# Efficiencies and Remedies under the ECMR

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This chapter gives an overview of the current state of the EC merger control rules related to efficiencies and remedies, and summarises the recent developments in these two highly important areas. Both areas can play a key role in the assessment of a merger case, and given their complexity, need to be analysed in the process as early as possible. In fact, efficient counselling requires discussions of possible efficiencies and remedies as early as during the Commission's informal guidance at the pre-notification stage. This is one of many aspects of the fact that, in the European Union, merger control filings are 'front-loaded', while US filings are 'back-loaded'.

## Efficiencies

On 1 May 2004, with the entry into force of the revised EC Merger Regulation (ECMR), a lengthy debate in the EU over whether efficiencies should be (positively) considered in merger control analysis finally came to an end. It is now clear that the revised ECMR provides a legal basis for efficiency considerations to be taken into account by the Commission when assessing notified concentrations. Under the old ECMR, there was arguably no room for such efficiency considerations as efficiencies were considered to be an inherent part of the 'merger privilege'. To the contrary, a number of cases seemed to suggest that the Commission viewed efficiencies as a reason for prohibiting a merger – the so-called 'efficiency offence'.

For example, in *MSG Media Service*, the Commission found that the efficiencies (the development of digital television, in this case) projected from the joint venture would enable the parties to outperform their competitors and thus enable a dominant position.[1] And in *GE/Honeywell*, the Commission rested its decision in part on the theory of 'conglomerate effects', under which the merger was deemed problematic because the combined entity would be a more efficient competitor.[2] Charles James, then head of the antitrust division of the US Department of Justice, deemed this reasoning "antithetical to the goals of sound antitrust enforcement" because it relied on pro-competitive efficiencies to prohibit the merger.[3]

The revised ECMR and the accompanying Horizontal Merger Guidelines have since changed the place of efficiencies in the merger analysis, at least on paper. It seems likely that in practice, however, efficiencies arguments will continue to face a high level of scrutiny from the Commission. In both Europe and the US, enforcers would be hard pressed to point to an otherwise anti-competitive merger that has been explicitly allowed to proceed on the basis of efficiencies.

### On which legal basis can efficiencies be invoked?

The revised ECMR, under article 2(3), provides for a competitive effects test: "A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular by the creation or strengthening of a dominant position, shall be declared incompatible with the common market". Unlike the old ECMR, the creation or strengthening of a dominant position is no longer in and of itself the focus of the Commission's attention. Instead, the threshold is more flexible and a concentration creating or strengthening a dominant position will no longer be prohibited if this position does not lead to a significant impediment to effective competition. Whether this is the case can only be assessed on the basis of an economics-driven analysis of the concentration's competitive effects. This obviously opens the door for efficiency considerations as integral to the Commission's substantive (ie, competitive effects) analysis and arguably not only if invoked by the parties in the form of an "efficiency defence".

Article 2(1) of the ECMR also contains a list of factors that the Commission must include in its economic analysis. Pursuant to article 2(1)(b), the Commission shall take into account, inter alia, "the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition". This provision, which has not been changed by the revised ECMR, is now recognised by the Commission as a legal basis for the consideration of merger-specific efficiencies.

The explicit recognition follows from recital 29 of the ECMR:

> *In order to determine the impact of a concentration on competition in the common market, it is appropriate to take account of any substantiated and likely efficiencies put forward by the undertakings concerned. It is possible that the efficiencies brought about by the concentration counteract the effects on competition, and in particular the potential harm to consumers, that it might otherwise have and that, as a consequence, the concentration would not significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position.*

### To what extent are efficiencies taken into account?

In its Horizontal Merger Guidelines, the Commission has provided guidance regarding the extent to which efficiencies are taken into account. The Court of First Instance has held that the Commission is bound by the Guidelines and other "notices which it issues in the area of supervision of concentrations, provided they do not depart from the rules in the Treaty and from the Merger Regulation".[4] According to the Guidelines, the Commission will not prohibit a concentration based on efficiency considerations, if:

> *the Commission is in a position to conclude on the basis of sufficient evidence that the efficiencies generated by the merger are likely to enhance the ability and incentive of the merged entity to act pro-competitively for the benefits of consumers, thereby counteracting the adverse effects on competition which the merger might otherwise have.*[5]

For the Commission to take account of efficiency claims, the efficiencies have to:

- *benefit consumers;*
- *be merger-specific; and*
- *be verifiable.*[6]

In order to benefit consumers, efficiencies must be "substantial and timely" and should occur in those relevant markets where otherwise competition concerns exist. The consumer benefit may lay in lower prices due to cost efficiencies (with cost reductions in variable and marginal costs being more likely to be relevant to the Commission's assessment than reductions in fixed costs), or new or improved products or services due to efficiencies in R&D.[7]

In order to be merger-specific, efficiencies have to be the "direct consequence" of the notified concentration and unable to be achieved by "less anti-competitive, realistic and attainable alternatives". The Commission considers alternatives of both non-concentrative (eg, licensing agreement or cooperative joint venture) and concentrative natures (eg, a concentrative joint venture or a differently structured merger) that are "reasonably practical" in the parties' business situation.[8]

In order to be verifiable, efficiencies must be "likely to materialise, and be substantial enough to counteract a merger's potential harm to consumers". To the extent possible, any efficiencies and the resulting consumer benefit have to be quantified. Where such quantification is not possible, the Commission requires the likelihood of not only a marginal but a "clearly defined positive impact on consumers" that will occur in a timely fashion.[9]

The draft Guidelines on Non-Horizontal Mergers, made public on 13 February 2007, state that when examining vertical or conglomerate mergers, the Commission will apply the same principles as in the Horizontal Merger Guidelines.[10] But the draft Guidelines recognise that vertical and conglomerate mergers are less likely than horizontal mergers to have anti-competitive effects. Since non-horizontal mergers involve products or activities that are complementary to each other rather than in direct competition, they can "provide substantial scope for efficiencies" through the integration of complimentary activities or products within a single firm and therefore be pro-competitive. Examples of efficiencies specific to non-horizontal mergers include the "internalisation of double mark-ups", allowing the integrated firm to profitably increase output on the downstream market; better coordination of production and distribution processes, leading to savings on inventory costs; and the creation of incentives with regard to investments in new products, production processes and marketing. Another example specific to conglomerate mergers is the creation of cost savings through economies of scope.[11]

### Who has to prove efficiencies?

The Commission's Horizontal Guidelines shift the burden of proof for the existence of countervailing efficiencies to the notifying parties. From the Commission's point of view, this may be desirable given the tight time schedule under which the authority has to carry out its merger review under the ECMR. However, it is not justified in light of the fact that, under the revised ECMR, efficiency considerations have to be seen as forming an integral part of the Commission's substantive (ie, competitive effects) analysis, not just when they are invoked by the parties in the form of an "efficiency defence".

### How to prove efficiencies?

According to the Horizontal Guidelines, it is:

> *incumbent upon the notifying parties to provide in due time all the relevant information necessary to demonstrate that the claimed efficiencies are merger-specific and likely to be realised. Similarly, it is for the notifying parties to show to what extent the efficiencies are likely to counteract any adverse effects on competition that might otherwise result from the merger, and therefore benefit consumers.*[12]

The evidence the Commission considers relevant includes:

> *internal documents that were used by the management to decide on the merger, statements from the management to the owners and financial markets about the expected efficiencies, historical examples of efficiencies and consumer benefit, and pre-merger external experts' studies on the type and size of efficiency gains, and on the extent to which consumers are likely to benefit.*[13]

This means that parties to a possible merger, from the very earliest stage, must bear in mind when drafting internal documents relating to the transaction that these documents might have to be used in order to substantiate an efficiency claim.

### When to bring efficiency claims?

Given the complexity of efficiency claims and the likelihood that they require extensive analysis, the Commission recommends that:

> *notifying parties put forward, already at the pre-notification stage, any elements demonstrating that the merger leads to efficiency gains that they would like the Commission to take into account for the purposes of its competitive assessment of the proposed transaction.*[14]

The notifying parties may want to submit the relevant information in the first draft of the Form CO, which is usually submitted to the Commission at the pre-notification stage requesting the authority's informal guidance. For this purpose, section 9.3 of the Form CO provides for specific questions, which would need to be answered if the parties "wish the Commission specifically to consider [efficiency gains] from the outset". However, the Commission notes that the parties are not required to offer any justification for not completing section 9.3 and that failure to provide the information on efficiencies does not preclude providing the information at a later stage. The Commission emphasises, however, that "the earlier the information is provided, the better the Commission can verify the efficiency claim".[15]

#### *Inco/Falconbridge*

The proposed acquisition of Falconbridge by Inco resulted in one of the first Commission decisions in which efficiencies arguments were addressed in detail after a full investigation. The Commission found that the proposed transaction would have created "by far the largest supplier in the EEA of nickel products to the plating and electroforming industry and the almost monopolistic supplier of high-purity nickel [...] and high-purity cobalt" used in super alloys.[16] According to the Commission, the new entity would have had the ability and incentive to increase prices on these markets without any significant competitive restraint. The efficiencies arguments put forth by the parties relied on the close proximity of the parties' respective mines/processing facilities in the Sudbury basin in Canada. The new entity (New Inco), they argued, would have been able to optimise operations and increase production at a lower cost through the integration of mines and mills leading to reduced transportation costs, economies of scale and elimination of duplicate functions performed separately by the parties. The parties further argued that the efficiencies were merger-specific as they related to the ability of the combined entity to shift production to the most appropriate or efficient facilities, which would not be realised if the facilities were separately owned; and that competitive conditions in the global nickel market would make it likely that the efficiencies would be passed on to customers. The Commission accepted that substantial efficiencies would likely be gained through the transaction but ultimately rejected the parties' 'efficiency defence'. First, the Commission determined that the efficiencies could be achieved by less anti-competitive means, such as a joint venture limited to operations in the Sudbury basin. Such a venture would have allowed the parties to benefit from the synergies resulting from the combined facilities while not preventing them from competing at the refining and marketing level. Second, the Commission rejected the parties' argument relating to pass-on to customers. The efficiencies would be achieved at the upstream mining and processing level and not at the final stage of nickel production, so the potential benefit would be spread between all finished nickel and cobalt products of New

Inco, a significant part of which are sold on other markets than the three relevant markets where competition concerns were identified. Finally, an entity such as New Inco, which would be in a virtually monopolistic position on the markets concerned, would lack sufficient incentives to pass on cost efficiencies to customers in the form of lower prices. The Commission therefore concluded that the efficiencies that might result from the proposed acquisition of Falconbridge by Inco were insufficient to remedy the Commission's competition concerns and rejected the parties' efficiency arguments. However, ultimately the proposed transaction received clearance on the basis of remedies offered by the parties.[17]

### Conclusion

The decision in *Inco/Falconbridge* and recent public statements by Commission officials[18] would seem to indicate that the Commission intends to continue a narrow course with respect to efficiencies. The limitations on efficiencies set out in the Horizontal Guidelines are substantial and when applied narrowly could even be prohibitive. In particular, a merger that would create an entity with significant market power, such as arguably the merged entity in *Inco/Falconbridge,* will be highly unlikely to be cleared on the basis of efficiencies.[19] Due to this narrow approach, few types of concentrations will be susceptible to efficiency arguments, the most important one probably being 'coordinated effects', where the Commission has advanced the theory that efficiencies may strengthen the merged firm's ability to compete, thereby diminishing its incentive to coordinate with others.[20]

## Remedies

The Commission rarely prohibits mergers outright. In fact, as of 30 June 2007, out of the 3,458 transactions filed with the Commission only 20 were blocked.[21] Instead, if a concentration raises serious concerns, the Commission typically grants clearance subject to certain conditions that will render the transaction compatible with the Common Market. It is therefore of utmost importance for merging parties to understand how to deal with the Commission when competition concerns need to be remedied.

### On which legal basis is it possible to remedy competition issues?

The ECMR provides that the Commission may decide to declare a concentration compatible with the Common Market following modifications by the parties. Commitments modifying a concentration are acceptable in Phase I (decision based on article 6(2) of the ECMR) and in Phase II (decision based on article 8(2) of the ECMR). Such modifications are more commonly referred to as remedies since their objective is to restore effective competition that otherwise would be distorted as a result of the concentration. There is, however, an important distinction between Phase I and Phase II remedies. The ECMR requires that commitments accepted by the Commission in Phase I must be such that they eliminate "serious doubts" as to the concentration's compatibility with the Common Market.[22] At this stage, "competition problems need to be so straightforward and remedies so clear-cut that it is not necessary to enter into in-depth investigations".[23]

Practical business time constraints (eg, resulting from securities or tax rules) sometimes require parties to avoid a Phase II investigation, which if initiated could jeopardise the deal's value or effectively end the proposed merger. In these cases, parties may have to accept far-reaching remedies required by the Commission in Phase I with the threat of a Phase II investigation in the background. There is little the parties can do about this difficult situation, except to make the best possible deal with respect to the remedies imposed. If the process proceeds to Phase II, the goal becomes to structure remedies that restore conditions of effective competition without destroying the business value of the deal. This means making sure commitments are based on substantiated concerns and narrowly tailored to address those concerns.

Once commitments are agreed to, recital 31 of the ECMR provides that, "the Commission should have at its disposal appropriate instruments to ensure the enforcement of commitments and to deal with situations where they are not fulfilled". Accordingly, the Commission can impose certain obligations to make sure the conditions agreed upon for the merger to proceed are carried out. But one should always keep in mind the distinction between "conditions" and "obligations" in the remedies process. If there is a breach of a condition to clearance imposed by the Commission (eg, the commitment to divest an asset), then the Commission's clearance decision is voided. If there is a breach of an obligation (eg, parties fail to meet a deadline), then the Commission may use its power to withdraw the decision and impose fines and penalties.

On 24 April 2007 the Commission announced a public consultation on a draft revised notice on remedies. The resulting revised notice will replace the 2001 Remedies Notice which currently is the guiding document on remedies. The new Notice on Remedies is expected before the end of 2007 and is intended to take account of the revised Merger Regulation, recent judgments of the European Courts and the results of the Commission's 2005 Mergers Remedies Study, a thorough ex-post analysis of 96 remedies included in merger decisions adopted between 1996 and 2000.[24] The draft revised Notice contains a detailed discussion of the types of remedies the Commission finds suitable and under what conditions, as well as how they may be implemented. Additional guidance can also be found in the standard model texts for divestiture commitments and the engagement of trustees (the Standard Models), and the Best Practice Guidelines for Divestiture Commitments (the Divestiture Guidelines).[25]

### What are the conditions in order for remedies to be taken into account?

Pursuant to recital 30 of the ECMR, "commitments should be proportionate to the competition problem and entirely eliminate it". When assessing whether the proposed remedy is sufficient under these criteria, the Commission considers, according to the Remedies Notice, all relevant factors relating to the remedy itself, including inter alia the "type, scale and scope of the remedy proposed, together with the likelihood of its successful, full and timely implementation by the parties". These factors are judged "by reference to the structure and particular characteristics" of the relevant market.[26]

When assessing whether the proposed remedy is able to eliminate the competition problem in question and restore effective competition, 'structural commitments' (such as the divestiture of businesses or other assets) are, as a rule, preferable to so-called 'behavioural remedies', which impose conditions on the way parties act on the market.

### Structural remedies

The Remedies Notice states that "the most effective way to restore effective competition, apart from prohibition, is to create the conditions for the emergence of a new competitive entity or for the strengthening of existing third-party competitors via divestiture".[27] The Commission's preference for divestiture remedies is understandable from a practical standpoint. Behavioural remedies generally require ongoing monitoring and enforcement, which is difficult in practice and requires the commitment of valuable resources. By contrast, divestiture is a one-time event that, assuming there are no problems with implementation, can be less resource-intensive and more effective. In order for divestiture commitments to be accepted,

the divested activities must consist of a viable business that, if operated by a suitable purchaser, can compete effectively with the merged entity on a lasting basis.[28]

The draft revised Notice defines a viable business as a business that can operate on a stand-alone basis, ie, independently of the merging parties as regards the supply of input materials or other forms of cooperation other than during a transitory period. Recent public statements by Commission officials indicate that the need to ensure independence of supply is receiving increased scrutiny.[29] In this regard the Commission prefers an existing stand-alone business such as a pre-existing company or group of companies. The Commission, however, will consider commitments in the form of carve-outs or divestiture of certain assets such as brands or licences, if the parts of the business subject to the carve-out or, in the case of divestiture of assets the assets to be divested, immediately form a viable business at the time they are transferred to the purchaser.[30]

The penchant for structural remedies generally and divestiture more particularly can be seen in the most recent cases. From January to 1 July 2007, the Commission cleared five concentrations subject to commitments in Phase I. Of those five, four involved divestiture of a business unit or production facility and the other involved a carve-out of the acquiror's business selling small UPS devices (*Schneider Electric/APC*).[31] In the same time period, the Commission cleared two concentrations subject to commitments in Phase II. One of those involved the divestment of manufacturing capacity and certain brands while the other (*Universal/BMG*) involved the divestment of music publishing catalogues. In *Universal/BMG*,[32] the Commission required divestments that arguably went significantly beyond the competition concerns identified by the Commission in order to ensure a viable remedies package. This approach is in line with the draft revised Notice, according to which "it may also be necessary to include activities which are related to markets where the Commission did not identify competition concerns if this is required to create an effective competitor in the affected markets".[33]

### Behavioural remedies with structural effects

The other type of remedy is broadly deemed 'behavioural'. Behavioural remedies can, however, take a number of forms and can even have structural effects.[34] Remedies may qualify as structural in some cases even where the divestiture of a business is not involved. The Commission is willing to accept behavioural commitments where they have structural effects on the market similar to those of divestments. Examples include exclusive licensing agreements, the termination of existing long-term supply or exclusive distribution agreements and access agreements.

This is in line with the CFI's *Gencor* judgment, pursuant to which remedies are structural where they cause an immediate and permanent change in the structure of the market and do not "require medium or long-term monitoring".[35] Outright divestiture is not the only form that can meet these criteria. For example, the Commission's 2005 Merger Remedies Study, which studied structural remedies in some detail, treated exclusive licences of intellectual property rights as structural remedies.

The primary benefit of behavioural remedies to both the Commission and the parties is that they can be flexible and capable of fine-tuning. They can be narrowly tailored to the particular concern, as opposed to the often blunt object of structural remedies. Behavioural remedies are particularly suitable for emerging markets, small national markets, to address issues of access and to lower barriers to entry.[36]

### Purely behavioural remedies without structural effects

Remedies that are not fully within the merging parties' control or are dependent on the action of third parties (eg, customers and suppliers) and remedies that lack a sufficient degree of certainty and permanence, such as the mere promise not to engage in excessive pricing, will in all likelihood not be accepted by the Commission on a stand-alone basis. But different types of behavioural and structural remedies can be mixed and matched to achieve the optimal result. For example, in *Lufthansa/Eurowings*, the Commission was concerned that the proposed acquisition of Eurowings by Lufthansa would eliminate competition on three intra-European routes: Cologne/Bonn-Vienna, Stuttgart-Vienna and Stuttgart-Dresden. To address the Commission's concerns, the parties committed to surrender slots at the airports of Vienna and Stuttgart. In the Commission's view, this created the conditions for competing airlines to enter the affected routes. Furthermore, the parties offered additional commitments, such as a frequency freeze on the affected routes and allowing competitor participation in Lufthansa's frequent flier programme on the affected routes, with the aim of making entry more attractive.[37]

### Crown jewels

Alternatively, primary and secondary remedies can be offered by merging parties in cases where the preferred primary remedy may be difficult to implement. The second alternative remedy must be equal to or better than the preferred remedy, and typically involves divestiture of the parties' 'crown jewel'. The possibility of accepting such crown jewels is foreseen in the Remedies Notice.[38]

The *Nestlé/Ralston Purina* case provides a good example of how alternative remedies can be structured. In this case, the first alternative was the licensing of Nestlé's Friskies brand in Spain. If this licensing alternative was not implemented in a certain time, then the option to license Nestlé's Friskies brands was no longer available to the parties and the second alternative (the crown jewel) would have to be implemented. The second alternative involved the divestiture of the 50 per cent shareholding of Ralston Purina in a Spanish joint venture.[39]

This crown jewels issue was addressed in the 2005 Merger Remedies Study. The Study explains, based on the cases studied, that the "Commission accepted alternative remedies in cases where the parties' preferred divestiture package would be acceptable, if implemented, but where the complexities of the particular case indicated that implementation of the 'first choice' remedy might not be possible". But alternative remedies were only used in four of the remedies considered in the Study, "of which three involved exits from joint ventures, and the fourth concerned the divestiture of a pipeline product. In three of these four remedies, the alternative commitment or crown jewel were divested".[40]

### Who has to prove that the proposed remedy restores effective competition?

The burden of proof lies with the notifying parties. Pursuant to the Remedies Notice:

> *it is the responsibility of the parties to show that the proposed remedies, once implemented, eliminate the creation or strengthening of [...] a dominant position identified by the Commission. To this end, the parties are required to show clearly, to the Commission's satisfaction [...] that the remedy restores conditions of effective competition in the common market on a permanent basis.*[41]
>
> *In assessing whether or not a remedy will restore effective competition the Commission will consider all relevant factors relating to the remedy itself, including inter alia the type, scale and scope of the remedy proposed, together with the likelihood of its successful, full*

> *and timely implementation by the parties. [...] It follows that it is incumbent on the parties from the outset to remove any uncertainties as to any of these factors which might cause the Commission to reject the remedy proposed.*[42]

The draft revised Notice reaffirms that the parties are required "to provide all such information available that is necessary for the Commission's assessment of the remedies proposal". For this purpose, the draft Notice envisions an amendment to Regulation 802/2004 of the EC Treaty (the Implementing Regulation) requiring the parties to submit a Form RM with their commitments proposal, providing "detailed information on the content of the commitments offered, the conditions for their implementation and showing their suitability to remove any significant impediment of effective competition".[43]

### When to offer (and implement) commitments?

In Phase I, commitments must be offered within 20 working days from the date of receipt of the notification. In Phase II, commitments must be submitted to the Commission within 65 working days from the initiation of the Phase II proceedings.[44] If undertakings are submitted in Phase I, the basic review period of 25 working days is extended to 35 working days. In Phase II, the review period of 90 working days is extended to 105 working days, unless the commitments have been filed within the first 55 working days after notification.[45] In *Babyliss*, the CFI held that the Commission is entitled to accept commitments offered in violation of the deadlines mentioned above, if it considers there to be enough time for a proper assessment.[46]

In cases involving divestiture commitments the Commission places great importance on the suitability of the purchaser. Often, depending on the circumstances of the case the remedies package may foresee that the parties may not complete the notified concentration before entering into a binding agreement with a suitable purchaser for the divested business, to be approved by the Commission (an 'up-front buyer'). While such a solution is a more common feature of US merger practice, arrangements of this type are on the increase in Europe. Recent examples include *Post Office/TPG/SPPL*, *Masterfood/Royal Canin*, *Sonoco/Ahlstrom*, *Bosch/Rexroth*, and *Procter & Gamble/VP Schickedanz*. In even more risky cases the Commission may even require a 'fix-it-first' remedy whereby the notifying parties identify and enter into a binding agreement with a purchaser during the Commission's merger control review. The choice depends on "the nature and the scope of the business to be divested, the risks of degradation of the business in the interim period up to divestiture and any uncertainties inherent in the transfer and implementation, in particular the risks of finding a suitable purchaser". It is advisable to discuss this issue with the Commission at the pre-notification stage.[47]

The Commission is open to early discussions with the merging parties regarding how to best remedy any competition concerns it may have. This question will be decided on a case-by-case basis and increasingly often leads the Commission to accept, under certain circumstances, behavioural commitments (in particular, in cases raising vertical concerns) while, in general, structural remedies are still the preferred choice. While behavioural remedies with structural effects are likely to be successful, the submission of 'merely' behavioural remedies may lead to an uphill battle, during which the Commission needs to be convinced that the proposed commitments are sufficient to remedy the competition concerns in terms of scale, duration and scope.

## The review clause

The draft Revised Notice includes a new section detailing the purpose of a review clause for a remedies package. The review clause "may allow the Commission, upon request by the parties showing good cause, to grant an extension of deadlines or to waive, modify or substitute, in exceptional circumstances, the commitments".[48] For divestiture commitments the parties can apply for an extension of deadlines if the request is made before the deadline but the Commission "will only accept that they have shown good cause if the parties were not able to meet the deadline for reasons outside their responsibility and if it can be expected that the parties will succeed in divesting the business within a short time frame".[49] While waivers or modifications of commitments will normally not be granted in the case of divestitures, they may be more relevant for other types of commitments, such as access commitments, which may be longer in duration and for which not all contingencies can be planned for at the time of the decision. Such waivers and modifications will only be accepted under exceptional circumstances.[50]

## Recent cases

In *Gaz de France/Suez*,[51] the Commission cleared the merger of Gaz de France and the Suez Group subject to a mix of structural and behavioural remedies. Gaz de France is active in the gas sector, in electricity generation and retail, and in energy services throughout Europe but mainly in Belgium and France. In Belgium, Gaz de France jointly controls SPE, the second-largest electricity and gas company. Suez is active in the utility industry and utility services in France and Belgium. Suez holds several subsidiaries in the electricity and gas sectors, mainly Electrabel, Distrigaz and Fluxys. The Commission's analysis concluded that the merger would significantly impede effective competition in the gas markets of both countries, the electricity market in Belgium and the district heating market in France, due to both horizontal and vertical effects. In the Belgian gas sector, according to the Commission, the merger would remove the competitive constraints exercised by Gaz de France on Suez and result in a dominant position and very high market shares on several different markets for the combined entity. In France, the converse was true, as the removal of Suez's subsidiary Distrigaz from the market would strengthen the dominance of Gaz de France. In the electricity sector in Belgium, a number of markets were identified in which the merger would have strengthened Suez's already dominant position and created market shares over 80 per cent, as well as vertical effects which would impede effective competition, in particular by giving the parties the ability and incentive to raise the prices of gas to competitors on the electricity market. Finally, the Commission found that the merger would create the strongest player on the market for district heating in France, notably by adding the market share of Cofathec-Coriance, a Gaz de France company, to that of Suez. The extensive remedies proposed included the divestiture of Distrigaz by Suez and of Gaz de France's interest in SPE. Additionally, the parties agreed to reorganise Fluxys and to refrain from controlling it by limiting their ownership interest and presence on the Board of Directors. The parties also agreed to carry out a number of measures and investments to improve infrastructure in Belgium and France. The Commission accepted these remedies following an in-depth investigation.

In *Evraz/Highveld*,[52] the Commission reviewed a merger between two companies active in the production of vanadium and steel products. Evraz operates mainly in the Russian Federation and is active in steel production and mining and produces vanadium feedstock through its steel operations. Highveld is a South African concern with a strong presence in Europe through its subsidiary Hochvanadium and is active in the production of steel and various vanadium products. While the steel production activities of the

parties featured very limited overlap and therefore raised no competition concerns, the Commission concluded that there were significant horizontal overlaps and affected vertical relationships in the markets for vanadium products. First, the combined entity would be vertically integrated all along the vanadium supply chain and, according to the Commission, there were concerns that due to its position upstream it could restrict access to vanadium feedstock to its downstream competitors and therefore raise the prices of finished vanadium products. Second, the new entity would have significant market power in the market for high-purity vanadium pentoxide and would be the main supplier of its downstream rivals. This would give the merged entity the ability and incentive to foreclose its rivals to increase its market power at the downstream level.[53] The remedies submitted by the parties, which were accepted by the Commission in Phase I, included both structural and behavioural remedies. First, the new entity agreed to divest Highveld's vanadium business composed of several production facilities in South Africa, as well as an equity interest in a part of the Mapochs mine, also in South Africa. Second, Highveld's 50 per cent interest in SAJV, a joint venture with two Japanese undertakings that produces ferrovanadium from vanadium pentoxide, would also be divested. Finally, Evraz committed to enter into long-term supply agreements with some of its primary downstream competitors in the vanadium supply chain. This commitment included a dispute-resolution procedure to be administered by a Monitoring Trustee.[54]

Recently, the Commission rejected remedy proposals by Ryanair in its proposed acquisition of Aer Lingus.[55] The two airlines were by far the largest airlines operating from Ireland and exerted competitive pressure on each other. The Commission's in-depth investigation discovered that the companies directly competed with each other on 35 routes to and from Ireland. The effects of the proposed merger would have been to create a monopoly on 22 of those routes and to significantly reduce customer choice on the remaining 13 by virtue of a market share over 60 per cent for the combined entity. Ryanair proposed to give up certain 'slots' (landing and take-off rights at airports at specific times) as a remedy. In previous cases involving airline mergers, the Commission accepted slot divestitures on the basis of the likelihood that the divestiture would attract market entry to ensure the existence of competitive constraints on the merged entity.[56] In *Ryanair/Aer Lingus*, after extensive market testing, the Commission concluded that the number of slots being offered was insufficient to attract market entry of a size necessary to exert competitive pressure equivalent to that exercised by Aer Lingus. Ryanair responded by offering to delay the acquisition until a suitable 'up-front buyer' could be found, but the Commission maintained that the slots to be divested would not protect competition even if a new market entrant was guaranteed. Due to this and other shortcomings the Commission blocked the merger.[57]

In *Piaggio/Aprilia*,[58] the Commission cleared the merger of two Italian scooter manufacturers. Piaggio is the fourth-largest European manufacturer of two-wheeled vehicles, with a market share in value of 10 per cent in the EU, behind the market leaders Honda and Yamaha, both with around 18 per cent, and Suzuki with 12 per cent. Piaggio is the European market leader in the segments of scooters, with a marginal presence in the motorbike market. Piaggio's main brands are 'Piaggio', 'Vespa', 'Gilera' and 'Derbi'. Aprilia is a smaller scooter and motorcycle producer with a more mixed portfolio, and some popular brands in motorcycles (Aprilia and Guzzi). The Commission's analysis covered numerous European countries, and focused on the markets for scooters and for small motorbikes, where the activities of the two companies overlap. The Commission concluded that in all the countries of the EU other than Italy, as well as in Italy with respect to the market for scooters above 50cc, no competition concerns arise from the operation. However, the analysis highlighted competition problems as regards the Italian market for scooters and mopeds with an engine up to 50cc. This market was rather limited in size, and had shrunk considerably in the past 10 years. But the Commission still concluded that the merger between market leader Piaggio and number two Aprilia could impede effective competition in Italy. According to the Commission, the merged entity would control a big portion of the supply to the Italian market, through a considerable number of well-known brands and models equipped with a state-of-the-art 50cc 4-stroke engine produced by Piaggio. To remedy the Commission's concerns, Piaggio undertook to supply the 50cc 4-stroke engine at commercial terms to other market players that wish to equip their models with such an engine. The Commission accepted such a behavioural remedy as it would restore competition. The Commission's decision also noted that Piaggio's acquisition of Aprilia would enable it to achieve greater economies of scale and to extend its product range thereby enabling the merged entity to compete more effectively with a number of other manfacturers that were well established and capable of exerting a strong competitive constraint over the merging entity. These were primarily the Japanese manufacturers Honda, Yamaha and Suzuki, which, according to the Commission, had a significant market position, a broad portfolio, a strong brand image supported by massive investments in marketing and their own distribution network.

In *Procter & Gamble/Gillette*,[59] the Commission reviewed a transaction creating one of the world's biggest consumer goods producers with a combined turnover of roughly €50 billion. Procter & Gamble is well known for its branded products, in particular in the field of household, beauty, baby and family care products. These include 'Ariel', 'Pringles', 'Oil of Olay', 'Tampax', 'Always', 'Pampers', 'Fairy', 'Head & Shoulders' and 'Pantene'. Gillette is a multinational manufacturer of consumer products, active in blades and razors, oral care products and batteries, using brand names such as 'Gillette', 'Oral B' and 'Duracell'. After the merger, the parties would own 21 brands with a turnover of more than US$1 billion each. The Commission's market investigation showed that the activities of both undertakings overlapped to a large extent only on the market for battery toothbrushes, where Procter & Gamble offers products under the brand 'SpinBrush', co-branded as 'Blend-a-Dent', 'Blend-a-Med', 'Blendi', 'Crest' or 'AZ'. Gillette sells battery toothbrushes under its 'Oral B' brand. In order to address the Commission's horizontal concerns, Procter & Gamble committed to divest its entire 'SpinBrush' toothbrushes business and to grant a licence for the co-brands used on these toothbrushes. As the commitment covered the whole of Procter & Gamble's battery toothbrush business, the Commission was satisfied that it would remove its competition concern on the battery toothbrushes market. Not surprisingly, however, the Commission's focus of attention was the conglomerate effects possibly resulting from the parties' significant portfolio of brands with large market shares in numerous product markets where their activities did not overlap. In this context, the Commission noted that "enlarging the product portfolio might bring efficiencies to retailers and consumers, for example benefits from having only one partner to negotiate with (one-stop-shop), suppliers having stronger innovation capacities, and economies of scale and scope". However, countervailing buyer power, rather than efficiencies, was the decisive argument against portfolio effects. The Commission found that anti-competitive conglomerate effects were unlikely to occur. The parties would continue to face significant competition from other suppliers of branded products with a comparable product portfolio even after the merger. Furthermore, the risk of exclusion of competitors or 'portfolio effects' was considerably mitigated by the ability and incentive of retailers to exercise countervailing buyer power.

Finally, in *Korsnas/Assidoman Cartonboard*,[60] the Commission assessed the merger between two Swedish companies active in the production of liquid carton packaging board (LPB), which is used for the production of packaging containers for liquid and semi-liquid foodstuffs such as milk, juice and soup. Producers sell LPB to so-called converters that convert it into liquid packaging containers and sell it to fillers for the packaging of milk and fruit juice. There were three main suppliers of LPB active in the EEA: Stora Enso and the two merging parties. The merger combined the second- and the third-largest LPB producers. The market structure on the demand side was found to be equally highly concentrated with three main customers (Tetra Pak, Combibloc and Elopak), known as converters, accounting for almost all LPB demand in the EEA, one of which (Tetra Pak) accounts for more than 50 per cent of the total demand. According to the Commission, the market investigation showed that the merging parties were likely to be constrained by sophisticated customers who exerted countervailing buyer power. The Commission also found it realistic to assume that the allocation of production among the increased portfolio of machines would allow the merged entity to increase overall production on the machines. The resulting efficiencies were likely to be passed on to consumers. Finally, those efficiencies were considered as being likely to enhance the ability and incentive of the merged entity to act pro-competitively for the benefit of consumers.

* * *

There is now – at least on paper – an important place for efficiencies in EC merger analysis, but in practice merging parties invoking the 'efficiency defence' are likely to continue to face an uphill battle with the Commission. Structural remedies continue to be preferred, but the Commission may accept behavioural remedies in specific cases, and some combination of the two can often be necessary in complex cases. In all cases, parties must consider their strategies for efficiencies and remedies early on, and substantiate their story for the Commission.

## Notes

* The authors acknowledge with gratitude the valuable assistance of Alexandros Papanikolaou in the update of last year's article.

1 Commission of 9 November 1994, case M469 (MSG). For an analysis of the Commission's decision, see Michael Rosenthal in *Telecommunications, Broadcasting and the Internet* (Garzaniti ed), paras 8.171-8.174 [2003].

2 Commission of 3 July 2001, Case M2220 (*GE/Honeywell*).

3 Charles A James, 'International Antitrust in the 21st Century: Cooperation and Convergence, Remarks Before the OECD Global Forum on Competition', Paris (17 October 2001), available at www.usdoj.gov/atr/public/speeches/9330.htm. For further theoretical and historic background information on the role of efficiencies before the revised ECMR came into effect, see Gian Luca Zampa, 'The Role of Efficiency under the EU Merger Regulation', *European Business Organization Law Review* 4 (2003), pp573 et seq.

4 Case T282/06, *Sun Chemical v Commission* [2007], para 55.

5 Guidelines, para 77.

6 Guidelines, para 78.

7 Guidelines, paras 79-84.

8 Guidelines, para 85.

9 Guidelines, para 86.

10 Draft Guidelines on Non-Horizontal Mergers, para 51.

11 Draft Guidelines on Non-Horizontal Mergers, paras 13-14, 52-56, 114-116.

12 Guidelines, para 87.

13 Guidelines, para 88.

14 Best Practices, para 18.

15 Form CO, footnote 1 to section 9.3.

16 Commission of 10 July 2006, Case M4000 (*Inco/Falconbridge*), paras 529-550. For a full discussion of the decision see Caroline Boeshertz, Pierre Lahbabi and Sophie Moonen, '*Inco/Falconbridge*: A nickel mine of applications in efficiencies and remedies', *Competition Policy Newsletter* 3 (2006), pp41-49.

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17 The transaction ultimately did not go through despite the clearance because Inco's bid was unsuccessful.
18 See for example 'Efficiencies argument in merger review facing "considerable hurdle"', 27 March 2007, available at www.mlex.com.
19 Guidelines, para 84.
20 Guidelines, para 82.
21 See Commission Statistics at the website ec.europa.eu/comm/competition/mergers/statistics.pdf.
22 Article 6(1)(2).
23 Remedies Notice (2001), para 11; recital 30 of the ECMR.
24 Draft Revised Notice, para 2.
25 Draft Revised Notice, para 21.
26 Remedies Notice (2001), para 7.
27 Remedies Notice (2001), para 13.
28 Remedies Notice (2001), para 14.
29 See 'Closer scrutiny for divestments in future merger reviews, says EC's Calviño', 10 May 2007, available at www.mlex.com; and 'EC taking 'stricter' line on independence of supply in merger divestments', 29 June 2007, available at www.mlex.com.
30 Draft Revised Notice, paras 32-38.
31 See Commission statistics at the website ec.europa.eu/comm/competition/mergers/statistics.pdf.
32 Commission of 22 May 2007, Case M4404 (*Universal/BMG*).
33 Draft Revised Notice, para 23.
34 For an in-depth analysis of remedies with structural effects, see David Went, 'The Acceptability of Remedies Under the EC Merger Regulation: Structural Versus Behavioural', *European Competition Law Review*, pp455 et seq (August 2006).
35 Case T102/96, *Gencor v Commission* [1999] ECR II-753, at [319].
36 Aeriel Ezrachi, 'Behavioural Remedies in EC Merger Control: Theory and Practice', Oxford Competition Academy (8 July 2005).
37 Commission of 22 December 2005, Case M3940 (*Lufthansa/Eurowings*).
38 Remedies Notice (2001), paras 22 and 23; Draft revised Notice, paras 44-46.
39 Commission of 27 July 2001, Case M2337 (*Nestlé/Ralston Purina*).
40 Merger Remedies Study, para 144.
41 Remedies Notice (2001), para 6.
42 Remedies Notice (2001), para 7.
43 Draft Revised Notice, para 7.
44 Article 19 of the Implementing Regulation (EC) No. 802/2004 of 7 April 2004, [2004] OJ L133/1.
45 Article 10(1) and (3) of the ECMR.
46 Case T114/02, Babyliss [2003].
47 Draft Revised Notice, paras 50 and 51.
48 Draft Revised Notice, para 70.
49 Draft Revised Notice, para 71.
50 Draft Revised Notice, para 73.
51 Commission of 14 November 2006, Case M4180 (*Gaz de France/Suez*), para 29. See also Kirsten Bachour, Giuseppe Conte, Peter Eberl, Clémentine Martini, Alessandro Paolicchi, Philippe Redondo, Augustijn Van Haasteren, Geert Wils, '*Gaz de France/Suez*: Keeping energy markets in Belgium and France open and contestable through far-reaching remedies', *Competition Policy Newsletter* 1 (2007) pp83-91.
52 Commission of 20 February 2007, Case M4494 (*Evraz/Highveld*).
53 Commission of 20 February 2007, Case M4494 (*Evraz/Highveld*), paras 62-64.
54 Commission of 20 February 2007, Case M4494 (*Evraz/Highveld*), paras 136-151.
55 Commission of 27 June 2007, Case M4439 (*RyanAir/Aer Lingus*), not yet published.
56 See for example Commission of 11 February 2004, Case IV/M3280 (*Air France/KLM*); Commission of 22 December 2005, Case M3940 (*Lufthansa/Eurowings*).
57 See Commission press releases of 27 June 2007, 'Mergers: Commission prohibits Ryanair's proposed takeover of Aer Lingus' (IP/07/893); and 'Mergers: Commission's prohibition of Ryanair's proposed acquisition of Aer Lingus – frequently asked questions' (MEMO/07/258).
58 Commission of 22 November 2004, Case M3570 (*Piaggio/Aprilia*), para 50.
59 Commission of 15 July 2005, Case M3732 (*Procter & Gamble/Gillette*), para 131.
60 Commission 12 April 2006, Case M4057 (*Korsnas/Assidoman Cartonboard*), paras 57 to 65.