that there will be some efficiencies – no matter how marginal – the parties can force the Commissioner to undertake expensive and time-intensive quantitative work even when she already has very strong qualitative evidence.

In the end, this may not serve merging parties as the Commissioner will need to require more information from the parties at an early stage to prepare for the detailed quantification. This certainly promises to make for longer information requests and slower reviews.

25 From the Tribunal decision: "**[209]** To summarize, the Tribunal has decided that it is likely that the Vendors would have operated a bioremediation treatment facility with an Incidental Secure Landfill for approximately one year from October 2011 to October 2012 (the "Initial Operating Period"). Thereafter, in the spring of 2013, the Babkirk Facility would have become a Full Service Secure Landfill."

26 This will depend, to some extent, on the ease with which a bioremediation facility could be converted – which will in turn depend on the degree of specific investment involved. It was also the case that, even as a bioremediation facility, Complete's plans did include a small landfill operation on the site as well.

Annex:
Consumer Surplus and Total Surplus Tests

When it comes to reviewing mergers that have both a negative effect on competition but also a positive effect on productive efficiency (i.e. the costs of producing output) there are two leading approaches adopted by different competition authorities. These approaches, or "tests", put different weights on the effects of the mergers on the surpluses (benefits) received by consumers and producers.

The consumer surplus test puts the greater weight on consumers, blocking any mergers that harm consumers at all. Consumer surplus represents the difference between the value consumers put on consumption of a particular quantity of a good and the price they have to pay for it. It is a kind of "consumers' profit" and can be illustrated as the area beneath a demand curve but above the price being charged. In the diagram 1, if price is P_0 this surplus will be captured by the areas A+B+C, but if price increases to P_1 it will fall to that represented by area A alone. A merger can result in prices rising, as from P_0 to P_1 here, and while we usually focus on price effects, it can also involve changes in other variables that consumers care about, like product quality or variety.[27] For our purposes here, we will consider price changes alone, in which case the consumer surplus test is really just a price test: a merger which would lead to higher prices will be blocked under this test.[28]

A total surplus test, by contrast, considers the effect of the merger on total surplus which is generally defined as the sum of consumer surplus and firms' profits. Hence it puts equal weights on consumer surplus and firms' profits and thereby allows a trade-off between harm to consumers and benefits to firms (and their shareholders).[29]

We can illustrate the total surplus test using this figure. Assume there are two firms in this market and that they are competing aggressively prior to the merger. This means that their pre-merger price, P_0, will be approximately equal to their average and marginal costs of production (MC_0). The merger will then create a monopoly and allow the firms to use their new market power to increase price to P_1. At the same time it will generate significant efficiencies in production that will lower the marginal costs to MC_1. Prior to the merger, as noted above, consumer surplus would have amounted to the areas A+B+C, but this will fall to A after the merger.

Prior to the merger there were no economic profits being earned given that prices were equal to unit

27 If other such variables are changed, the demand curve will shift somewhat and the post-merger consumer surplus must be found under the new demand curve.

28 If quality or other variables consumers care about change then the test becomes: block any mergers that reduce consumer surplus.

29 As noted earlier, the total surplus test was that described in the seminal article by Oliver Williamson in 1968, *supra* note 8.

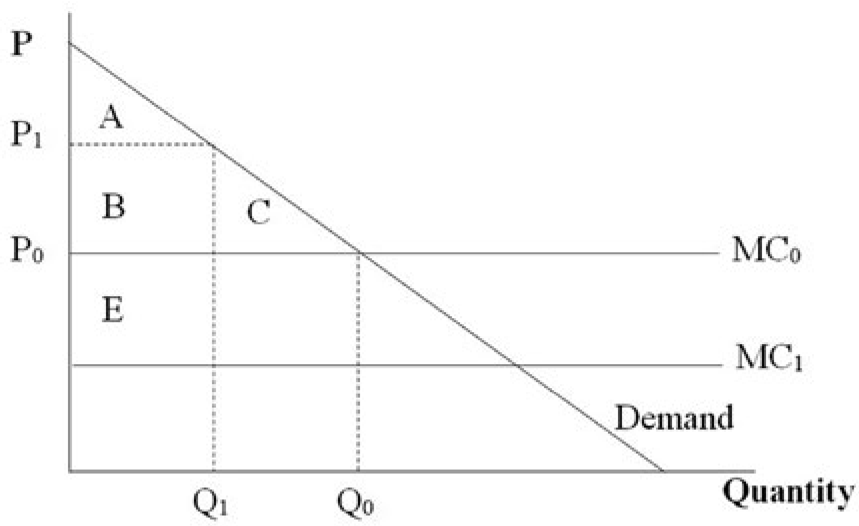

Diagram 1

costs.[30] Therefore, pre-merger total surplus is illustrated A+B+C. After the merger, price rises above unit costs generating profits represented by areas B+E in the graph, an area defined by the profit per unit ($P_1 – MC_1$) multiplied by the number of units sold post-merger (Q_1). Of this quantity, area B is profit generated through the higher price alone, while E adds additional profits due to the lower costs attributable to the new efficiencies. Notice that area C is a portion of pre-merger consumer surplus that is not transferred to firms in the form of profits due to the reduction in quantity purchased. It is referred to as a "deadweight loss" attributable to the higher price.

Total surplus post-merger will then be A+B+E. The total surplus test compares this total surplus post-merger with that experienced pre-merger (A+B+C) and allows mergers for which total surplus increases – in this case if area E is bigger than area C. That is, mergers would be permitted under the total surplus test even when prices rise and consumer surplus falls, as long as the efficiency gains (E) exceed the portion of the lost consumer surplus that is not transferred to the firm as profits (i.e. the deadweight loss C). [31]

To sum up, if a merger does not increase price (or otherwise reduce consumer surplus) it will pass both the consumer surplus and total surplus tests and be approved. If it increases price it will fail the consumer surplus test but it may still pass the total surplus test if it generates efficiencies that are greater than the deadweight loss attributable to the higher prices.

I am grateful to a number of people who have contributed to my understanding of this case, including (without implicating) Andy Baziliauskas, Adam Fanaki, Patrick Hughes, Roger Ware, Kevin Wright and, in particular, Renée Duplantis and Ralph Winter; as well as participants in discussions at the Vancouver Competition Policy Roundtable, the Competition Bureau's "Meet the Economists" event and the Canadian Bar Association Competition Law Section's annual meetings. As always, Jennifer Ng provided very valuable research assistance

30 Economic profits are profits beyond a normal return on invested capital. Hence, zero economic profits do still provide a normal return to investors, just not anything beyond that. As a result, firms have no incentive to exit a market if they are earning zero economic profits.

31 In the case illustrated here, it would appear that area E is larger than area C, suggesting that the merger would be allowed under a total surplus test. But of course, the relative sizes of E and C will depend on the achievable efficiencies and the magnitude of likely price increases, so mergers must be evaluated on a case by case basis under this test as well as under the consumer surplus test.

Recent developments in the assessment of efficiencies of EU mergers

Benno Buehler and Giulio Federico
European Commission, DG Competition

1. Introduction

With the adoption of the revised European Commission Merger Regulation (ECMR) in 2004[1], there is a clear basis to take efficiencies into account in the assessment of notified concentrations. Both the accompanying Horizontal Merger Guidelines (HMG)[2] as well as the Non-Horizontal Merger Guidelines (NHMG)[3] set out the criteria under which the European Commission (the "Commission") analyses efficiency claims.

The prominence of efficiency arguments has risen in recent cases, inter alia because merging parties have relied on such arguments more often in merger proceedings. Moreover, the General Court has in two recent instances ruled on certain aspects of the assessment of efficiencies. This paper discusses some issues which were raised in recent cases and which may be relevant for future ones.

The structure of the article is as follows. In Section 2 we provide a description of the conceptual role played by efficiency claims in the assessment of mergers, in part on the basis of the discussion contained in the Commission's HMG. In Section 3 we briefly overview the merger cases examined by the Commission over the past four years (2012-2015) where an efficiency assessment has played a prominent role, identifying some of the key issues at stake in each case. In Sections 4-6 we discuss in turn three overarching issues which have often been relevant in the assessment of efficiencies in recent cases: (a) whether efficiencies should be distinguished from other types of "pro-competitive effects"; (b) how to establish the pass-on to consumers from efficiencies, and to balance this against any competition harm; and (c) the relevance and implications of the distinction between static and dynamic efficiencies. Section 7 concludes.

2. Role of efficiencies in merger assessment

The ECMR and the HMG point out that in some cases the Commission may acknowledge pro-competitive effects for the benefit of consumers. These may counteract adverse effects on competition which the merger might otherwise have.[4] The total competitive effect of a merger is thus the net impact of positive effects which ultimately are to the benefit of consumers and of negative effects which harm consumers.

The Commission examines efficiency claims with respect to three key criteria:

- Whether the efficiencies are verifiable, that is, whether the merging parties provided sufficient evidence to the Commission, so that it can be "reasonably certain that the efficiencies are likely to materialize, and be substantial enough"[5];

1 Council Regulation (EC) 139/2004 of 20 January 2004 on the control of concentrations between undertakings, 2004 O.J. (L 24), pp. 1-22.
2 Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings, 2004 O.J. (C 31), pp. 5-18.
3 Guidelines on the Assessment of Non-Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings, 2008 O.J. (C 265), pp. 6-25.
4 ECMR, recital 29; and HMG, paragraph 77.
5 HMG, paragraph 86.

- Whether the benefit of the efficiencies is likely to be passed on to consumers in a timely manner (as opposed to being kept by the merged entity or its owners);
- Whether the efficiencies are merger-specific, that is, whether they could not have been achieved by any realistic less anti-competitive means.

All three of these criteria play an important conceptual role in the economic assessment of efficiencies.
Clearly, efficiencies need to be carefully verified, since merging firms may have an interest in presenting an optimistic view on the positive effects of mergers, as this may raise the odds of receiving regulatory clearance. Moreover, the standard of verification used by firms when assessing the possible synergies from the transaction may not meet the standard of proof that a competition authority should be using in order to ensure that consumers are ultimately not adversely affected by a transaction.

The role of the second criterion becomes apparent when recalling that the Commission is supposed to investigate whether a notified transaction impedes effective competition which otherwise would bring benefits to consumers.[6] Since the assessment is focused on the potential effects of a transaction on customers, the positive effects from a merger can be taken into account only to the extent they are relevant to customers. For example, synergies in the form of cost savings only matter for a merger assessment to the extent these savings create an incentive for the merged entity to reduce prices (or increase quality), in order to increase its sales. In contrast, customers will usually not benefit from fixed cost savings which typically increase the profits of the merged entity, without affecting its pricing incentives.

The criterion of merger-specificity is best understood when considering that, in general, when "*assessing the competitive effects of a merger, the Commission compares the competitive conditions that would result from the notified merger with the conditions that would have prevailed without the merger.*"[7] In some cases the counterfactual situation in the absence of the concentration differs from the status quo. For example, improvements for customers may sometimes not only be achieved by a given notified transaction, but also by alternative and realistic means. For example, economies of scale may be achieved if competitors cooperate at the production level, without the need to reduce retail competition by means of a full merger. Similarly, in the context of an industry or firm that is undergoing a restructuring process (i.e. closing inefficient facilities) a merger may not be required to achieve efficient restructuring as this could also be undertaken on a stand-alone basis. Benefits which can be expected to be achieved in the absence of the merger should not be causally attributed to a merger and therefore do not constitute valid grounds to clear a merger, in particular if the merger entails significant anti-competitive effects.[8] By the same logic of course, anti-competitive effects that may follow a merger but that are not caused by the merger (e.g. price increases due to closure of capacity that would have occurred independently of the merger) should not be a reason to object to a transaction.[9]

This discussion illustrates that the three cumulative criteria can be justified by reference to the general approach of assessing the effect of a transaction on customers by comparing the merger scenario to an alternative scenario in the absence of the transaction. Therefore, although the competitive assessment and the assessment of efficiencies are discussed separately in the guidelines and also in many decisions, they can be thought of as forming part of a single comprehensive approach to merger control.

3. A brief survey of recent case practice (2012-2015)

Over the past four years (i.e. during the period between 2012 and end-2015), the Commission has undertaken an in-depth examination of efficiency claims made by merging parties in 9 intervention cases (including the *TeliaSonera/Telenor* merger which was withdrawn in September 2015), and in one unconditional clearance (the *Nynas/Harburg* case cleared in 2013). The efficiency assessment

6 It is generally accepted that competition agencies are supposed to assess the effects of notified transactions on consumer welfare.

7 HMG, paragraph 9.

8 Farrell and Shapiro (2001) discuss this argument more in detail.

9 This consideration is for example reflected in the treatment of failing firms as set out in paragraphs 89 to 91 of the HMG.

in each of the 9 cases where the Commission has adopted a final decision is briefly summarized in the table annexed to this paper (see Annex).[10] In the 8 intervention cases where a decision was adopted (as summarized in the Annex), the Commission did not find that the efficiency claims made by the merging parties were capable of outweighing the competitive harm established by the Commission's investigation in each relevant market. Therefore, a finding of significant impediment to effective competition was made in these decisions, with respect to at least one relevant market. In some of these cases however the efficiency claims were at least partially accepted by the Commission and balanced against the competition harm. This was notably the case in *Deutsche Boerse/Euronext*, *UPS/TNT Express*, *Ineos/Solvay*, *Orange/Jazztel* and *GE/Alstom*. In particular, in the *UPS/TNT Express* case the Commission had no competition concerns in a number of national markets, taking into account the fact that efficiencies outweighed the competitive harm (together with additional qualitative evidence available on these markets).[11] In *Orange/Jazztel*, the accepted efficiencies were not sufficient to entirely offset the identified anti-competitive effects but were taken into account in the assessment of the remedies submitted by the merging parties.[12] In an additional case (*Outokumpu/Inoxum*) the Commission considered whether the variable cost savings claimed by the parties were sufficient to offset the harm to consumers indicated by the Commission's quantitative assessment. Finally, in the unconditional clearance case (*Nynas/Harburg*), the Commission accepted part of the efficiency claims made by the parties, but did not find it necessary to engage in a balancing exercise given the lack of competitive harm relative to the counterfactual absent the transaction.

The issues raised in the assessment of efficiencies undertaken by the Commission in recent cases are varied, and are linked to all three of the criteria established in the Horizontal Merger Guidelines. For example:

- The issue of merger specificity was particularly relevant in the recent telecom cases (most notably in *Telefónica DE/E-plus*, but also in *H3G/Telefónica Ireland*, and *Orange/Jazztel*), as the Commission found that a significant part of the network-related efficiencies claimed by the merging parties could be achieved by realistic less anti-competitive means, such as network sharing or co-deployment (which is a common practice in several European telecom markets);
- The lack of likely pass-through to consumers of the claimed cost savings was an important reason why part of the efficiency claims were not accepted by the Commission in *Telefónica DE/E-plus* and *H3G/Telefónica Ireland* (given that in both cases most of the claimed synergies were of a fixed cost nature), *GE/Alstom*, and *Ineos/Solvay*; and
- Insufficient verifiability of the efficiency claims (largely due to lack of the necessary documentary evidence) played an important role in the assessment of the efficiencies in *UPS/TNT Express*, *Deutsche Borse/Euronext* and *Orange/Jazztel*, and more generally was an issue for some of the more detailed claims in the other cases summarized in the Annex.

As set out in particular in Sections 5 and 6 below these cases also illustrate the type of claims that the Commission has accepted in its recent decision practice, as well as the kind of balancing exercise that the Commission applied in cases where harm had also been established.

4. Pro-competitive vs. efficiency effects

In some recent cases, the argument was made that certain effects of the merger ought to be regarded as "pro-competitive effects" which should be dealt with by the Commission within the general competitive assessment of a merger, and not be assessed under each of the three efficiencies criteria. A common justification for such an argument is that certain aspects of a transaction are inherently linked to the nature of the merger, and therefore cannot be assessed in isolation.

However, as the discussion in Section 2 illustrates, the three criteria for the assessment of efficiencies are rooted in the general approach of assessing mergers, and therefore provide the correct substantive test for analyzing possible pro-competitive effects from a transaction (be they

10 At the time of writing this article, the Commission adopted another decision (*M.7630 FedEx/TNT Express*), where it found that "the transaction will give rise to verifiable, merger-specific efficiencies due to network cost savings which will benefit customers" (see Press Release of January 8 2016, IP/16/28). This decision is not reviewed in this article.

11 See paragraphs 935 and 939 of the *UPS/TNT Express* Decision.

12 See paragraph 939 of the *Orange/Jazztel* Decision.

in the form of lower cost and/or higher quality resulting from a merger).

For example, not explicitly applying the criterion that efficiencies must result in a benefit to consumers would effectively imply that the focus of the assessment of efficiencies could risk shifting away from analyzing the impact on consumers, and would thus introduce an inconsistency vis-à-vis the remaining competitive assessment. Similarly, not applying a merger-specificity criterion to alleged pro-competitive effects from a transaction could lead to a situation where the appropriate counterfactual analysis is not undertaken, with the possible consequence of attributing to the merger beneficial effects which could materialize also in the absence of the transaction.

Efficiency arguments have become more prominent in recent EU mergers

The *Telefonica DE/E-plus* case provides a good illustration of the need to apply the merger-specificity criterion to an alleged pro-competitive effect of a transaction, in order to ultimately reach the correct competitive assessment. In that case, the notifying party claimed that merging the mobile networks of the parties would generate sizable benefits to consumers such as quality increases due to an improved LTE coverage. However, the Commission found evidence that the parties might have engaged in network sharing[13] in the absence of the merger. Network sharing effectively would have allowed the parties to achieve similar quality improvements as those achieved with the merger. Thus, in the future consumers could have benefitted from a higher quality network even if the notified merger had not been approved. If consumers can be expected to enjoy the claimed quality increases by means of network sharing in the absence of the merger, they would be harmed by a merger which, in addition to the claimed quality increases, would also entail anti-competitive effects.

The primary difference from treating any pro-competitive effects as formal efficiencies, as opposed to anti-competitive effects that are treated generally within the competitive assessment of a transaction, is the application of the *burden of proof* to the merging parties rather than to the Commission.[14] For reasons that are set out in the HMG, placing the burden of proof for efficiency claims on the merging parties is justified to the extent that such claims are based on information that is primarily in the hands of the merging parties.[15]

The substantive criteria that are applied to assess efficiencies should also not depend on how a decision is structured. In the *Nynas/Harburg* clearance decision for example, the discussion of efficiencies was tightly integrated within the competitive assessment (as opposed to being presented at the end of the competitive assessment, as a countervailing factor) largely for presentational convenience. Nevertheless the three efficiency criteria in the HMG were applied by the Commission.[16] This illustrates that the same substantive criteria to evaluate efficiencies should be applied irrespective of where in a decision efficiencies are assessed.

5. Pass on and balancing in practice

The recent decisions reviewed in this article also illustrate how the Commission assesses what part of claimed benefits can be expected to be passed-on to customers. A number of relevant aspects have been raised by these cases, including the treatment

13 Due to recent technological improvements, mobile network operators may share important parts of mobile networks, allowing them to realize economies of scale from operating larger networks.

14 Crane (2011) argues that both the European and the US merger control system effectively impose a higher standard of proof for efficiencies compared to potential anti-competitive effects of a merger which may have undesirable consequences.

15 See HMG, paragraphs 85 and 87. The General Court has accepted in recent decisions that the burden of proof for demonstrating efficiencies should lie with the merging parties (see *Ryanair v. European Commission*, Case T-342/07, paragraph 407, and *Deutsche Börse AG v. European Commission*, Case T-175/12, paragraphs 262 and 275). The General Court has also accepted more generally that the two-step approach whereby the Commission faces the burden to demonstrate anti-competitive effects from the transaction, and the parties have the burden to demonstrate the existence of efficiencies (*Deutsche Börse AG v. European Commission*, Case T-175/12, paragraphs 275 and 294).

16 See in particular Section 7.4.4.3 of the Decision.

of demand-side benefits, the assessment of asset re-optimization which does not improve the joint production capabilities of the merging parties, and the analytical tools which can be used to undertake a balancing exercise. We discuss these three issues in turn below.

> The three criteria for assessing efficiencies set out in the Horizontal Merger Guidelines are rooted in the general conceptual framework employed to assess mergers

5.1. Treatment of demand-side efficiencies

In *Deutsche Boerse/NYSE* the issue arose of whether demand-side efficiencies (where the claimed benefit accrues directly to the customer) should be treated differently than supply-side efficiencies (where the benefit accrues directly to the merging entities). The parties argued that demand side efficiencies, such as reduced collateral requirements, arise directly on the side of the customer and thus do not need to be "passed on" by the combined entity through price reductions (as is often the case for supply-side efficiencies).

However, in its decision on *Deutsche Boerse/NYSE* the Commission outlined that, even though consumers may directly save costs as a consequence of reduced collateral requirements, the merged entity could raise prices and therefore claw-back at least some part of the savings.[17]

The Commission's reasoning was based on a standard economic argument. If the value to consumers of a good increases, it is typically rational for sellers to increase the price, since consumers will have a higher willingness to pay for the good.[18] Under assumptions commonly made in economic models to predict unilateral effects of mergers, the part of the benefits which resides with the customer after claw-back is similar to the part of supply side benefits (such as cost savings of the merging firms) that would be expected to be passed on to customers.

The General Court upheld the reasoning of the Commission regarding potential claw-back of demand-side efficiencies.[19] It confirmed that even if benefits arise directly at the side of the consumers (such as the alleged benefits of reduced collateral requirements) the Commission is entitled to assess whether some of the benefits could be clawed back by the merged entity.

5.2. Impact of asset re-optimisation which does not improve the joint production capabilities of the merging parties

Economic literature on horizontal mergers and efficiencies shows that in a standard setting of homogenous goods competition, cost savings from output reallocation that could take place post-merger between firms with different costs (that is to say from the firm with higher cost to that with lower costs) should not qualify as efficiencies.[20] Intuitively, this result hinges on the observation that savings of this type do not improve the choice set of suppliers available to consumers relative to the pre-merger situation, since consumers could also have purchased from the firm with lower cost absent the merger. Similarly, the low cost firm could have expanded its output pre-merger, and it does not need to merge with another firm in order to serve more customers. Savings due to output reallocation across merging firms therefore are not capable of offsetting the anti-competitive effects of a horizontal merger between suppliers of homogenous goods.

This result applies whenever the production capabilities of the merged entity are no different

17 Paragraphs 1235-1242.

18 See for example Willig (2011). If the value of a product to customers increases, then the demand for this product at a given price increases. In light of this increased demand a producer can further increase its profit by raising somewhat the price and thus the margin for every sold unit of this product even if this has a dampening effect on demand.

19 See judgment of the General Court, *Deutsche Börse AG v European Commission*, Case T-175/12, paragraphs 267-280.

20 See Farrell and Shapiro (1990). A scenario with post-merger output re-allocation (or rationalization) but not further reduction in costs is explicitly denoted in the article by Farrell and Shapiro as a "merger with no synergies".

from those of the merging parties *jointly* before the merger. Absent any other form of efficiency (e.g. lower production cost due to economies of scale or asset complementarity), the only impact of the horizontal merger in this setting is therefore the loss of competition between the parties and the associated potential increase in price.[21]

Whilst the economic result described above is formally established in the economic literature relating to quantity competition, the underlying reasoning can also be applied to a setting with localized price competition between firms selling largely homogenous goods, as the Commission did in the recent *Ineos/Solvay* merger. In this case, the parties had argued that as a result of the merger they could re-allocate output from distant plants of one of the merging parties (facing higher transport cost) to closer plants of the other merging party (with lower transport costs), and that the resulting savings in transport cost would be partially passed-on to consumers.[22] The Commission however noted that, absent any other cost-reduction effects, the transport costs of the plant located closer to customers would not change. This implies that the only effect of the merger would be the removal of the competitive constraint exercised by the other merging party on the firm owning the best located plant, with no reduction in the cost of supply of the closest plant.[23] In line with the Farrell-Shapiro result, given that the merged entity's combined production possibilities would not improve relative to those available to the parties jointly pre-merger, cost savings due to output rationalization within the merged entity would not be capable of preventing a price increase post-merger and were therefore not accepted as efficiencies.

5.3. Assessing the degree of pass-on of variable cost savings

A variety of economic techniques are available to assess the degree of pass-on of variable cost efficiencies and, where applicable, balance them against the harm from a horizontal merger. Quantitative balancing of harm and efficiencies can be undertaken more easily when efficiencies can be incorporated within the same economic framework used by the Commission for the assessment of the harm.

5.3.1. *Price-pressure techniques*

The use of price-pressure techniques by the Commission in recent mergers in the telecommunications industry is a good example of a single analytical framework which can be used to assess both the anti-competitive effects as well as the efficiencies deriving from a merger.[24] The fundamental insight behind price-pressure techniques is that a horizontal merger will generate an upward pricing pressure on the merging parties, given that part of the loss of sales from a price increase will be recaptured by the other merging party. This upward pricing pressure is very similar to the pressure to raise price induced by a marginal cost increase faced by each of the merging parties. This effective "cost increase" from a loss of competition in turn results in an increase in the price paid by customer as a function of the degree of pass-on of cost changes.[25] Similarly, the downward pricing pressure from a cost reduction due to efficiencies translates into a decrease in the final price according to the same assumptions on the degree of pass-on. Applying a single framework to assess upward pricing pressure and efficiencies therefore has the advantage that both the anti-competitive and the pro-competitive effects are modelled symmetrically in terms of pass-on.[26]

21 A similar line of reasoning was accepted by the General Court in *Ryanair v. European Commission*, Case T-342/07, paragraph 439.

22 Customers may procure from multiple plants, including plants that are not the closest to them, due to advantages from multi-sourcing (e.g. in terms of security of supply). The presence of multi-sourcing was a feature of the *Ineos/Solvay* case.

23 For example, for customers where Ineos owned the closest plant, and Solvay also supplied from a plant located farther way, the merger would have led to output reallocation from the Solvay plant to the Ineos plant, thus reducing overall transport costs. However, the transport cost of the Ineos plant would not have changed post-merger, implying that the competitive options available to customers would not improve compared to the pre-merger situation.

24 Price-pressure techniques (including in some cases calibrated linear merger simulations) have been used by the Commission in *H3G/Orange Austria* (2012), *H3G/Telefonica Ireland* (2014), *Telefonica DE/E-plus* (2014) and *Orange/Jazztel* (2015).

25 See Farrell and Shapiro (2010). This paper shows that the incentive to raise price as a consequence of a loss of competition can be expressed as an additional shadow-cost faced by the merging firms. The applicable pass-on rate determines to what extent this shadow-cost is then passed-on to customers in the form of a price increase.

26 The economic literature shows that it is possible to exactly compute the degree of marginal cost reduction required to offset a price increase from a horizontal merger (so-called "compensating marginal cost reduction (CMCR)". See in particular Werden (1996).

The Commission undertook a quantitative balancing of anti-competitive effects and of efficiencies using price-pressure techniques in the recent *Orange/Jazztel* case. In this case, the Commission accepted Orange's efficiency claim regarding the elimination of double marginalisation. Pre-merger, Jazztel did not own a mobile infrastructure and relied on wholesale access to Orange's mobile infrastructure in order to provide mobile communication services to its retail customers. The transaction reduced the perceived variable costs in the provision of mobile services for former Jazztel products, as it eliminated the wholesale margin that Jazztel was paying to Orange for wholesale access to its mobile network. This reduction in marginal cost can be expected to be passed-on in part to customers in the form of reduced prices. On the other hand, the Commission was concerned that the loss of competition between the competitors Orange and Jazztel would induce the merged entity to increase the prices for its products. The Commission carried out a so-called calibrated merger simulation in order to quantitatively analyze these two effects within a single analytical framework. For reasons described above, this approach has the advantage that the impact on consumers of anti-competitive and pro-competitive effects are analyzed based on the same assumptions (such as the shape of demand), which ensures internal consistency.

5.3.2. Models of capacity-constrained price competition

The Commission has relied on a model of capacity-constrained price competition (a so-called "Bertrand-Edgeworth" model) in two recent cases involving largely homogenous products (*Outokumpu/Inoxum* and *Ineos/Solvay*). Like for the case of price-pressure techniques, this quantitative approach also allows for an internally consistent treatment of the anti-competitive effects of the transaction and of potential countervailing efficiencies.

In both cases, the Commission relied on the Bertrand-Edgeworth model to test the impact of the variable cost savings claimed by the merging parties, and to establish whether they were of sufficient magnitude to offset the estimated price increase due to the consolidation of capacities implied by the respective mergers. In *Outokumpu/Inoxum*, the Commission found that the variable cost synergies claimed by the Parties were not particularly large (in the range of 0-5% of total variable cost), and they were in any event not sufficient to outweigh the illustrative price increase implied by the Bertrand-Edgeworth model. For example, in the Commission's calibration of the model using actual sales and capacity data, the price effects after synergies remained in the range of 5 to 10%. Similarly, in *Ineos/Solvay* the Commission found that even applying the entire variable cost efficiencies claimed by the merging parties, a calibrated Bertrand-Edgeworth model predicted price effects in the range of 5 to 20% (depending on the calibration assumptions).[27] In both of these cases, the Commission therefore undertook a quantitative balancing of harm and efficiencies, on the basis of a single analytical framework.[28]

> Over the past four years the Commission has undertaken an in-depth efficiency assessment in 10 cases

5.3.3. Reliance on alternative quantitative frameworks

In *UPS/TNT Express*, the Commission determined the degree of pass-on of potential cost savings based on an empirical analysis which had been prepared to assess the potential anti-competitive effects of the merger. In order to estimate the likely price impact from the merger, the Commission relied on a price concentration analysis.[29] Whereas

27 See paragraph 1239.
28 In *Ineos/Solvay* the Commission also noted that any remedy that would be required to prevent the loss of competition from the merger would also likely effect the efficiencies deriving from the transaction, given that the efficiencies were partially based on the larger scale achieved by the merged entity (see paragraphs 1212-1215 of the Decision). This implied that any assessment of the remedy would need to factor in the lower level of efficiencies associated with the transaction. In any event, the parties did not submit an updated efficiency assessment together with their proposed remedies, implying that the Commission did not need to undertake an additional quantitative assessment of the merger in light of the remedies and of adjusted efficiency effects.
29 A price concentration study effectively examines how the prices charged by suppliers vary with the level of concentration (or the number of competitors) across different markets, after accounting for further factors that may affect the price level.

the primary aim of that analysis was to assess by how much the price level could be expected to increase if the number of suppliers would be reduced through the merger, it also delivered an estimate to what extent lower costs could be expected to be passed on to customers in the form of price reductions. The Commission accepted that the merger would likely result in cost savings for air transport and assumed that the pass-on rate of cost savings would be as estimated in the price-concentration analysis. Based on this analysis, whereas the accepted efficiencies outweighed the price effects indicated by the price-concentration analysis in a number of EEA countries, they were not sufficient to offset the price effects in all EEA countries.

5.3.4. Qualitative balancing

The recent examples described above show that in some cases it is possible to undertake a fairly detailed quantitative balancing of the potential anti-competitive effects of a merger and of efficiencies. This is however not feasible in all instances and in some cases the Commission may need to rely on a qualitative balancing exercise instead. This was for example the case in the *Deutsche Boerse/NYSE* decision. In this case the parties inter alia argued that the merger would allow their common members to achieve significant collateral savings by allowing them to pool their clearing operations, thereby bringing together their highly correlated, risk-offsetting products.[30] The Commission accepted as verifiable collateral savings only a fraction of the original claim (in the order of EUR 40-120 million), of which only a part could be expected to be passed on to customers and to be merger-specific. The Commission then went on to qualitatively balance the potential benefits of customers from efficiencies with the likely anti-competitive effects due to an increased market power of the merged entity. Given the relatively small size of fees compared to the total cost of trading, it was considered likely that the merged entity could increase fees (or reduce rebates) substantially.

30 The parties estimated that customers could save just over roughly EUR 3.1 billion of collateral. The Commission pointed out that the benefit for consumers from lower collateral requirements would be the return on capital that would does not need to be posted as collateral any more following the merger and which could then be invested otherwise. Hence, not the level of saved collateral, but rather the implied opportunity costs of capital would be the relevant measure for the collateral savings.

Since the verifiable benefit to customers due to reduced collateral requirements was only a small fraction of the notifying parties' revenues from their derivative business, the Commission found that they would be already offset by a relatively small price increase of the merged entity. The General Court recently upheld the Commission's reasoning.[31] The General Court further confirmed that although the Commission could not quantify the expected anti-competitive effects, it was right to conclude that the level of verifiable collateral efficiencies was insufficient to counter the likely anti-competitive effects for the reasons provided in the decision.

6. Static versus dynamic efficiencies

The efficiency assessments performed by the Commission in a number of recent cases also shed some light on the debate on dynamic versus static efficiencies. This debate is linked to the more general issue of whether dynamic considerations (such as effects of a merger on innovation and investment) should be given a more prominent role than static concerns (such as short run increases in market power and closure of production facilities). In discussing this issue, we first address the fact that mergers which lead to dynamic effects may be associated with consumer harm according to economic principles that are similar to those at work in connection to static effects (Section 6.1). On this basis, a more permissive policy towards mergers which may entail dynamic effects does not appear to be justified. Specifically, there is no reason to assess dynamic efficiencies by adopting a more lenient standard than the one applied to static efficiencies. We then discuss practical implications of this insight, and touch upon issues which were relevant in the recent assessment of dynamic efficiency claims by the Commission (Section 6.2).

6.1. A brief discussion of dynamic effects of mergers

Whereas loss of horizontal competition especially in concentrated markets typically gives rise to an increase in market power and thus static anti-competitive effects, it is sometimes argued that the relationship between competition and innovation (or investment) is more complex.

31 See judgment of the General Court in *Deutsche Boerse AG v. European Commission*, Case T-175/12.

Shapiro (2012) provides a comprehensive discussion of principles which govern this relationship and surveys the relevant economic literature. In his paper, Shapiro argues that the effect of a merger on the ability to innovate (or to invest) depends on the extent to which complementary assets are brought together by the merger (the "synergy principle").[32] There is thus a similarity to static efficiencies, which also arise often as a consequence of bringing together complementary assets.

The incentives to innovate are in turn driven by the prospect of attracting additional sales by providing greater value to customers or by reducing costs through innovation (the "contestability principle"). The incentives are also affected by the extent to which a successful innovator can capture the social benefits resulting from its innovation (the "appropriability principle").[33]

Based on these three principles (and in particular the second one), there is a conceptual similarity between a potential anti-competitive effect of a merger on innovation and the more conventional static effect of a loss of price-based competition. As it is well understood from the logic of the Upward Pricing Pressure framework, if a firm decreases its price, it will typically attract additional customers from its competitors, which entails a negative externality on them. If a firm merges with a competitor, the merged entity will internalize the effects of price competition on the profits earned by the other merging party. The incentive to raise price following a horizontal merger is thus the result of internalizing the negative externality that is at work between the merging parties absent the merger.

Likewise, if a firm innovates and creates products which are more valuable to consumers, it will attract additional customers at the expense of its competitors and thus entail a negative externality on them. Post-merger, the merged entity will take into account that profits from improving the products of one merging party through innovation may entail decreasing profits for the other merging party. Put differently, through a horizontal merger the merged entity partially internalizes this negative externality of innovation on competing firms' profits. This tends to reduce its incentives to innovate.

In summary, horizontal mergers may improve the ability of the merged entity to innovate in particular if they bring together assets that are complementary, and whose complementarity could not be exploited absent the merger. Dynamic efficiency claims need to be understood and assessed in this overall framework.

However, there is no clear indication that dynamic efficiencies can be generally expected to arise more frequently than static efficiencies. Moreover, in addition to the more standard static concern that a horizontal merger may increase market power of the merged entity and there therefore trigger price increases, there is also a risk that horizontal mergers may undermine the incentives to innovate. Hence, adopting a generally more lenient stance when assessing mergers in industries where dynamic effects are particularly prominent, for example by lowering the standard of proof for dynamic efficiencies, is not warranted.

6.2. Practical implications for the assessment of dynamic efficiencies

The elements of the efficiency claims made in recent cases which have been accepted by the Commission concerned predominantly static efficiencies, i.e. efficiencies which directly improve the ability or the incentives of the merged entity to compete.[34] This raises the question of whether dynamic efficiencies are more difficult to establish in practice and if so why.

In a number of recent cases dynamic efficiencies were claimed, in particular in the telecom sector. The *H3G/Telefónica Ireland* case offers a good illustration of the challenges associated with demonstrating that dynamic efficiencies can lead to benefits to customers which are both substantial and sufficiently predictable. Given that benefits to customers from dynamic efficiencies typically arise only indirectly, it is necessary to establish a number of causal relationships in order

32 A similar reasoning applies to investment as opposed to innovation.

33 For example, appropriability is limited if there is rapid imitation of a given innovation, implying that the profits from innovation are competed away quickly.

34 Examples are variable cost savings such as those acknowledged in *Nynas/Harburg* or the elimination of double marginalization such as the one successfully claimed in *Orange/Jazztel*.

to pin down the nature and the extent of benefits to customers.

In that case, one of the main efficiency claims was that fixed cost synergies from economies of scale would lead to higher investment given H3G Ireland's financial constraints pre-merger. This efficiency claim was ultimately rejected by the Commission inter alia because of two issues. First, the Commission considered that the parties had not provided sufficient evidence to show that fixed cost savings due to the merger could be indeed be expected to be re-invested (as opposed to being distributed among shareholders). Second, according to the Commission, the parties did not demonstrate the benefits to consumers associated with the alleged additional investments.

A number of economic techniques are available to measure the pass-on of variable cost savings

As regards the first point, the parties claimed that financial constraints imposed at the international group level implied that some profitable investments could not be undertaken by H3G's Irish subsidiary in the absence of the merger. The parties sought to establish this claim in part by means of an econometric study showing that higher profitability triggers additional investments.[35] The Commission however did not accept the evidence from this study for a number of reasons. One of them was that the study was based on a heterogeneous sample of firms (some of which generated a significant part of their revenues in sectors other than mobile telecommunications). Another reason was that the study was performed with data at group level, and did not directly address the financial constraints allegedly due to the workings of internal capital markets. The Commission was generally concerned about the applicability of the results from such a broad empirical study to the specific case.

Moreover, the Commission had doubts on whether the internal capital market within which Hutchison 3G's Irish subsidiary operated actually constrained its ability to pursue profitable investment opportunities. In addition, even if one were to accept that constraints from an internal capital market were significant pre-merger, it was not clear that according to the same logic higher earnings due to the merger would actually be retained by the Irish subsidiary post-merger.

As regards the second point, the parties in *H3G/Telefónica Ireland* argued that additional investments due to economies of scale would be beneficial to customers but did not provide any detail on the actual magnitude of the resulting benefits to customers. Without appropriate information on the expected consumer benefits from an efficiency claim, the Commission cannot accept the claim and balance it against the harm from a merger.[36] This is an important point since effects of higher investments on customers may materialize in different ways and it is often not evident how much customers value those benefits. For example, in the mobile telecom industry it is often argued that additional investments would increase the coverage or the download speed provided by a mobile network. In *Telefónica DE/E-Plus* the parties submitted an extensive analysis aimed at quantifying the consumer benefits from improved network quality. The discussion contained in the *Telefónica DE/E-Plus* Decision illustrates the challenges of such an analysis.[37]

To sum up, dynamic efficiencies are in practice often difficult to demonstrate because the claimed benefits to consumers arise predominantly indirectly. The efficiency claims often consist of several interlinked elements all of which need to be established to a sufficient standard in order to show that claimed benefits are both significant and sufficiently predictable. This typically makes dynamic efficiencies more challenging to demonstrate in practice than static efficiencies.

35 The parties made additional economic submissions on this point which are assessed in the Commission Decision.

36 HMG, paragraph 86.

37 Paragraphs 987 to 1058.

7. Conclusion

Since the revision in 2004, the ECMR sets out that a merger may induce pro-competitive effects to the benefit of consumers which, if shown to the requisite standard, need to be taken into account in the overall assessment of that concentration. The prominence of efficiency arguments has risen in recent cases, inter alia because merging parties have relied on such arguments more often in merger proceedings.

Efficiencies were accepted in past decisions exclusively if the three efficiency criteria set out in the HMG were met. This article has illustrated how these efficiencies criteria are rooted in the overall framework to assess mergers set out in the ECMR and in the accompanying guidelines. Arguments sometimes put forward that certain pro-competitive effects of a merger should not be assessed under each of the three efficiencies criteria therefore appear to be misplaced, as this would risk an inconsistency with the overall merger control framework.

This article has further described techniques which have been used in practice to assess certain aspects of efficiencies such as pass-on to consumers or balancing against anti-competitive effects. It has also discussed the relevance of the distinction between static and dynamic efficiencies, arguing that dynamic efficiencies are often difficult to demonstrate, given the indirect nature of the effects and the need to maintain a rigorous standard of proof also for this type of efficiency claims.

The role of efficiencies in the assessment of mergers may continue to increase in the future, in line with the trend from recent merger cases. The recent decisions in which efficiencies played a prominent role provide concrete examples on the arguments which have been raised in past efficiency claims, and how they have been assessed by the Commission. In combination with recent Court Judgments on efficiencies, this body of recent precedents can hopefully provide useful guidance for future efficiency claims in merger procedures.

The views expressed are those of the authors and cannot be regarded as stating an official position of the European Commission. We are grateful to Thomas Buettner, Daniel Coublucq, Massimo Motta and Annemiek Wilpshaar for comments on an earlier draft.

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Annex Table: Summary of Recent Merger Cases with Efficiency Claims and Assessment

Case (Year of Adoption)	Efficiency Claims Made by the Parties	Commission Assessment
M.6166 Deutsche Borse/Euronext (2012)	The merging parties claimed (a) collateral savings from additional cross-margining opportunities; (b) liquidity benefits through the reduction of bid-ask spreads; and (c) IT savings through the combination of networks	Commission rejected the liquidity benefits and IT savings as not verifiable. Collateral savings considered verifiable, partly merger specific and partly passed on (due to ability of merged entity to claw back some of the savings). Efficiencies that were accepted do not offset likely harm from the merger (qualitative balancing).
M.6471 Outokumpu/Inoxum (2012)	The merging parties claimed variable costs efficiencies at the melting and hot rolled level due to higher capacity utilisation. When expressed as a share of total variable costs, the claimed efficiencies were limited (in the range of 0-5% on average).	The Commission only considered the claimed variable cost synergies in its assessment of the impact of the merger. The quantitative model used by the Commission showed that the claimed marginal cost savings were not sufficient to offset a likely price increase.
M.6570 UPS/TNT Express (2013)	The merging parties claimed savings in pick-up and delivery (from route optimisation), in air network (from air network and flight schedule re-optimisation), and in administrative activities.	The Commission rejected pick-up and delivery savings as not verifiable given that they were based on outdated analysis. Air network savings accepted and balanced against likely competitive harm on the basis of a price-concentration analysis.
M.6360 Nynas/ Shell/ Harburg Refinery (2013)	Parties claimed that due to the merger Nynas would increase capacity at the Harburg refinery and substitute imports from outside the EEA with cheaper own production.	Commission accepted that the savings in import costs for Nynas were verifiable, merger-specific and likely to be partially passed on to consumers.
M.6905 INEOS / Solvay / JV (2014)	Parties claimed savings from procurement (in relation to three inputs), variable transport cost, production optimisation and variable SG&A.	Commission rejected procurement and production optimisation savings on grounds they are not merger-specific (e.g. not linked to greater purchasing by the merged entity) and not verifiable. Variable transport cost savings only partially accepted as an efficiency due to concern that output reallocation across existing plants would not benefit consumers since it did not improve the joint production possibilities of the merged entity. Efficiencies claimed by the parties were in any event not sufficient to outweigh the price effects indicated by the Commission's quantitative model.
M.6992 Hutchison 3G / Telefónica Ireland (2014)	Parties claimed that the transaction would lead to fixed cost synergies from economies of scale, which would lead to higher investment given H3G Ireland financial constraints pre-merger. Consumers would also benefit from additional roll-out of LTE technology.	Commission rejected efficiencies from scale economies given concerns on merger-specificity (in light of network sharing agreements involving the parties) and benefit to consumers (given the fixed cost nature of the claimed savings, and concerns whether such savings would lead to greater investment). LTE deployment efficiencies rejected in part due to evidence that claimed incremental coverage would also be achieved absent the merger.
M.7018 Telefónica Deutschland/ E-Plus (2014)	Parties claimed that the merger would lead to significant fixed cost savings which would be passed on to consumers, and to improved quality (in terms of network coverage and speed).	Commission found that significant part of cost savings and that claimed improvements in network quality were not merger-specific in light of alternative network sharing arrangements. Non-network related cost savings rejected as efficiencies due to fixed cost nature.
M.7421 Orange / Jazztel (2015)	Parties claimed that the merger would eliminate double-marginalisation of mobile services procured by Jazztel pre-merger, and would also lead to greater fibre roll-out of the merged entity due to economies of density.	Commission accepted double-marginalisation efficiencies, but found that beneficial effects did not outweigh price effects predicted by quantitative analysis. Fibre roll-out efficiencies not accepted as verifiable in part due to lack of documentary evidence, and not merger-specific due to alternative co-deployment arrangements.
M.7278 GE/Alstom (2015)	Parties claimed efficiencies primarily from savings in sourcing and manufacturing for thermal products and services.	Commission rejected majority of efficiency claims due to lack of merger-specificity lack of verifiability of some of the claimed savings, and fixed cost nature of some of the synergies. A part of the efficiencies was however accepted.

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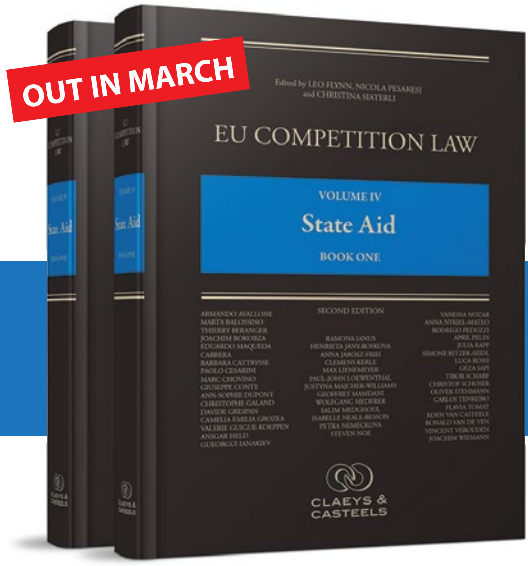

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Edited by

LEO FLYNN
Member of the Legal Service, Dir C
AIDE Team, EC

NICOLA PESARESI
Head of Unit, State Aid Strategy,
DG COMP, EC

CHRISTINA SIATERLI
Deputy Head of Unit, Enforcement
and procedural reform, DG COMP, EC

Written by

ARMANDO AVALLONE
MARTA BALOSSINO
THIERRY BERANGER
JOACHIM BOKOBZA
EDUARDO MAQUEDA CABRERA
BARBARA CATTRYSSE
PAOLO CESARINI
MARC CHOVINO
GIUSEPPE CONTE
ANN-SOPHIE DUPONT
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VINCENT VEROUDEN
JOACHIM WIEMANN

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info@claeys-casteels.com | tel: +31 570 60 61 00 | fax: +31 570 60 67 69

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