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“The role of efficiencies in the assessment of mergers in the EC legislation”

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Abstract

Mergers result in some serious competition concerns, but it is often forgotten that they may also generate positive effects to economy as a whole. The wording of the EC Merger Regulation no 139/2004 allows the efficiency gains to be evaluated during the assessment of a given merger. The provisions provide information that efficiencies brought about by the merger might counteract the effects on competition, and in particular the potential harm to customers. What is more, the Commission issued guidelines both for appraisal of horizontal and vertical mergers where the problem of efficiencies is investigated in details with provision of certain rules on how they should be evaluated and under which conditions.

In spite of this approach towards efficiencies stemming from mergers, the issue is still not explicitly explained by the European Commission. Thus, in this master thesis the author will examine the legal understanding of efficiency gains as means lessening anti-competitive effects of a given merger in the EC competition law. It will be also attempted to answer the question if merger efficiencies are likely to lead to clearance of the merger accused of causing certain anti-competitive effects on the European common market under the EC Merger Regulation.

The efficiencies stemming from mergers falling under the EC Merger Regulation no 139/2004 should cumulatively fulfill the conditions: provide benefits to
customers, be merger specific and be verifiable. However, the current Commission’s practice does not prove that efficiencies claimed by merging parties will lead to allowance of the merger accused of causing anti-competitive effects on the European common market. In opinion of the author, the Commission is provided with legal bases to raise the importance of efficiencies in the mergers’ assessment and it is very likely that the future ruling will go towards increasing of their significance.
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1. Introduction

1.1 Background

Since the creation of the EC merger control legislation, the debate on the role of efficiencies has been always present. Mergers result in some serious competition concerns, but it is often forgotten that they may also generate positive effects to economy as a whole. The wording of the Regulation no 4069/89 on the Control of Concentrations between undertakings (later – the EC Merger Regulation or the ECMR) did not allow for an explicit treatment of efficiency gains in the into EU merger control regime, even though the article 2.1 (b) of the “old” ECMR provided legal bases for taking them into account. It stated that during the appraisal, the European Commission (hereinafter, the Commission) should take into account, among other aspects, “the development of technical and economic progress provided that it is to consumers’ advantage and does not form an obstacle to competition”. It shows that the Commission could by then consider efficiencies under the notion of technical and economic progress and take them into account if they fulfill the two provisions, i.e. they are to customer advantage and they do not provide any harmful effects to the common market.¹ Throughout the years, however, the Commission in its case law decisions did not treat efficiency claims with much attention and sometimes declared contradictory opinions with regard to them.

The reform of the ECMR regime in 2004 seems to have changed the Commission’s approach towards efficiencies which is proved by incorporating an additional recital 29. The provisions of the recital provide information that efficiencies brought about by the merger might counteract the effects on competition, and in particular the potential harm to customers. What is more, the Commission issued guidelines both for appraisal of horizontal and vertical mergers where the problem of efficiencies is investigated in details with provision of certain rules on how they should be evaluated and under which conditions.

1.2 Problem statement

In spite of the new approach towards efficiencies stemming from mergers, the issue of efficiencies is still not explicitly explained by the European Commission. Thus, in this master thesis the author will examine the legal understanding of efficiency gains as means lessening anti-competitive effects of a given merger in the EC competition law. It will be also attempted to answer the question if it is possible that under the EC Merger Regulation no 139/2004 efficiencies claimed by merging parties will lead to clearance of the merger accused of causing certain anti-competitive effects on the European common market.
1.3 Delimitations

The thesis takes an EU perspective on competition law regarding efficiency gains from mergers and explores the functions of the rules on efficiencies in the EU regulatory system and the legal and practical effects it may cause in the community. The function of these provisions in an international or a national context will thus not be subject to investigations. Remedies are not taken into account as well.

Although there are many different ways of distinguishing efficiencies, in this paper will be used the most common one, i.e. static and dynamic efficiencies. The main focus will be put on evaluation of efficiencies stemming from horizontal mergers, because creating and abusing of dominant position by vertical mergers entail to lesser extent than it is the case with horizontal mergers. The economic theory will be used only to explain the mechanisms and forms of creating efficiencies through mergers.

1.4 Methods and Materials

The analysis and conclusions of the thesis will be primarily based upon EC primary and secondary acts from competition jurisprudence. Also, the case law of the two legislation system will be examined. Further, in case of unclear and vague interpretation of certain problems in official documents, the other sources of information about EC Merger Control will be examined, e.g. speeches of EU officials, thematic literature, economic and legal publications, etc.
1.5 Structure

This paper consists of 4 chapters (excluding the introductory Chapter 1).

Chapter 2 provides introduction to the efficiency concerns in the merger analysis. The background information for the introduction will be taken from economic theory and will include description of efficiencies’ typology, approaches towards welfare standard choice and towards appraisal of efficiency gains in the assessment of mergers.

In chapter 3, the evaluation of the concept of efficiency gains in the EC merger control legislation will be conducted. Firstly, the author describes a process of creation and development of the EC merger regulation since the beginnings of EC competition law, until the recent reform in 2004. Secondly, the development of the concept of merger efficiencies in the EC primary legislation will be examined. And lastly, the brief analysis of the pre-2004 reform case law in regard to merger-related efficiencies will be provided.

The objective of chapter 4 will be to develop legal understanding of the role of efficiency gains under the ECMR 139/2004. It will begin with the analysis of post-2004 reform case practice of the Commission. Later, the rules on assessment of efficiencies pointed out in the ECMR and the guidelines will be discussed, i.e. benefit to customers (including issues such as: accepted efficiency types, timeliness, welfare standard choice), merger specificity, verifiability (including issues such as: evaluation of quantitative and qualitative efficiencies, burden of
proof, standard of proof, general presumptions and case-by-case approach) and other related issues (including issues such as: pass-on to customers, efficiencies as an offence).

The last chapter will consist of conclusions of the master thesis.
2. Efficiency concerns in the merger analysis

2.1 Typology of efficiencies

Competition policies in most of modern countries contain strict treatment regarding to merging companies. Of course, mergers result in some serious competition concerns, but it is often forgotten that they may also generate positive effects to economy as a whole. Motives which lead companies to merge are differentiated. One of them is that mergers aim at gaining greater market shares by lessening involvement of their competitors. This may cause temptations to taking advantage of stronger market power and abuse of dominant position. However, such competition threats effectively blur all the positive effects of mergers, e.g. greater managerial efficiency and operational synergies (effects of scale, effects of scope, technical integration advantages, etc.).

This subsection will present definition and typology of these efficiencies, as it is important to clearly understand which kinds of efficiencies may be taken into account by the Commission during the assessment of mergers under the Merger Regulation. Although there are many different ways of distinguishing efficiencies, in this paper will be used the most common one, i.e. static and dynamic efficiencies.
2.1.1 Static efficiencies

So called static efficiencies are those which assume static allocation of a given volume of resources. They consist of two types of advantages: productive and allocative.

Productive efficiencies

This distinction refers to different types of efficiencies which may be generated by mergers in a course of production process, i.e.:  

- rationalization – post-merger cost savings produced by shifting of production from high marginal cost facilities to low marginal cost plants;
- economies of scale – increases of production generate savings in average costs; in a short term, economies of scale are produced by elimination of duplication of tasks which without a merger would be impossible to divide; in the long term, cost savings are met if doubling of all inputs provides more than a doubling of total output;
- economies of scope – when it is profitable to produce several related products within the same facility;
- purchasing economies – cost savings produced due to post-merger increase of bargaining power;
- reduction of slack – limiting the managerial inefficiencies through raised discipline for management resulted from a merger.

Treatment of Efficiencies in the Competition Act, Consultation Paper, Competition Bureau Canada, 2004 http://www.competitionbureau.gc.ca;
**Allocative efficiencies**

This kind of efficiencies is generated by mergers when all available final and intermediate resources are most effectively allocated between all market participants.\(^4\) Due to merger activity in a particular market, the other companies may be encouraged to increase their prices through decrease in output. This may prevent consumers from purchasing the product and producers from increasing their output.\(^5\)

**2.1.2 Dynamic efficiencies**

Dynamic efficiencies are more controversial than static and cause greater problems to competition authorities. This happens because of two reasons. Firstly, they usually are non-quantifiable which makes it difficult to contrast them with quantifiable anti-competitive effects of mergers. Secondly, some of the dynamic efficiencies are said to cause anti-competitive effects themselves. Paradoxically, they are often considered as threatening competition, e.g. when a very innovative product of a merger takes over greater share of a given market. Dynamic efficiencies (also called innovative efficiencies) are intimately related to economic growth and dynamic performance.\(^6\) They occur when merged parties may take advantage of their higher potential to develop and introduce new

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\(^4\) Fackelmann Ch. R., *Dynamic efficiency considerations in EC merger control, An intractable subject or a promising chance for innovation?* The University of Oxford Centre for Competition Law and Policy, 2006, p. 9;

\(^5\) *Treatment of Efficiencies in the Competition Act, Consultation Paper*, op. cit., p. 41;

\(^6\) Utton M., op. cit., p. 274;
products and production methods. Generated efficiencies mainly come from economies of scale in R&D institutions which implement innovative products, etc. However, due to possible abuse of dominant position, merging firms may decide to limit R&D expenditures and slow down the pace of technical innovations.\textsuperscript{7}

Regardless the possible anti-competitive behavior of mergers, dynamic efficiencies are given more attention than before, as they are the ones which consumers benefit the most. The most common forms of merger-related innovative efficiencies are:\textsuperscript{8}

- economies of scale and scope coming from horizontal integration of complementary R&D resources;
- avoidance of parallel R&D;
- joint usage of intellectual property;
- greater amount of financial means dedicated to R&D, which could not have been given by companies before merger;
- reduction of economic risk regarding uncertainty of research and development activities;
- faster creation of product innovation and higher returns from product or process innovation.

Another problem regarding dynamic efficiencies concerns their temporal dimension. Static efficiencies are produced in a certain point in time. Dynamic efficiencies are being generated through a continuous period and the longer they

\textsuperscript{7} Ibid., p. 277;
\textsuperscript{8} Fackelmann Ch. R., op. cit., p. 5;
develop the greater possible advantages from them (e.g. by learning by doing, evolution of R&D, etc.).

2.2 Welfare standard choice

Welfare standard choice answers the question on how to measure effects of mergers and whom they should benefit in the first place.

2.2.1 Total surplus (or Williamson’s) standard

Total surplus standard relates to the whole amount of customers’ and producers’ surplus resulting from mergers. If due to a merger profits of a producer increase, but they do not have any impact on price or quality of a product, such a merger is permissible until the producer’s profit exceed the disadvantages to customers. In other words, the standard allows such a situation when customers or producers are worse off than before the merger. In the total welfare standard the transfer of wealth matters and it does not matter from which side was the transfer made: from customers to producers or other way round.

This type of standard is supported by many economists. However, the politicians (including merger control authorities) are reluctant to adopt it, mostly due to acceptance of potential harmful effects for customers.

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9 Ibid., p. 6;
10 *ICN Merger Guidelines Project, Chapter 6 Efficiencies*, April 2004, p. 26;
11 Ibid., p. 29;
2.2.2 Consumers’ surplus standard

This approach is one of the most commonly used standards among competition authorities. The consumers’ surplus standard requires advantages to be passed on to customers. It assumes that a given merger is permissible as long as it does not reduce net consumers’ surplus, meaning that the effect to the customers should be at least equal than prior to merger. Consumers’ advantages are interpreted as price decreases and other benefits, such as launching of new products, improved quality or better service.\footnote{Ibid., p. 24;}

2.2.3 Price standard

Price standard bases on similar assumptions as consumers’ surplus standard. The difference occurs when it comes to other efficiencies than price reduction. According to price standard, mergers produce cost savings which should be transferred to customers in a form of lower prices. The standard does not recognize product quality improvements or other benefits taken into account by consumers’ surplus standard.
2.2.4 Hillsdown standard

The Hillsdown standard allows the existence of consumers’ loss if efficiencies from mergers exceed this loss.

2.3 Main approaches on appraisal of efficiency gains in the assessment of mergers

The analysis of efficiency gains stemming from mergers causes many discussions among competition authorities and competition law authors. It happens due to unclear status of mergers. According to one group of authors, mergers provide mostly anti-competitive effects, whereas according to others, they create efficiencies which may outweigh these anti-competitive behaviors and therefore may provide substantial advantages to competitiveness of a given market. However, most of the scientists nowadays are of an opinion that efficiencies originating in merger activity provide advantages to the market. The question is whether the competition authorities will take them into account while assessing legality of mergers.

The analysts of benefits coming from mergers have to answer number of specific questions\textsuperscript{13}. First of all, it has to be defined which types of efficiency gains should be taken into consideration. If it should be cost savings and reduction in prices

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\textsuperscript{13} Strohm A., *Efficiencies in Merger Control: All you Always Wanted to Know and Were Afraid to Ask*, 2004, p. 2;
only, or also qualitative benefits in a form of new improved products, services, etc.

Secondly, the competition authorities have to make a choice of welfare standard, i.e. **who is expected to benefit** from the efficiencies when balancing anti-competitive effects of a merger against possible advantages. The old EC merger regulation\(^\text{14}\) was based on German legislation whose structural approach gave no place for efficiency analysis, as mergers were appraised under the test of their ability to increase prices, and did not considered the changes in qualities or other quantities resulting from mergers\(^\text{15}\). Paradoxically, such an approach was not compatible with its provision of costumers' advantage under Article 2.1 (b), which states that efficiency gains may have positive impact on consumer welfare, and therefore they should be taken into consideration\(^\text{16}\).

And eventually, the third question identifies the way under which the efficiency analysis will be implemented into the merger control system. The theoretical studies elaborated several of different approaches, however, two of them will be explained in this paper, as they seem the most likely to be implemented under the EC Merger Regulation.


\(^{15}\) Strohm, op. cit. p. 3;

\(^{16}\) Council Regulation (EEC) No 4064/89, para. 2.1 (b);
2.3.1 Integrated approach

According to Strohm\textsuperscript{17}, the assessment of price reductions caused by the activity of a merger should be integrated into merger regulation as one of the main factors when solving the problem of impact of mergers to the competition. This so-called integrated approach does not assume the efficiencies may be balanced against negative effects on competition, as it is a case in another approach (case-by-case). This analysis is based on partial price-theory, and as a result, it considers efficiencies specific only to this theory. Hence, several conditions were formed to define which kinds of efficiency gains should be taken into consideration.

Firstly, the efficiency gains should be connected with cost savings. For example, the efficiencies generated in a form of new goods are not analyzed, as they do not contribute cost savings in the relevant market. At this point, the question arises which cost savings should be assessed, whether fixed or variable. Theoretically, variable costs from an increase of production alone have impact on prices. Fixed costs do not participate in the price calculation of a profit-based company, as variable cost reductions are its main target\textsuperscript{18}. Hence, the integrated approach will include the reduction of variable costs. Moreover, cost savings have to be precisely quantifiable, which enables to evaluate whether the efficiencies lead to optimal profit at a reduced price.

\textsuperscript{17} Strohm, op. cit., p. 5;
\textsuperscript{18} Strohm, op. cit., p. 6;
According to the price theory, the efficiencies in a form of cost reduction must be achievable in the short term\textsuperscript{19}. The price theory model is comparative-static, i.e. the pre-merger situation will be compared with post-merger situation on an alike demand curve. Any change in demand would alter the profit maximization relationship of price and production.

Concluding, the concept of integrated approach presented by Strohm does not provide comparison of the positive and negative aspects which mergers provide to the market, as under this approach the assessed merger cannot cause any competition problems. In other words, the integrated approach is applied in favor of a merger only in such cases when it leads to reduction of prices.\textsuperscript{20}

This idea was also pointed out by Röller, Stennek and Verboven\textsuperscript{21} who noticed the efficiency justifications are implemented in different ways, depending on the definition of competition. Competition may be described through analysis of the price level, and horizontal mergers may be considered as pro-competitive (reducing prices) and anti-competitive (increasing prices). On the other hand, one may define competition through degree of market power which may be determined by the price to cost mark-up that company charge. According to this definition, all horizontal mergers limit competition at least slightly, and some of them reduce it significantly.

\textsuperscript{19} Ibid.;
\textsuperscript{20} Ibid., p. 7;
2.3.2 Case-by-case approach

The second definition of competition mentioned in the previous subsection provides basics for another way of implementing efficiency concerns into merger control system. According to this definition almost all horizontal mergers should be prohibited, as they impede competition. However, the efficiencies which stem from mergers in question act as a defense which weighs out the accusations of lessening the competition. This approach is based on the Williamson Trade-Off theory in which possible efficiency gains are balanced against anti-competitive effects related with activity of mergers. According to Strohm\textsuperscript{22}, the main idea of efficiency defense is based on so called a rule of reason which was developed in the US legislation and is commonly used in the antitrust legislation. Due to awkwardness of the first American antitrust acts, it was decided to examine whether merger arrangements actually promoted and improved or simply limited the competition. In other words, the possible pro-competitive effects of a given agreement were balanced with anti-competitive practices, and then decision was made if the trade restraint was reasonable or not\textsuperscript{23}.

According to Ilzkovitz and Meiklejohn\textsuperscript{24}, the efficiency defense should be incorporated into the merger control system through case-by-case approach. This approach examines each efficiency gain in every single case of a merger and balances them against all the anti-competitive effects of each individual merger. The main advantage of this approach is that it reduces to the minimum

\textsuperscript{22} Strohm, p.5;
\textsuperscript{24} Röller, Stennek and Verboven, op. cit., 2001, p. 98;
errors which may occur when assessing mergers on a basis of efficiency gains. Firstly, it may happen that authorities approve a merger which cause harm to the competition. Secondly, mergers which generate some efficiency gains may be rejected. The case-by-case approach, due to its individual and explicit character, significantly limits the possibility of making such mistakes. However, such an individual approach to each case provides some difficulties, since it involves extremely high costs of gathering data about market powers of a merger and possible benefits.

2.3.3 General presumptions approach

This approach does not require that much information costs to be taken, as it was a case with the case-by-case approach. It relies on structural indicators of concentration, i.e. market shares or concentration index. On this basis, presumptions are made, that under certain threshold for the structural indicators, benefits produced by mergers are always large enough to weigh out the anti-competitive effects.\textsuperscript{25} For instance, if a threshold of joint market share is set at the level of 25% it may be assumed that up to this level mergers produce positive or at least neutral net effects on competition. It is taken for granted that in mergers, which slightly impede competition, produced efficiencies are more significant than anti-competitive effects.

\textsuperscript{25} Ilzkovitz, op. cit., 2001, p. 22;
2.3.4 Sequential approach

It seems to be possible to conduct and quite reasonable to combine the case-by-case approach with explicit efficiency defense and the presumption approach into one complex theory. The sequential model was suggested by authors related to the Commission and is aimed at reducing the number of cases in which costly efficiency defense is implemented.

In order to do that, a two-fold procedure was elaborated under which a merger agreement was firstly examined under the general presumptions approach and then rejected or accepted, depending on the effect of the analysis. For instance, if a bottom threshold of market share was set at a low level, the pro-competitive effects of a merger agreement, which does not exceed this level, would be assumed to be more significant than possible restrictive effects. Such an agreement would therefore be claimed compatible with a common market. On the other hand, if the authorities positioned the level relatively high (e.g. 60% of joint market shares), an agreement which transcends this level would be presumed to create anti-competitive effects which would dominate over efficiencies.

Secondly, the merger agreements which did not undergo the presumption procedure would be sent for further investigation under which an explicit efficiency defense (case-by-case) would be conducted. The question arises then to what level the threshold of degree of market dominance (above which the

26 Ibid.,
27 Ibid., p. 22-25;
efficiency defense would not be carried out and the merger would be rejected) and the threshold of degree of lack of market dominance (under which the efficiency defense would not be conducted and the merger would be approved) should be set up to provide the most optimal effect. According to Röller, Stennek and Verboven\textsuperscript{28}, if the costs of gathering information fell, both levels should be shifted to the extremes, i.e. L level goes closer to the beginning of the scale, and E level gets closer to the end of a scale (see Figure 1). With lower information costs, it would be less expensive to provide thorough efficiency analysis and thus more cases with usage of case-by-case approach would be possible. Moreover, it would also limit the number of errors of computing the net effects of a merger. On the other hand, if the information costs significantly rose, it would prove to be less costly to shorten the distance between the high and low level of thresholds. Concluding, the implementation of the efficiency defense mostly depends on the costs of gathering information. In a case, when these costs are set up at considerably high level, the efficiency defense becomes too expensive to be conducted, and thus proves to be impractical\textsuperscript{29}.

\textsuperscript{28} Röller, Stennek and Verboven, op. cit., 2001, p. 101;
\textsuperscript{29} Ibid., p.102;
Figure 1 Alternative efficiency defenses

3. Development of the concept of efficiency gains in the EC merger control legislation

This chapter describes how the EC merger control legislation evaluated towards acknowledgement of efficiencies.

First of all, the history of development of the merger control system in the European Community will be presented from its beginning to the implementation of the reformed EC Merger Regulation.

3.1 Development of EC Merger Regulation

The EC competition law has its origins at the very beginning of the European integration. In 1951, the Treaty of Paris under its Article 66.7 provided that the companies which “have or acquire on the market (...) a dominant position which protects them from effective competition in a substantial part of the common market”\(^{30}\) should be prohibited. By this time, the High Authority, the forefather of the European Commission, received competences required to prevent the use of such a dominant position for purposes opposing to fair competition in the common market. In other words, mergers of coal and steel companies required approval of the High Authority.

In 1957, the Treaty of Rome stated that one of the Community aims was to create a system ensuring that competition would not be distorted in the common market.

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\(^{30}\) The Treaty Establishing the European Coal and Steel Community, 1951, art. 66.7;
Further, the Treaty established the competition policy of the European Community by implementing a new chapter titled “Rules Governing Competition” which contains antitrust framework applying to enterprises. It implied more specific provisions under Articles 85 (now Article 81) and 86 (now Article 82) which until now act as a basis for most of the secondary legislation concerning competition, e.g. EC Merger Regulation.

Article 85.1 contained a prohibition of all agreements between undertakings, which might affect the Community trade and which prevented, restricted or distorted competition on the single market, particularly agreements which fixed purchase or selling prices, limited production, development or investment, etc. However, in paragraph 3 the article allows some exemptions from the prohibition, i.e. those agreements which lead to improvement of production or distribution of goods, or to promotion of technical ad economic progress, “while allowing consumers a fair share of the resulting benefit”\(^\text{32}\). Nevertheless, the exempt agreements cannot give a possibility of eliminating competition concerning a substantial part of the product in question, and enforce restrictions which are not essential for achieving the above objectives.

The provisions of Article 86 enclosed an understanding of any abuse of a dominant position, as incompatible with the single market in situation of influencing trade between Member States. The conditions under which such an abuse takes place is similar to those presented in the Article 85.1, i.e. fixing

\(^{31}\) Article 3 (f) of the Treaty Establishing the European Economic Community, Rome, 25.03.1957 (non-consolidated version) (Treaty of Rome);

\(^{32}\) Article 85 (3) of the Treaty of Rome;
prices, limiting production, etc. However, different from the previous article, the Article 86 does not allow any exemptions from the prohibition.

Although the general provisions of Article 85 and 86 of the Treaty of Rome impose the prohibition of some concentrations, they do not provide any specific rules to all the merger aspects and this gap had to be filled out by the Court of Justice case law. For example, Continental Can decision under which the Court ruled that that there was an abuse of a dominant position if an enterprise, already holding a dominant position, strengthened it by acquiring a competitor. After several other cases of this type, it was decided that proper legislation should be adopted to supervise not only mergers which already existed, but also future agreements between firms which would create future mergers.

### 3.1.1 The EC Merger Regulation

In 1989 the Council of Ministers implemented the Regulation No 4064/89 on the control of concentrations between undertakings, which built specific rules of law directed at significant mergers. In Recital 6 we read that the articles of the EEC Treaty which concern competition issues were not sufficient to control all operations which might prove to be incompatible with the common market. The EC Merger Regulation provided the EC competition law with a very specific tool

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34 Judgment of the Court of 21 February 1973,
35 Ibid.;
37 Recital 6 to the ECMR (1990);
of unitary control for concentrations, which required pre-notification to the European Commission for assessment of the agreements.\textsuperscript{38}

The Regulation itself outlined conditions under which a concentration between undertakings fell under prohibition of Article 81 and 82 of the EC Treaty. It applied to all the concentrations which had a Community dimension which was measured by its size (in terms of “Community-wide turnover”) and influence on the Community market (international character).

\textbf{3.1.2 The reform}

After ten years of existence of the Merger Regulation, in 2001 the Commission published Green Paper which started a wide-ranging debate on the reform of the system of merger control\textsuperscript{39}. Consequently, the Council adopted in 2004 the new Merger Regulation No 139/2004.\textsuperscript{40}

Under this reform, the merger control regime was said to alter towards more significant flexibility in procedural terms, higher effectiveness in jurisdictional terms and greater transparency in substantive aspects. The jurisdictional organization was improved in order to streamline the process of referrals to and from the Commission. The rewording of substantive test eventually caused that oligopolies and all the other post-merger situations which threaten competition


\textsuperscript{39} Rules applicable to firms..., op. cit.;

\textsuperscript{40} Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), O.J. L24/1;
became covered by the test.\textsuperscript{41} The old dominance test was replaced by the new one which was wider in scope. In the Article 2.3 of the new ECMR is stated that those mergers should be prohibited which significantly impede effective competition, so it varies from the character of the old regulation which aimed mostly at showing strengthening or creation of dominant position. Of course, abuse of dominant position remains the most significant impediment for competition, thus it is still under Commission’s highest consideration.\textsuperscript{42} In Recital 26, it is stated that concentrations incompatible with common market are those which “significantly impede effective competition, in the common market or in a substantial part thereof, in particular as a result of the creation or strengthening of a dominant position”. The Recital 25 of the ECMR provides some guidelines on this matter under which in some situations oligopolistic markets may involve the elimination of important competitive restraints that the merging undertakings had exercised upon each other, as well as a reduction of competitive pressure on the remaining competitors. These circumstances in effect may cause significant impediments to the competition even if the parties to the oligopoly do not coordinate their behavior, and even if the merger is not the largest company in the market\textsuperscript{43}.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{41} Merger control: Merger review package in a nutshell, http://ec.europa.eu/comm/competition/publications/special/3_merger.pdf;
\item \textsuperscript{42} Ibid.;
\item \textsuperscript{43} Ilzkovitz, 2006, p. 54;
\end{itemize}
\end{footnotesize}
3.2 Development of the concept of merger efficiencies in the EC legislation

The efficiencies appeared for the first time in the EC merger regulation as one of the factors which are taken into account when appraising the mergers. Although the wording of the old and new regulations does not differ at this matter, as they both emphasize importance of the development of technical and economic progress provided that it is to customers’ advantage and does not provide an obstacle to competition, the character of implementation of this condition changed significantly.

Under the old regulation, the requirement that mergers should provide economic and technical progress, which does not harm competition, seems to reject any efficiency claims of the merging parties, as raising the efficiency of the merger causes an increase of its market power. In OECD report on competition policy and efficiency claims in horizontal agreements (1996), it is concluded that that “there is no legal possibility of justifying an efficiency defense under the Merger Regulation. Efficiencies are assumed for all mergers up to the limit of dominance - the ‘concentration privilege’. Any efficiency issues are considered in the overall assessment to determine whether dominance has been created or strengthened and not to justify or mitigate that dominance in order to clear a concentration which would otherwise be prohibited.

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44 Council Regulation No 4064/89, Article 2.1 (b);
45 Ilzkovitz, 2006, op. cit., p. 55;
Everything changed after the reform in 2001. The new merger regulation, besides the provisions of Article 2.1 (b), provides in recital 29 the first exact indications of the role of efficiencies in the assessment of mergers. It emphasizes the need to taking any substantiated and likely efficiencies into account which will determine the impact of a merger on competition in the common market. It states further that efficiencies generated by a merger may outweigh the potential negative effects on competition and customers.

Nevertheless, it seems to be quite strange that decision-makers which formulated the new regulation did not change the wording of Article 2.1 (b), but resorted only to incorporate efficiency issues into the preamble. Logically, if the rules that had been worked out by the Commission in the old regulation were exercised in the new regulation, it would cause contradictions within one and the same regulation. Hence, commentators suggest such an interpretation of this problem that the recital can be interpreted as comparing “effects of competition” with “potential harm to customers”\(^{47}\). Further, the Commission issued the guidelines which present its view towards many aspects of the Merger Regulation among which the role of efficiencies was included.

However, before analyzing the Merger Regulation and the guidelines in the context of efficiency gains, it is necessary to provide some information on the case law elaborated by Community institutions which may provide some hints on how to interpret the ECMR in regards to merger efficiencies.

\(^{47}\) Ilzkovitz, 2006, op. cit., p. 56;
3.3 Pre-2004 case law

One of the main changes brought by the new regulation was introduction of efficiency gains into the investigation of mergers. This controversial aspect appeared throughout the years in the Commission investigations. In this section, the analysis of the Commission’s cases pre-2004 reform will be held.

3.3.1 AT&T/NCR

The Commission met efficiency concerns for the first time while analyzing the acquisition of a small computer and telecommunication company NCR by a potentate in this market, i.e. AT&T. Although both companies were American, they had some businesses performed in the European Union, so that the Commission began the procedure to claim if the concentration infringed EC legislation.

During the procedure, the Commission raised a question if a flow of technological and marketing know-how from AT&T would improve the position of NCR in the future. Although it did not found any serious reasons to support this thesis, the Commission did not exclude a possibility that potential benefits stemming from the concentration may have created or strengthened a dominant position.

The Commission in its final decision found out that the acquisition did not raise serious doubts as to its compatibility with the common market. In these

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49 Ibid., para. 2;
proceedings efficiencies were not taken into account, as it was unclear if they would be realized and proved in the future. However, the Commission’s viewpoint in this matter seemed to be certain towards so called efficiency offence. “On the basis of the information currently available to the Commission concerning the present situation and future developments in these markets, these potential benefits to AT&T/NCR do not lead to the conclusion that the concentration will result in the creation or strengthening of a dominant position”.50 It means that if the Commission did not find the benefits large enough to strengthen the position of the merger and did not prohibit the merger on basis of efficiencies. However, the interpretation shows if the Commission found the efficiencies significant enough, it would take them into account as another proof against the merger.

3.3.2 Aerospatiale/Alenia/De Havilland

In the next case, French Aerospatiale and Italian Alenia, two companies active in aerospace business, jointly acquired Canadian De Havilland company which specialized in production of turbo propeller planes. The acquisition was made through a company which was jointly controlled by the former firms where these two already formed a concentration. The companies in question claimed that through acquisition of De Havilland, they would reduce costs which would stem from rationalizing parts of procurement,

50 Ibid., para. 31;
marketing and product support. However, the Commission considered those cost savings not significant enough to outweigh the anti-competitive effect of the concentration. Moreover, the “doubtful” efficiencies were said not to arise from the concentration itself, but could be achieved by any other De Havilland owner. The Commission also did not consider the merger to “contribute to the development of technical and economic progress” within the meaning of Article 2.1 (b), and even if there was such a development, it would not be “to the consumers’ advantage”. In spite of the benefits, consumers would cope with a dominant position of the concentration which might cause a risk of transferring into a monopoly.

Concluding, although the Commission did not consider efficiency claims as a mean lessening anti-competitive effects of the merger, it presented first indications of how the future efficiency concerns should be examined. In its conclusions, the Commission clearly stated that efficiencies should be significant and merger specific and they ought to be advantageous to customers.

### 3.3.3 Air France/Sabena

The Air France/Sabena case is one of the first Commission cases where rather thorough assessment of efficiencies was held. The merging parties claimed the

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52 Ibid.;  
53 Ibid., para. 69;  
54 Air France/Sabena Case No IV/M157 [1992] OJ C 272;
efficiencies in a form of providing new service shuttle would benefit customers. The new routes, however, were declared by the Commission as incompatible with a common market as they led to creation of dominant position in certain markets (routes: Paris-Brussels, Nice-Brussels and Lyon-Brussels). Only the Paris-Brussels route was cleared thanks to existence of a highspeed train connection which was said to be complementary (not perfectly though) to the air route service offered by the merging parties. Nevertheless, the Commission did not declare the benefit to customer as an effect justifying the creation of a dominant position.

3.3.4 ACCOR/Wagon-Lits

In ACCOR/Wagon-Lits case, the Commission did not pay much attention to the claimed efficiency gains. The claimed efficiencies, in a form of increased productivity, were said to be vague and insubstantial, and thus had not been a subject for evaluation. Further, the Commission expressed serious doubts on if the efficiencies were merger specific and if they would be passed on to customers.

3.3.5 MSG Media Service

In the MSG Media Service case it went back to the tradition of avoiding clear attitude towards pro-competitive effects of mergers. MSG Media Service was

formed as a concentration of three German leading companies in the media and telecommunications industry. It aimed at providing technical, business and administrative handling of payment-financed television and other communication services, including conditional access and subscriber customer management, as well as the provision of the necessary technical infrastructure for the supply of such services and all related businesses.\textsuperscript{56} According to the Commission, MSG Media Service affected competition in some of these markets.

The parties presented efficiency claims referred to Article 2.1 (b) under which services of the joint venture would promote spread of digital television.\textsuperscript{57} However, the Commission observed that the provision of technical and economic progress did not apply to activities which restricted competition. It shows that the Commission would only accept efficiencies if they outweigh the anti-competitive effects within the same activities. Further, the Commission doubted if the advantages offered by MSG would really contribute positively to the development of technical and economic progress.

\textbf{3.3.6 Nordic Satellite Distribution}

In Nordic Satellite Distribution case, the Commission regarded a joint venture established by three Scandinavian companies as incompatible with the common market. The Nordic Satellite Distribution (NSD) was formed to provide the satellite transmission services via cable networks or direct-to-home broadcasts.

\textsuperscript{57} Ibid., para. 100;
for TV programs in three Nordic countries: Denmark, Sweden, Norway and Finland.\textsuperscript{58}

The parties decided to refer to the clause of technical and economic progress under Article 2.1 (b) and claimed that the NSD would create in short to medium term improvements of distribution of satellite TV in Nordic market. In the long term, the company was supposed to make substantial rationalizations possible for cable TV operators and other networks to the consumers’ benefit.\textsuperscript{59} However, the Commission did not share this reasoning, as in its opinion the declared short-term efficiencies were unlikely to be achieved.\textsuperscript{60} As far as the long term economic advantages to consumers were concerned, the Commission recognized them as possible to cause anti-competitive effects on the market. Therefore, even if the joint venture provided an infrastructure which could be highly efficient and beneficial to consumers, the creation of such an infrastructure would not necessary be essential with use of restrictive means\textsuperscript{61}. In other words, the efficiencies proposed by the parties were not specific to the concentration.

\textbf{3.3.7 ABB/Daimler-Benz}

The ABB and Daimler-Benz decided to merge in the field of rail transportation which would lead to creation of the world largest company on the market. The Commission’s conclusion on the transaction was the following. “[...] the transaction will not worsen the situation; structurally speaking it will tend to

\textsuperscript{58} Nordic Satellite Distribution Case No IV/M.490, Commission Decision 96/177/EC [1996] OJ L 53/20, para. 4;
\textsuperscript{59} Ibid., para. 145;
\textsuperscript{60} Ibid., para. 146;
\textsuperscript{61} Ibid., para. 151;
improve it. It can be assumed that the cooperative arrangements entered into in the past were the result of the lack of capacity of competitors, or at least German competitors other than Siemens, to make an independent tender for the manufacture of mainline train sets. It may be that significant competition internal to the duopoly will arise after the transaction because cooperation between Siemens and AEG on the ICE project will come to a stop, but that cannot yet be said with sufficient certainty. The fact that Siemens and GEC Alsthom have announced that they will be cooperating on the marketing of the ICE and TGV high-speed trains outside Europe may be an indication that there will indeed be more competition inside the duopoly on this market. 62 This ruling shows that, adversely to the Air France/Sabena case, the efficiencies acted advantageously for the transaction and was the efficiencies analysis was an important part of the decision making process.

3.3.8 Ciba-Geigy/Sandoz 63

In this case, the Commission evaluated the role of claimed dynamic efficiency within the merger in a chemical sector. The parties declared creation of efficiency gains – R&D synergies and economies of scale being effect of the synergies. However, similarly to Air France/Sabena case, the Commission stated that the efficiencies would lead to an additional strengthening of the new entity's R&D

63 Ciba-Geigy/Sandoz Case No IV/M737, Commission Decision 97/469/EC [1997] OJ L 201/1;
potential and therefore, might cause serious competition concerns in the crop protection sector.

3.3.9 Danish Crown/Vestjyske Slagterier

In this case, the Commission investigated the compatibility with the EC law a merger of two largest Danish slaughterhouses. The parties claimed that the merger would result in large costs savings, achievement of volumes which would enable the merger to supply consumers with a full assortment and which would make it possible to maintain the market position on the Japanese market.\(^{64}\) In its decision on this matter, the Commission explained that Article 2.1 (b) of the Merger Regulation takes into account the development of technical and economic progress only to the extent that it was to customers' benefit and did not cause an obstacle to competition. Therefore, the efficiencies claimed by the Danish companies could not have been taken into consideration, as they created a dominant position. In other words, if the creation of a dominant position was once declared by the Commission, the efficiencies would not be taken into account, i.e. efficiency defense would have no practical scope.\(^{65}\) Besides, the Commission was not sure if the cost savings could not have been achieved (at least partially) without the merger and whether it was not impossible for parties to

\(^{64}\) Danish Crown/Vestjyske Slagterier Case No IV/M.1313, Commission Decision 2000/42/EC [2000] OJ L 20/1, para. 198;

\(^{65}\) Ilzkovitz, op. cit. p. 15;
merge with other partners, whereby similar advantages could have been attained.\textsuperscript{66}

### 3.3.10 GE/Honeywell

In 2000, American advanced technology and production companies conducting business also in the EU decided to enter into a merger agreement, under which Honeywell became wholly owned subsidiary of GE.\textsuperscript{67} The Commission analyzed several aspects of the transaction and eventually pointed out an idea of the merging parties to bundle some products and services, are likely to support creation of a dominant position. The parties offered so called mixed bundling which relied on selling complementary products together at a price lower than the price charged when selling separately which in result would benefit customers.\textsuperscript{68} However, the Commission considered such selling techniques as increasing likelihood of market foreclosure and thus subsequently eliminating the competition in the markets where the bundling was proposed.\textsuperscript{69} According to its argumentation, in short to medium term the incentives for the merger to sell bundles of products might change. For example, when new generations of aircraft equipment were launched, instead of bundles of products the company might offer technical bundling, i.e. the products would be available only as an integrated system which was incompatible with individual elements offered by

\textsuperscript{66} Danish Crown, op. cit. para. 198;  
\textsuperscript{67} GE/Honeywell Case No IV/M.2220, Commission Decision 2004/134/EC [2004] OJ L 48/1, para. 5;  
\textsuperscript{68} Ibid., para. 351;  
\textsuperscript{69} Ibid., para. 354;
competitors.\textsuperscript{70} This of course could reduce profits of competitors and eventually lead to their withdrawal from the market.

Due to the above mentioned reasons, the Commission concluded that the merger of GE and Honeywell would lead to the creation or strengthening of a dominant position on the aircraft production market, and therefore should be declared incompatible with the common market.\textsuperscript{71} What is worth mentioning, the same case was held in the USA and the merger was approved by American antitrust institutions. Consequently, the European Commission decision met fierce criticism not only from the US antitrust agencies, but also from economists, antitrust legal scholars and editorial writers.\textsuperscript{72} According to US Department of Justice (US DoJ), efficiency and aggressive competition benefit consumers, even if they make other companies lose market shares or even withdraw from a market.\textsuperscript{73} Further, the US DoJ concluded that creating a merger might help companies to improve their ability to compete, and therefore, the US antitrust authorities believed it illogical to prohibit mergers, since they generated efficiencies or innovations.\textsuperscript{74}

\textsuperscript{70} Ibid.;
\textsuperscript{71} Ibid, para. 567;
\textsuperscript{73} Ibid., p. 6;
\textsuperscript{74} Ibid., p. 7;
4. Efficiency gains under the EC Merger Regulation no 139/2004

In order to analyze the role of efficiencies under the new EC Merger Regulation, the recent case law will be examined. Since the acceptance of the ECMR in 2004, the number of Commission cases concerned with efficiencies was not large. The analysis of the case law will be limited to those decisions which may enlighten the point of view of the Commission towards the efficiencies, i.e. Procter & Gamble/Gillette, Korsnäs/AssiDomän Cartonboard, Inco/Falconbridge, Repsol Butano/Shell Gas (LPG), Aster 2/Flint Ink.

The examination of the new Commission’s practice in respect to efficiencies will be held in the second part of the chapter. The basis for the analysis will be the guidelines issued by the Commission which stipulate that efficiencies will be taken into account only on the following cumulative conditions:

- benefit consumers,
- be merger specific,
- be verifiable.

4.1 Post-2004 case law

75 Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, (2004/C 31/03) (Horizontal Mergers Guidelines); Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings, (2008/C 265/07) (Non-horizontal or Vertical Mergers Guidelines);
4.1.1 Procter & Gamble/Gillette\textsuperscript{76}

In the Procter & Gamble/Gillette case, the parties claimed the efficiencies stemming from the merger in a form of enlargement of the product portfolio. These efficiencies were said to benefit customers, e.g. by having only one partner to negotiate with (one-stop-shop), suppliers having stronger innovation capacities, and economies of scale and scope (e.g. offering a full truckload of the same product or even a full truckload of products from the same factory). As a conclusion, the transaction was assumed to be unlikely to lead to foreclosure of competitors as a result of bundling non-complementary products.\textsuperscript{77}

Eventually, the Commission decided not to oppose the merger and declared it compatible with the law. However, the efficiencies were not the main and deciding factor for total clearance of the operation, but one of the several others.

4.1.2 Repsol Butano/Shell Gas (LPG)\textsuperscript{78}

In the Repsol Butano/Shell Gas (LPG) case, the Commission acknowledged the efficiencies claimed by the parties, but again, it was one of the factors to declare the concentration compatible with the common market.

The acquisition of Shell Gas, and in particular of its LPG infrastructure, was said to give to Repsol the ability to compete more effectively in the Portuguese markets and challenge the Galp’s and BP’s position. Having access to Shell’s

\textsuperscript{76} COMP/M.3732, Procter & Gamble/Gillette, 15 July 2005.

\textsuperscript{77} Ibid. para. 131;

\textsuperscript{78} COMP/M.3664, Repsol Butano/Shell Gas (LPG), 2 March 2005.
LPG infrastructures, Repsol would significantly reduce its transport costs and gain the needed flexibility to more effectively operate and compete in the Portuguese markets. Furthermore, it would have a strong incentive in fully profiting of the synergies and economies of scale which it might realize operating on a wider scale in the two sides of the border.79

4.1.3 Aster 2/Flint Ink80

Again, the Commission concluded that the concentration will not significantly impede effective competition in the common market, but the efficiencies were not the main and deciding factor for the clearance. In the Aster 2/Flint Ink case, the merging parties brought about reasoning that the new entity was probable to extract cost and R&D synergies, which could result in stronger competition with other firms.

4.1.4 Korsnäs/AssiDomän Cartonboard81

Although the Commission for the next time didn’t recognize the efficiencies as the most important factor for mitigating anti-competitive effects of the merger, it provided the most detailed analysis of the efficiencies since the ECMR reform. Particularly, the following issues raised are worth mentioning:

79 Ibid., para. 33-34,
81 COMP/M.4057, Korsnäs/AssiDomän Cartonboard, 12 May 2006
the extended product portfolio would allow the merged entity to compete more effectively with the main competitor (StoraEnso) than Korsnäs and AD Cartonboard separately,\textsuperscript{82}

- efficiencies in a form of savings in input cost, reductions in personnel costs and improvement in production efficiencies were likely to appear. Korsnäs estimated that these three categories of savings will amount to 0-5\% of the net sales of the merging parties (including products other than liquid packaging boards),\textsuperscript{83}

- the Commission also acknowledged that customers could benefit from R&D generated by the merger, as well as from implementing best practices across the two production sites,\textsuperscript{84}

- the Commission’s market investigation revealed that according to respondents, the proposed transaction entails a certain scope for efficiencies, although they did not all agree that the benefits would be substantial and passed on to consumers. However, a large majority of converters and competitors agreed that the broader portfolio of the merged entity would improve the ability of the merged entity to better compete with other main competitor, StoraEnso,\textsuperscript{85}

- in other part of the analysis, the Commission repeats after the guidelines that in order to take into account efficiency claims in its assessment, it

\textsuperscript{82} Ibid. para. 35.
\textsuperscript{83} Ibid, para. 57.
\textsuperscript{84} Ibid. para. 58.
\textsuperscript{85} Ibid. para. 60.
must be in a position to reach the conclusion that the efficiencies are merger specific, verifiable and benefit consumers,

- the Commission stated that “it appears realistic to assume that the allocation of production among the increased portfolio of machines will indeed allow the merged entity to increase overall production on the machines (for instance by running longer batches thereby reducing time spent on switching). In light of the abovementioned term sheet agreement with Tetra Pak and on the general absence of concern about the transaction among customers, the Commission considers that the parties have sufficiently established that this category of efficiencies is likely to occur and be passed on to consumers”.

Concluding, the Commission confirmed the merging parties efficiency claim that the efficiencies were likely to enhance the ability and incentive of the merged entity to act pro-competitively for the benefit of consumers, and therefore strengthen the conclusion that the proposed transaction will not significantly impede effective competition as a result of non coordinated effects.

### 4.1.5 Inco/Falconbridge

In another case, however, the Commission declined the efficiencies claims of the merging parties. It was discovered that the efficiency gains brought about by the proposed transaction would most likely not benefit directly consumers and

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86 Ibid. para. 63.
87 Ibid. para. 64.
88 COMP/M.4000, Inco/Falconbridge, 4 July 2006.
would thus not counteract the adverse effects on competition. The parties claimed that the efficiencies were likely to be achieved from the close proximity of their respective mines/processing facilities in the Sudbury basin, which would help them to optimize their mining and processing operations. This would allegedly result in increased production at lower cost and would benefit all nickel customers. However, the Commission accused the parties to have failed to demonstrate that the efficiencies brought about by the proposed transaction were not attainable with a less anti-competitive alternative (not merger specific) and would directly benefit end customers in the three relevant product markets where competition concerns had been identified. For these reasons, the Commission did not declare the presented efficiencies to be considered to offset the adverse effect of the proposed transaction on competition.

4.2 Benefit to consumers

The Guidelines provide main and quite general view on which kinds of efficiencies are probable to be investigated. In paragraph 79, it is described that “efficiencies should be substantial and timely, and should, in principle, benefit consumers in those relevant markets where it is otherwise likely that competition concerns would occur”.

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89 Ibid. para. 5.
90 Ibid, para. 31.
4.2.1 Which types of efficiencies benefit customers?

Firstly, it is necessary to identify types of efficiencies which are the most probable to benefit customers, substantial and timely. The Guidelines\textsuperscript{91} allow not only cost savings, but also other efficiencies stemming from mergers’ activity. They do not specify, however, to what extent they should benefit customers to be called “substantial”. In the Aerospatiale/Alenia/De Havilland case, the Commission considered the claimed efficiencies (in a form of cost savings that amounted to 0.5% of the post-merger turnover) not to be sufficient enough.\textsuperscript{92} Whereas, in the Korsnäsfors Assidomän Cartonboard case, the Commission declared the savings, which were expected to amount up to 5% of the net sales of the merging parties, as substantial. It may suggest that the Commission takes now a, so called, sliding-scale approach\textsuperscript{93}, i.e. the greater the possible anti-competitive effect the greater the claimed efficiencies should occur. The guidelines also point out that in a case of an intensive concentration (up to a monopoly) it is very unlikely that the efficiencies would be large enough to be counted as a proof allowing for the concentration.\textsuperscript{94} Very unlikely, but possible – in Korsnäsfors Assidomän Cartonboard case the Commission accepted the efficiencies, even though the merger led close to a duopoly.

\textsuperscript{91} Horizontal Mergers Guidelines, op. cit., para. 80;
\textsuperscript{92} Aerospatiale/Alenia/De Havilland case, op. cit., para. 65;
\textsuperscript{93} Davies J., Schlossberg R., Efficiencies – a changing horizon in horizontal merger control, Freshfields Bruckhaus Deringer, 2007, p. 6;
\textsuperscript{94} Horizontal Mergers Guidelines, op. cit., para. 84;
Static efficiencies

The EU guidelines are not that specific in this matter and draft a general view that “cost savings in production or distribution may give the merged entity the ability and incentive to charge lower prices following the merger”\(^95\). It may be concluded then that the efficiency gains allowed by EU authorities stem from such processes, as rationalization, economies of scale and scope, and other productive efficiencies, because they lead to lowering the prices. Analyzing the most recent cases, the parties claimed and the Commission acknowledged some specific types of static efficiencies, i.e.:

- economies of scale and scope - Procter & Gamble/Gillette, Korsnäs/AssiDomän Cartonboard, Repsol Butano/Shell Gas (LPG),
- costs reductions - Korsnäs/AssiDomän Cartonboard, Inco/Falconbridge, Repsol Butano/Shell Gas (LPG), Aster 2/Flint Ink.

Fixed and variable costs

The Horizontal Guidelines provide cost savings in production and distribution as an example of efficiencies which may encourage merged parties to charge lower prices than before the merger\(^96\). According to the Commission, reductions in variable or marginal costs are more likely to provide lower prices for customers and, therefore, they will be more valuable source of efficiencies in the mergers’ appraisal. Generally, fixed costs savings are said not to be so closely related to

\(^{95}\) Ibid., para. 80;
\(^{96}\) Ibid., para. 80;
the prices of goods and services, especially in the short term\textsuperscript{97}, and therefore, the Commission would not put so much weight on them.

Efficiencies in relevant or other markets

The new Merger Control regime includes efficiencies emerging in relevant markets only. “Efficiencies (...) should, in principle, benefit customers in those relevant markets where it is otherwise likely that competition concerns would occur”.\textsuperscript{98} It is said that the complete cost-benefit analysis should also include cost savings realized in other markets, but such an analysis turns out to be quite complex and costly. Moreover, if such gains were analyzed, anti-competitive effects related to other markets should also be included, e.g. the benefits for consumers in one market should be weighted against the anti-competitive effects in another market where competition is harmed.\textsuperscript{99}

The Commission in its Inco/Falconbridge ruling stated that the efficiencies should particularly benefit customers in three relevant product markets where competition concerns had been identified.\textsuperscript{100} It proves the Commission takes into account only efficiencies existing in the relevant markets.

Another important issue is a situation when a merger creates benefits to customers in one market, but causes negative competition concerns in another one. The question is if the efficiencies in one market can outweigh the anti-competitive effects in another. In the consumer welfare standard, which probably

\textsuperscript{97} Ibid., footnote 107;
\textsuperscript{98} Ibid., para. 79;
\textsuperscript{99} Röller, 2006, op. cit. p. 139;
\textsuperscript{100} Inco/Falconbridge case, op. cit., para. 31;
is used by the Commission (details in the next subsection), a merger may be allowed only if the consumers are better off or at least their situation does not change after the merger agreement. In the above mentioned case, customers in other market would be harmed, so the general rule would be infringed. However, the EU officials stated that it would be reasonable to allow a trade off between pro-competitive effects in one market with anti-competitive effects in another market when the products are complementary and where efficiencies would, therefore, benefit the same group of customers.\textsuperscript{101}

Other efficiencies in non-horizontal mergers

The Non-horizontal Mergers Guidelines indicate that vertical and conglomerate mergers also provide substantial scope for efficiencies\textsuperscript{102}. Because vertical and some conglomerate mergers produce complementary products or services, the common activities of the merged companies may generate substantial efficiencies and be pro-competitive. The Non-horizontal Mergers Guidelines point out some examples of kinds of efficiencies which stem from the process of complementarity:

- internalization of double mark-ups – it means decrease in mark-ups downstream which is likely to provide higher demand also upstream; hence, vertical consolidation may lead to greater incentive for price decrease and output increase due to the fact that consolidated company

\textsuperscript{101} Davies J., Schlossberg R., op. cit., p. 7;  
\textsuperscript{102} Non-horizontal Guidelines, op. cit., para. 13;
may absorb the larger fraction of benefits\textsuperscript{103}; however, it should be mentioned that the efficiencies concerned with double mark-ups may not always be merger-specific and, as such, they cannot be taken into account;

− savings in inventories costs as a result of better coordination of production and distribution processes\textsuperscript{104};

− incentives of the parties with regard to investments in new products, new production processes and in the marketing of products, e.g. pre-merger, a downstream entity could not be reluctant to invest in marketing or information campaigns targeted to customers about the qualities of upstream company’s products; post-merger, it is very likely that such a marketing strategy would be used\textsuperscript{105};

− specifically, conglomerate mergers may provide cost savings in a form of economies of scope e.g. by using “mixed bundling”, that is, by supplying goods together rather than separately\textsuperscript{106};

\textit{Dynamic efficiencies}

In paragraph 81 of the Guidelines, the Commission points out that consumers may also benefit from new or improved products or services. As an example, it

\textsuperscript{103} Ibid.;
\textsuperscript{104} Ibid., para. 56;
\textsuperscript{105} Non-horizontal Guidelines, op. cit., para. 57;
\textsuperscript{106} Ibid., para. 118;
provides efficiencies resulting from gains in the sphere of R&D and innovations. For example, a joint venture company set up in order to develop a new product may bring about the type of efficiencies that the Commission can take into account.

In the case law, the Commission does not always accept the pro-competitive role of dynamic efficiencies. Before 2004 reform, in the GE/Honeywell ruling the parties’ claims on efficiency gains stemming from mixed bundling (as a new product, not a reason of economies of scope) met accusations of causing anti-competitive effects. After 2004, the Commission accepted and claimed dynamic efficiencies in number of cases, e.g.:

- enlargement of a product portfolio - *Procter & Gamble/Gillette, Korsnäs/AssiDomän Cartonboard*;

- R&D synergies - *Korsnäs/AssiDomän Cartonboard, Aster 2/Flint Ink*.

However, due to its characteristic, it is more difficult for merging parties to claim dynamic efficiencies compatible with Commission’s requirements, such as verifiability, substantially, timeliness and quantified (wherever possible).

### 4.2.2 Timely

As far as timeliness is concerned, the Commission will examine whether entry would occur in relatively short period of time and be sustained to deter or defeat the use of market power. What makes an appropriate time period, depends on the characteristics and dynamics of the market, as well as on the specific
capabilities of potential entrants. However, the Commission will accept only those efficiencies which occur within two years.\textsuperscript{107} In Korsnäs/AssiDomän Cartonboard case, some of the claimed efficiencies were claimed to be generated shortly after the completion of the transaction and the Commission seemed to be comforted with the merging parties’ assurance.\textsuperscript{108} It the case of timeliness, again, the Commission undertakes the sliding-scale approach, i.e. the later the efficiencies will be realized and passed on to customers, the less importance they will have during the merger control procedure.

\textbf{4.2.3 Welfare standard}

First indications on which welfare standard should be used by the competition authorities is contained in the Article 2.1 (b) which clearly states that appraisal of concentrations should take into account “development of technical and economic progress provided that it is to consumers’ advantage and does not form an obstacle to competition”. In Recital 29 to the ECMR and in paragraph 76 of the Horizontal Guidelines, it is said that efficiencies may outweigh the negative effects on competition and in particular the potential harm to customers. Besides, according to the guidelines, mergers may be allowed if they generate different types of benefits which can lead to reduction of prices or other advantages to consumers\textsuperscript{109}, under condition that consumers would be not worse off than

\textsuperscript{107} Horizontal Mergers Guidelines, op. cit., para. 74;
\textsuperscript{108} Korsnäs/AssiDomän Cartonboard case, op. cit., para. 59;
\textsuperscript{109} Horizontal Mergers Guidelines, op. cit, para. 80;
before the merger. Consistent with this, the Commission seems to choose the price standard or consumers’ surplus standard.

The price standard implies that the post-merger price should not be higher, i.e. it should fall or at least remain unchanged, so the condition of not deteriorating consumers’ situation is completed. However, this standard takes into account price efficiencies only and ignores non-price benefits, e.g. in a form of product or service improvements. Moreover, it allows price efficiencies to cause some losses in quality of a product or service, and therefore provide some disadvantages to customers. For instance, if a company reduced the number of brands due to a merger, the price standard would approve it, but the consumers’ welfare would be lower due to quality losses.

In the guidelines we read that the non-price efficiencies (“new or improved products or services, for instance resulting from efficiency gains in a sphere of R&D and innovation”) should also be allowed, so the welfare standard chosen by the Merger Regulation actually is the consumers’ surplus standard. It means that no matter what kind of efficiencies are considered, price or non-price, a merger may be allowed only if the consumers are better off or at least their situation does not change due to a merger. For example, even if the post-merger prices rise consumers may still remain better off, as they benefit from product or service improvements which are high enough to outweigh the

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110 Ibid., para. 79;
113 Horizontal Mergers Guidelines, op. cit, para. 81;
negative price effects of a merger. Of course, the question of verifiability and quantifiability of such an efficiency arises (this particular issue will be examined in the following sections).

The previous practice of the Commission in accordance to Article 81.3 of the EC Treaty may prove the choice of consumers’ surplus standard under the Merger Regulation, as it seems not to be consistent to use different standards to each competition rule. Indeed, the EC competition law aims at promoting consumer welfare.\textsuperscript{114} Although the Merger Regulation welfare standard differs from the one used in Article 81.3 (the condition of “allowing consumers a fair share of the resulting benefit”\textsuperscript{115} sounds less consumer oriented than the “it is to consumers’ advantage” of the Merger Regulation\textsuperscript{116}), the main idea remains the same. According to the guidelines on the application of Article 81.3\textsuperscript{117}, the fair share of benefits relates to overall benefits, meaning customers do not have to obtain a share of each and every advantage indicated by the first condition of Article 81.3. Speaking more precisely, the net effect of the restriction must be at least neutral to the customers directly or indirectly affected by the restriction.

\section*{4.3 Merger specificity}

The Commission ruling in several cases (De Havilland, Nordic Satellite Distribution, Danish Crown, Inco/Falconbridge, Korsnäs/AssiDomän)

\begin{footnote}
\textsuperscript{114} Rakovsky C., Verouden V., 2003, op. cit., p. 205;
\textsuperscript{115} Article 81.3 of the EC Treaty;
\textsuperscript{116} Röller, Steank, Verboven, op. cit., p. 82;
\textsuperscript{117} Guidelines on the application of Article 81.3 of the EC Treaty, para. 81;
\end{footnote}
Cartonboard) required efficiencies to stem from mergers, i.e. they should emerge as a direct consequence of the merger in question and there should not exist any less restrictive way of achieving these benefits. Of course, the undertakings are not required to find any hypothetical or theoretical alternatives which do not meet with market conditions and business realities. For example, in the Korsnäs/AssiDomän Cartonboard case, the Commission stated that in order to be taken into account the efficiencies should be taken into account as a counteracting factor.\textsuperscript{118} In the case of extended product portfolio benefit, it would be rather difficult to achieve them through a joint venture.

The guidelines provide some examples of alternatives which may be used in this case:

- practices of non-concentratative nature – a licensing agreement, a cooperative joint venture;
- practices of a concentrative nature – a concentrative joint venture, a differently structured merger.

A common practice among merging companies is claiming such efficiencies as avoidance of duplication in R&D works or access new technologies. In fact, the same objectives could be attained through joint ventures and cooperative agreements\textsuperscript{119}.

Similar problem was discussed in guidelines on application of Article 81.3 of the EC Treaty. It noticed a dilemma what if the invoking undertakings could have

\textsuperscript{118} Korsnäs/AssiDomän Cartonboard case, op. cit., para. 61;
gained the efficiencies on their own, without signing up an agreement. For example, when the parties of restrictive agreement plan to generate cost savings stemming from economies of scale or scope, they are obliged to clarify why the same savings would not be achievable through internal growth and price competition. In this case, the Commission suggests using the minimum efficient scale on the relevant market. Basically, it means that the smaller the minimum efficient scale compared to the present size of one of the parties in question, the less probable that the efficiency gains will be assumed agreement specific.

4.4 Verifiability

4.4.1 Quantitative vs. qualitative efficiencies

The EC jurisdiction indicates some rules on which kind of information the firms should provide and what kind of documentation should they present. Basically, the efficiencies have to be easy to verify so that the Commission was convinced that they are “likely to be materialized, and be substantial enough to counteract a merger’s potential harm to customers”. Therefore, the preferred types of efficiencies are quantitative ones which can be easier evaluated. As far as qualitative gains are considered, they must clearly identify positive influence on

120 O. J. No C 101/108 of 27.04.2004, para. 76;
121 The minimum efficient scale is the level of output required to minimize average cost and exhaust economies of scale;
122 Horizontal Mergers Guidelines, op. cit, para. 86;
customers. Having that in mind, it would be very difficult to prove that dynamic efficiencies would be substantial enough to outweigh possible anti-competitive effects. However, in several cases (i.e. Korsnäs/AssiDomän Cartonboard, Aster 2/Flint Ink) the Commission accepted efficiencies in R&D, which would mean that the evidence provided by the parties was complete and sufficient.

4.4.2 Burden of proof

The Commission decided that the burden of proving the probable efficiencies will be put on the merging companies. All the necessary information which are possessed by the management should be provided in due time to prove that the claimed efficiencies are merger-specific and likely to be realized. According to practitioners, the way of providing information to the Commission is very important and should not be underestimated by the merging parties.

4.4.3 Standard of proof

The documentation essential for verification pointed out by the guidelines should particularly include:

- internal documents which merging parties used to decide whether to merge or not;

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123 Ibid., para. 87;
124 Shyam Khemani, op. cit., p. 201;
125 Horizontal Mergers Guidelines, op. cit., para. 88;
- statements from the management to the owners and financial markets about the expected efficiencies;
- historical data about possible efficiencies;
- pre-merger external experts’ studies on the type and size of efficiencies and on the extent to which customers are likely to benefit.

4.4.4 Appraisal of efficiency gains

As mentioned before, the merger control regime has to involve a system of evaluation of efficiencies stemming from mergers. The EU Merger Control Regulation does not provide many clues on what such a method should be. In the US merger guidelines, it is stated that mergers approaching to a monopoly would never be allowed, no matter what efficiencies it produces.\textsuperscript{126} In the EC guidelines, we are provided with detailed information on which types of evidence should be showed upon in order to estimate the efficiencies. This means the EU authorities will examine possible efficiencies on a case-by-case basis. However, using provisions of Article 81.3 of the EC Treaty, a merger which eliminate competition in respect of a substantial part of the products in question should never be allowed. If the Commission undertook similar approach, it would mean that up to certain concentration density, the sequential approach would be the correct one, i.e. general presumptions approach for high concentration density transactions and case-by-case approach for transactions under certain

\textsuperscript{126} Rölle, 2006, op. cit. p. 143;
concentration threshold. However, in the recent cases, the Commission’s evaluation treated efficiencies more as ones of arguments for (or against) the merger, but never as the deciding one. It would suggest that the proper path is the integrated approach. But this time, as mentioned in section 2.3.1 of this paper, the integrated approach is applied in favor of a merger only in such cases when it leads to reduction of prices. The wording of the ECMR allows other types of efficiencies, so the integrated approach may not be the correct one.

4.5 Other issues concerning efficiencies

4.5.1 Pass-on to customers

Pro-competitive effects of mergers fall within interests of the Commission not only when considering their existence, but also when the competition authorities has to distinguish to what degree the efficiencies has to be passed on to customers.\textsuperscript{127} In the guidelines, it is stated that “the greater the possible negative effects on competition, the more the Commission has to be sure that the claimed efficiencies are substantial, likely to be realized, and to be passed on to a sufficient degree to the customers”.\textsuperscript{128} Then, a question may arise, to what extent efficiencies should be considered sufficient enough to countervail negative effects? Some guidance on this matter may be drawn from the Commission’s conclusion that the merger approaching to a monopoly would hardly ever

\textsuperscript{127} Ibid., p. 141;
\textsuperscript{128} Horizontal Mergers Guidelines, op. cit, para. 84;
generate cost savings high enough.\textsuperscript{129} It appears that this approach is not very popular among economists and other stakeholders. They criticize the Commission that such a presumption, and the intuition on which it is based, conflict directly with a well-developed conclusion of economic theory: the demand conditions that create the greatest incentives to increase non-price efficiencies also create the greatest incentive to decrease price as a result of efficiencies.\textsuperscript{130} Another issue related to pass-on to customers is a problem of a role for market share in explaining firm-specific pass-on. According to Röller and Stennek\textsuperscript{131}, pass-on is very limited when the market share of the firm is either very small or very large. In case of a merger with intermediate shares of 40% to 50%, it is very likely that it would lead to the greatest pass-on. For instance, in the Korsnäs/AssiDomän Cartonboard case, the parties delivered to the Commission a term sheet agreement with a customer for the post-merger period, which seems to convince the Commission that the efficiencies would be passed on to customers to a satisfactory level.

\section*{4.5.2 Efficiencies as an offence (anti-competitive effects)}

The Article 2.1 (b) of the Merger Regulation states that the technical and economic progress should be taken into account provided that it does not form

\textsuperscript{129} Ibid.;
\textsuperscript{130} Yde p., Vita M., \textit{Merger Efficiencies: The ‘passing-on’ fallacy}, [in]: Antitrust 59, summer 2006;
an obstacle to effective competition. In other words, if efficiencies generated by
merges cause competition concerns, for instance in a form of blocking new entry
or getting rid of competitors from the market, they should be treated as an
offence.

Such a view the Commission provided in MSG Media case, where it agreed that
the efficiencies claimed by the parties could have contributed to technical and
economic progress, but such efficiencies might also cause serious competition
concerns in a form of eliminating competitors from the market, and therefore
should be announced incompatible with a common market. This ruling only
proves the possibility of efficiency offence, as efficiencies may also have anti-
competitive effects on competition in a given market.

In respect to this situation, a question arises what if similar case happened under
the reformed Merger Regulation 139/2004. If merging companies did not claim
the efficiencies it would be possible that the Commission omitted anti-competitive
effects of the efficiencies and the merger could be claimed compatible with a
common market before the merger’s effects on costs were analyzed.

The most recent case law examples show that the Commission did not follow an
efficiency offence approach. In cases where efficiencies in a form of extended
product portfolio were claimed, they were not declared as causing competition
concerns, but all of them were announced pro-competitive.
5. Conclusions

The EC merger control regime after the reform in 2004 was provided with more detailed explanation of the role of efficiencies in the assessment of mergers falling under provisions of the EC Merger Regulation. However, many aspects of the evaluation remain vague and unclear. In this master thesis, the author analyzed the primary legislation, as well as the secondary sources of law and other sources of information, in order to indicate the certain or most probable path the Commission follows with regards to merger-specific efficiency claims. The conclusions of the analysis are the following.

The efficiencies stemming from mergers falling under the EC Merger Regulation no 139/2004 should cumulatively fulfill the conditions: provide benefits to customers, be merger specific and be verifiable.

As the analysis revealed, only certain types of efficiencies are most probable to be substantial enough to be taken into account by the Commission. The efficiency gains allowed by EU authorities stem from such processes, as rationalization, economies of scale and scope, and other productive efficiencies, because they lead to lowering the prices. Also, dynamic efficiencies are taken into account, even though they cause some serious problems with verifiability.

As far as the substantiality of the efficiencies is concerned, in a case of an intensive concentration (up to a monopoly) it is very unlikely that the efficiencies would be large enough to be counted as a proof allowing for the concentration.
Reductions in variable or marginal costs are more likely to provide lower prices for customers and, therefore, they are more valuable source of efficiencies in the Commission’s mergers’ appraisal. Generally, fixed costs savings are said not to be so closely related to the prices of goods and services, especially in the short term\textsuperscript{132}, and therefore, the Commission would not put so much weight on them.

The Commission takes into account only efficiencies existing in the relevant markets. For example, if a merger creates benefits for consumers in one market, they should be weighted against anti-competitive effects in the market where competition is harmed.

In the case of timeliness, the Commission undertakes the sliding-scale approach, i.e. the later the efficiencies will be realized and passed on to customers, the less importance they will have during the merger control procedure.

It is most probable that the Commission has chosen a customer welfare standard when assessing who should be a beneficiary of the benefits stemming from mergers. The wording of the ECMR in article 2.1 (b), recital 29 and the guidelines imposes that benefits should be to customers’ advantage and should be passed on to customers. It is very unlikely that the Commission chosen the price standard, as the non-price efficiencies (“new or improved products or services, for instance resulting from efficiency gains in a sphere of R&D and innovation”)\textsuperscript{133} should also be allowed. Any other described standards allow some amount of anti-competitive effects to be taken by customers.

\textsuperscript{132} Horizontal Mergers Guidelines, op. cit, footnote 107;
\textsuperscript{133} Ibid., para. 81;
In terms of merger specificity of the efficiencies, the primary legislation as well as the case law shaped certain information on conditions required for efficiencies, i.e. they should emerge as a direct consequence of the merger in question and there should not exist any less restrictive way of achieving these benefits.

As stated before, when it comes to verifiability of merger efficiencies, the preferred types of efficiencies are quantitative ones, as they can be easier evaluated. As far as qualitative gains are considered, they must clearly identify positive influence on customers. Having that in mind, it would be very difficult to prove that dynamic efficiencies would be substantial enough to outweigh possible anti-competitive effects.

Commission’s approach towards the assessment of the mergers is still unclear. The most probable scenario is that up to certain concentration density, the sequential approach would be the correct one, i.e. general presumptions approach for high concentration density transactions and case-by-case approach for transactions under certain concentration threshold. However, in the recent cases, the Commission’s evaluation treated efficiencies more as ones of arguments for (or against) the merger, but never as the deciding one. It would suggest that the proper path is the integrated approach. But this time, as mentioned in section 2.3.1 of this paper, the integrated approach is applied in favor of a merger only in such cases when it leads to reduction of prices. The wording of the ECMR allows other types of efficiencies, so the integrated approach may not be the correct one.
Eventually, answering the problem statement question from the section 1.2 of this paper, the current Commission’s practice does not prove that efficiencies claimed by merging parties will lead to clearance of the merger accused of causing certain anti-competitive effects on the European common market. However, in opinion of the author, the Commission is provided with legal bases to raise the importance of efficiencies in the mergers’ assessment and it is very likely that the future ruling will go towards increasing of their significance.
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