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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 important areas. Efficiencies have, so far, played a relatively small role in the European Commission's merger control practice but recent decisions indicate that merging parties are more frequently attempting to demonstrate efficiencies and that the Commission is paying greater attention to how efficiencies should be analysed in merger proceedings. Remedies can play a crucial role in any merger review that raises competitive concerns, and being able to structure effective remedies (without jeopardising the value of the transaction) could mean the difference between clearance and prohibition. Both efficiencies and potential remedies, given their complexity, should be analysed at the earliest possible stage. In fact, efficient counselling requires discussion of possible efficiencies and, to the extent possible, remedies proposals during the Commission's informal guidance at the pre-notification stage, so that the proposals can be fully analysed by the Commission within the tight time constraints imposed by the EC Merger Regulation (ECMR). This is one of the many ways in which European merger control filings are 'front loaded', requiring a heavier investment of time and resources earlier in the process, while US filings are, by comparison, 'back loaded'.

Efficiencies

On 1 May 2004, with the entry into force of the revised ECMR, a lengthy debate in the EU over whether efficiencies should be (positively) considered in merger control analysis finally came to an end. 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 'efficiency offence'.[1] The revised ECMR provides a clear legal basis for efficiency considerations to be taken into account by the Commission when assessing notified concentrations.[2] The accompanying Horizontal Merger Guidelines set out in detail the criteria under which the Commission will analyse efficiencies, while the more recent Non-horizontal Merger Guidelines adopt the same strict criteria but cite efficiencies as a reason why non-horizontal mergers are less likely to raise concerns.

The number of cases in which parties put forward efficiencies proposals for the Commission's consideration appears to be increasing; however, it seems likely that, in general, efficiencies arguments will continue to face a high level of scrutiny from the Commission. The Commission's decision clearing the acquisition of Falconbridge by Inco was one of the first to feature a complete analysis of efficiencies, and indicated that merging parties would have to clear a very high bar in order to successfully present an 'efficiency defence'.[3] Subsequent decisions (discussed further below) have mainly supported this view.

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 revised text makes clear that the creation or strengthening of a dominant position is no longer the sole focus of the Commission's attention. Instead, the threshold is more flexible: a concentration creating or strengthening a dominant position will no longer be prohibited if the transaction does not lead to a significant impediment to effective competition. Whether this is the case can only be assessed on the basis of an economic 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, where appropriate, 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 (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, efficiency considerations will 'save' a merger from prohibition if:

> *[T]he 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, but for the efficiencies, competitive concerns would exist. The consumer benefit may be reflected in lower prices due to cost efficiencies (with cost reductions in variable and marginal costs more likely to be relevant to the Commission's assessment than reductions in fixed costs), or new or improved products or services generated by efficiencies in R&D.

The Horizontal Guidelines make clear that mergers with a high degree of possible negative effects on competition will be required to demonstrate especially strong efficiencies. It is highly unlikely that a merger resulting in a level of market power approaching monopoly could be declared compatible with the common market on the grounds that efficiencies would be sufficient to counteract the anti-competitive effects.[7]

In order to be merger-specific, efficiencies have to be the 'direct consequence' of the notified concentration and should not be achievable 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 nature (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 must be quantified. Where such quantification is not possible, the Commission requires the likelihood of not only a marginal impact but a 'clearly defined positive impact on consumers' that will occur in a timely fashion.[9]

The Guidelines on Non-horizontal Mergers, adopted on 28 November 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 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 complementary 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',[11] which allows the integrated firm to profitably increase output on the downstream market; better coordination of production and distribution processes, which leads 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.[12]

Who has to prove efficiencies?

The Commission's Horizontal Guidelines place the burden of proof for the existence of countervailing efficiencies on the notifying parties, on the basis that most of the information enabling the Commission to assess whether efficiencies will be sufficient to justify clearing a merger is solely in the possession of the merging 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, this view seems questionable as, under the revised ECMR, efficiency considerations must form an integral part of the Commission's substantive (ie, competitive effects) analysis, not just upon invocation by the parties in the form of an 'efficiency defence'. Nevertheless, for all practical purposes it is the merging parties that must raise and substantiate efficiencies claims.[13]

How are efficiencies proven?

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.*[14]

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.*[15]

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 should efficiency claims be raised?

Given the complexity of efficiency claims and the likelihood that they will 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.*[16]

The notifying parties should, if possible, submit the relevant information in the first draft of the Form CO, which is usually submitted to the Commission at the pre-notification stage when 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, nevertheless, that 'the earlier the information is provided, the better the Commission can verify the efficiency claim'.[17]

Recent cases

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.[18] 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

and 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 competitive 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 competitive concerns and rejected the parties' efficiency arguments. However, ultimately the proposed transaction received clearance on the basis of remedies offered by the parties.[19]

In *Ryanair/Aer Lingus*, the failed attempt of a hostile takeover of Aer Lingus by Ryanair and the last merger prohibited under the ECMR, the Commission provided one of its most detailed analyses to date of efficiencies proposed by a party to a merger.[20] The two airlines were by far the largest airlines operating from Ireland and were each other's primary competitive constraint on Irish routes. 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 argued that substantial efficiencies would result from the takeover mainly in the form of operational cost savings, as a result of larger scale and rationalisation within Aer Lingus once Ryanair's business model would be applied to Aer Lingus. The Commission concluded that Ryanair's proposed efficiencies did not meet the criterion of verifiability, noting that they rested on various strong assumptions that could not be independently verified. Ryanair, according to the Commission, provided no objective or convincing evidence that it would be able to lower Aer Lingus' costs to its own levels apart from a general confidence in its 'more ruthless management style'. The Commission noted that all of the efficiency claims were based on documents created specifically for purposes of the merger procedure. Documents, dated pre-merger, which objectively and independently assessed the scope for efficiencies did not exist. Such documents were in the Commission's view critical to show that Ryanair's business model was non-replicable and superior to that of Aer Lingus, and that its cost structure could be successfully transferred to Aer Lingus after the merger. The Commission also concluded that several of Ryanair's claims were not true efficiencies but rather mere rent transfers, and that the hostile nature of the takeover bid could complicate the integration of the airlines and cast further doubt on the claimed efficiencies. For the sake of completeness, the Commission's decision also included its conclusions to the effect that the efficiencies were not merger-specific (since many of them could be achieved by Aer Lingus alone) and that cost savings were not sufficiently likely to be passed on to consumers due to the fact that the merger would, on many routes, create a virtual monopoly without sufficient incentive to lower prices.

The Commission also examined efficiencies claims in the context of several non-horizontal mergers, including two vertical mergers involving manufacturers of navigable digital map databases. In both *TomTom/Tele Atlas*[21] and *Nokia/NAVTEQ*[22] the merging parties submitted that the mergers would lead to efficiencies generated by the elimination of double mark-ups. The respective integrated firms, it was argued, would recognise that the true cost for an additional map database is a fraction of the percentage of the price of the final product represented by the database. As a result the merged firms would have an incentive to expand sales to take advantage of the higher profits they would make on sales of the final product. Assuming a certain percentage of the cost decrease would be passed on to consumers in order to increase sales, the result would be a decrease in the average market price of the respective final products. The Commission concluded that these efficiencies would be largely merger-specific because, while volume discounts were common in the industry, they were too limited to substantially eliminate double mark-ups. Hence, the elimination of these mark-ups could not be achieved to the same extent through other forms of vertical cooperation short of merger. The parties also proposed other types of efficiencies, based on the principle that vertical mergers 'may align the incentives of the parties with regard to investments in new products, new production processes and in the marketing of products'. The parties submitted a study which attempted to calculate the efficiencies but the Commission, while accepting that consumers could benefit from the improved technology, questioned the methodology used by the parties and observed that the efficiencies were difficult to quantify. In both of these cases, the Commission ultimately declined to reach an ultimate conclusion on the efficiencies proposals, but noted that the apparent efficiencies 'strengthened' its conclusions that neither merger gave rise to anticompetitive effects.

Most recently in *KLM/Martinair*, the Commission approved the acquisition of Martinair by KLM. In its decision, the Commission discussed the merits of a study submitted by the parties which put forward the type and the size of supply-side efficiencies (such as joint purchasing benefits, overhead reductions, rationalisation of frontline operations, systems integration and network efficiencies) and demand-side efficiencies (such as elimination of the double marginalisation effect for feeder passengers, an increase in flight bundles available to passengers, a reduced risk of delay, frequent flyer benefits and improved check-in facilities) which would arise if the parties merged. The Commission dismissed the relevance of the study for both supply-side and demand-side efficiencies. With regard to supply-side efficiencies, the Commission stated that the study should have examined 'to what extent such [supply-side] efficiencies would be passed on to consumers'. Since the parties' study did not distinguish between efficiencies affecting the parties' fixed costs and those affecting variable cost, the Commission concluded that it could not

infer from it the expected reduction in the parties' operating cost and hence the possible pass-on to consumers. With regard to demand-side efficiencies, the Commission stated that even if the demand-side efficiencies presented by the parties existed to some extent, they were difficult to quantify and the study's attempt to do so relied on 'rather strong' assumptions. Ultimately, the Commission did not take the efficiencies presented by the parties into consideration because the underlying assumptions in the study were found to be too strong to allow any inference on their ultimate quantification, and no clear-cut indication could be drawn from the study.[23]

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Commission decisions which include analysis of proposed efficiencies, as well as public statements by Commission officials,[24] would seem to indicate that the Commission intends to continue steering a narrow course with respect to efficiencies. This is certainly true for the assessment of horizontal mergers. The limitations on efficiencies set out in the Horizontal Guidelines are significant and when applied narrowly could even be prohibitive. Ironically, a merger that would create an entity with significant market power, such as that of Ryanair and Aer Lingus, will be unlikely to be cleared on the basis of efficiencies.[25] This means in practice that it is exactly those cases where efficiencies would be most needed to counter the Commission's concerns that they will be discounted. Due to this narrow approach, few horizontal concentrations will be compatible with efficiency arguments, and in practice there has as yet been no merger reviewed by the Commission in which efficiencies have been decisive in clearing a concentration.[26] In non-horizontal mergers such as *TomTom/Tele Atlas* and *Nokia/NAVTEQ*, efficiencies arguments may meet with less resistance from the Commission, and in practice can at least 'strengthen' a finding that a concentration is compatible with the common market, in itself a role that merging parties will no doubt welcome. Another area where efficiencies may prove significant in future cases may be in the context of '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.[27]

Remedies

The Commission rarely prohibits mergers outright. In fact, as of 30 June 2009, out of the 4,129 transactions filed with the Commission only 20 have been blocked.[28] 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 great importance for merging parties to understand how to deal with the Commission when competition concerns must 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.[29] At this stage, 'competition problems need to be so straightforward and remedies so clear-cut that it is not necessary to enter into an in-depth investigation[…]'.[30] Recent examples of such broad, simple Phase I remedies include *IPIC/MAN Ferrostaal AG*, in which the acquirer agreed to divest the target's minority stake in Eurotecnica, a supplier of high-quality melamine, thereby ensuring that the merged entity could not control entry or expansion on this market by favouring Eurotecnica's customer AMI, controlled by the acquirer IPIC; and *RWE/Essent*, in which, in order to address the Commission's concerns on the German markets for wholesale electricity and gas, RWE agreed to divest Essent's controlling interest in SWB, an undertaking competing with RWE on these markets.[31]

Practical business-related 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 parties' aim will be 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, 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 met. 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, the parties fail to meet a deadline), then the Commission may use its power to withdraw the decision and impose fines and penalties.

On 22 October 2008, the Commission published a revised Notice on remedies which replaces the 2001 Remedies Notice. The new Notice on remedies 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.[32] The 2008 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).[33]

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.[34]

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 '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 maintain effective competition, apart from prohibition, is to create the conditions for the emergence of a new competitive entity or for the strengthening of existing competitors via divestiture'.[35] 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.[36]

The 2008 Notice defines a viable business as a business that can operate on a stand-alone basis, that is, independently of the merging parties as regards the supply of input materials or other forms of cooperation other than during a transitory period.[37] Public statements by Commission officials indicate that the need to ensure independence of supply is receiving increased scrutiny.[38] 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.[39]

The Commission's preference for structural remedies generally, and divestiture more particularly, can be seen in the most recent cases. From 1 January through 30 June 2009, the Commission cleared seven concentrations subject to commitments in Phase I, all of which involved substantial divestments.[40] In the same time period, the Commission cleared two concentrations subject to commitments in Phase II. In *Lufthansa/SN Holding (Brussels Airlines)* the Commission's investigation showed that the merger gave rise to concerns on routes from Brussels to three German cities and Zurich. The parties committed to divest take-off and landing slots on those routes that would allow new entrants to operate flights on each of the routes. In order to make the divested slots more attractive to potential new entrants, any such entrant would receive grandfathering rights over the relevant slots once it had operated a route for a certain specified time period.[41] In *Arsenal/DSP*, the merger would have eliminated competition between the two main producers of solid benzoic acid in the EEA. Arsenal agreed to divest its production plant in Estonia, and therefore its entire solid and liquid benzoic acid production capacity, to a third party in order to ensure the existence of a credible alternative supplier.[42]

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. 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'.[43] 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.[44]

Purely behavioural remedies without structural effects

Remedies that are not fully within the merging parties' control or are dependent on the actions 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/SN Holding (Brussels Airlines)*, the parties' commitment to surrender slots at the relevant airports was supplemented by providing for an efficient and timely slot allocation mechanism, as well as ancillary remedies such as interlining, special pro-rate or codeshare agreements and participation in frequent flier programmes. In the Commission's view, this package of commitments made entry of new operators on the routes concerned likely.[45]

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.[46]

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.[47]

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'.[48]

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

The Court of First Instance confirmed, in its judgment in *EDP-Energias de Portugal*, that the burden of proof rests with the Commission to demonstrate that commitments validly submitted by the parties to a concentration do not render the concentration, as modified by the commitments, compatible with the common market. This judgment affirmed that insofar as the burden of proof is concerned, a merger modified by remedy proposals is subject to the same criteria as an unmodified merger.[49]

The 2008 Notice notes the Commission's ultimate burden of proof in light of the EDP judgment but 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, Commission Regulation 1033/2008, amending Council Regulation 802/2004 (the Implementing Regulation), now requires 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'.[50]

When should commitments be offered (or implemented)?

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.[51] 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.[52] In *EDP* and *MyTravel*, the CFI held that the Commission must take account of commitments offered in violation of the deadlines mentioned above provided that, first, those commitments clearly and without the need for further investigation resolve the competition concerns previously identified, and second, that the Commission has sufficient time to consult the member states on those commitments.[53] 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). Examples of up-front buyer remedies in the Commission's decisional practice 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.[54] 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.[55]

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 leads the Commission to accept, under certain circumstances, behavioural commitments (in particular, in cases raising vertical concerns) although, 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 will need 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 2008 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, in exceptional circumstances, to waive, modify or substitute the commitments'.[56] 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 subsequently will succeed in divesting the business within a short time frame'.[57] 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.[58]

Recent cases

In *Friesland Foods/Campina* the Commission investigated a proposed merger between the two largest dairy cooperatives in the Netherlands. Both were active in the collection and processing of raw milk into consumer and industrial dairy products. The Commission found that the concentration as notified would have significantly impeded effective competition in the Dutch markets for the procurement of raw milk, fresh basic dairy products, value added yoghurt and quark, fresh flavoured dairy drinks, fresh custard and porridge and cheese, as well as the market for long-life dairy drinks in Belgium, Germany and the Netherlands.

To address the Commission's concerns, the parties committed to divest Friesland's fresh dairy product business (including the transfer and licensing of brands and a plant in Nijkerk); one of Campina's cheese plants; and two Campina brands for long-life dairy drinks.

The divestments alone, however, were not sufficient to gain clearance because the Commission remained concerned that the merging parties would foreclose access to raw milk of their downstream competitors, including the divestment businesses. Therefore, the parties complemented the divestments with a set of commitments, combining structural and behavioural elements, to ensure downstream competitors would retain access to raw milk. These commitments consisted of three elements. First, the parties committed to enact transitional supply agreements allowing the divested businesses to

source raw milk from the notifying parties during a transitory period under competitive conditions. Second, the Dutch Milk Fund would subsequently be set up to ensure access to raw milk to the divested businesses and other competitors. The Fund would remain in place until more structural changes in the market for raw milk were achieved. Third, the merged entity agreed to reduce exit barriers for dairy farmers who choose to leave the newly formed cooperative. This measure would attempt to provide a long-term structural solution by creating a source of Dutch raw milk that was independent from FrieslandCampina.[59]

In *RCA/MÁV Cargo* the Commission investigated the acquisition of MÁV Cargo, a subsidiary of the Hungarian state-owned railway company, by RCA (a subsidiary of the Austrian railway incumbent). Both MÁV Cargo and RCA were active in the provision of rail freight transport and freight forwarding services. The Commission's main concern was that the acquisition would have resulted in the elimination of the most likely potential competitor to the incumbent in each of Austria and Hungary. In addition, an option to take a minority stake in MÁV Cargo was held by GySEV, an integrated rail and infrastructure company with its own rail network located in both Austria and Hungary. In the Commission's view, the GySEV option intensified the concerns by creating a structural link between the merging parties and the only other entity with the potential to develop into a serious competitor of either of them. In order to secure a clearance, therefore, RCA committed to cut all its structural links with GySEV (including the cancellation of GySEV's option) and review all cooperation agreements between the two companies, thereby strengthening GySEV as an independent player and preserving its incentive to compete with the new entity created by the merger. The main shareholders of GySEV, the Austrian and Hungarian governments, submitted declarations by which they committed to ensure that the structural links to the merged entity would be cut and that the influence of the Austrian government over GySEV's rail freight activities would be limited. One notable feature of the commitments in this case is that the effectiveness of the remedies required a change in the Articles of Association of GySEV, a third party. Since the Commission has no power to accept or monitor commitments by a third party, it applied the 'up-front buyer' type of divestiture remedy to the facts of the case. RCA committed not to close the transaction until the change in the Articles of Association safeguarded by the Austrian and Hungarian governments took effect.[60]

The Commission cleared the acquisition of English Welsh & Scottish Railway Holdings (EWS) by Deutsche Bahn, subject to commitments. This case was unusual in that the Commission's concerns were not that the merger would strengthen the position of the merging parties in any relevant market, as they in fact had no overlaps, but rather that it would strengthen the dominant position of a third party. The Commission was concerned that the merger would result in the weakening of the competitive constraint exercised by EWS in France as a new entrant in competition with SNCF, the French rail incumbent. This concern was on the basis that Deutsche Bahn may not have the same incentives to pursue the rail freight transport business in France with the same intensity as EWS would absent the merger. To remedy the Commission's concerns, Deutsche Bahn committed to a behavioural remedy designed to ensure it would continue to compete with SNCF on the French market. Deutsche Bahn committed to fulfil EWS' expansion plans in France over five years based on EWS' Business Plan, through investments in key assets and personnel. As an additional guarantee, the merging parties committed to provide fair and non-discriminatory access to EWS Driver Training Schools and maintenance facilities in France for all third-party rail operators other than SNCF, thereby lowering the potential barriers to entry and expansion for any other undertakings which may enter the French rail freight market.[61]

* * *

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' in horizontal mergers are likely to continue to face an uphill battle with the Commission. There is significantly more room for efficiencies in the context of non-horizontal mergers, where, however, the complexity of the analysis might result in a lengthy and burdensome Phase II investigation but ultimately a positive outcome can be expected as likely. 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. An increased use of upfront-buyer solutions by the Commission can also be observed. In all cases, parties must consider their strategies for efficiencies and remedies early on, and substantiate their story for the Commission.

Notes

1 See, for example, Case IV/M.69 (*MSG Media Service*), in which the Commission found that the efficiencies expected from the joint venture would enable the parties to outperform their competitors and thus attain a dominant position; and Case COMP/M.2220 (*GE/Honeywell*), in which the Commission's prohibition decision relied in part on a theory of conglomerate effects whereby the merged entity would be a more efficient competitor and drive competing firms out of the market by creating a structure which they would be unable to duplicate.
2 See article 2(1)(b) and Recital 29, ECMR.
3 Case COMP/M.4000 (*Inco/Falconbridge*).
4 Case T-282/06, *Sun Chemical Group v Commission* [2007] ECR II-2149, para 55 citing Case T-114/02 *BaByliss v Commission* [2003] E.C.R. II-1279, para 143; and Case T-119/02 *Royal Philips Electronics v Commission* [2003] ECR II-1433, para 242.
5 Horizontal Merger Guidelines, para 77.
6 Horizontal Merger Guidelines, para 78.
7 Horizontal Merger Guidelines, paras 79–84.
8 Horizontal Merger Guidelines, para 85.
9 Horizontal Merger Guidelines, para 86.
10 Guidelines on Non-Horizontal Mergers, para 53.
11 Guidelines on Non-Horizontal Mergers, para 13. Vertical integration of complementary activities within a single firm can lead to a decrease in mark-ups downstream and therefore higher demand upstream. A part of the benefit of this increase in demand will accrue to the upstream suppliers. An integrated firm will take this benefit into account and recognise an incentive to decrease prices and increase output because the integrated firm can capture a larger fraction of the benefits.
12 Guidelines on Non-Horizontal Mergers, paras 13–14, 52–57, 115–118.
13 See, for example, Case COMP/M.4874 (*Itema/BarcoVision*), para 76 No. 54.
14 Horizontal Merger Guidelines, para 87.
15 Horizontal Merger Guidelines, para 88.
16 Best Practices, para 18.
17 Form CO, footnote 1 to section 9.3.
18 Case COMP/M.4000 (*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.

19 The transaction ultimately did not go through despite the clearance because Inco's bid was unsuccessful.
20 Case COMP/M.4439 (*Ryanair/Aer Lingus*), paras 1099–1151.
21 Case COMP/M.4854 (*TomTom/Tele Atlas*).
22 Case COMP/M.4942 (*Nokia/NAVTEQ*).
23 Case COMP/M.5141 (*KLM/Martinair*), paras 408–411.
24 See, for example, 'Efficiencies argument in merger review facing "considerable hurdle"', 27 March 2007, available at www.mlex.com.
25 Horizontal Merger Guidelines, para 84.
26 In 2008, however, both the United Kingdom's Office of Fair Trading (OFT) and the Dutch competition authority (NMa) cleared horizontal mergers in part due to likely efficiencies. In its review of the acquisition of GCap Media plc by Global Radio UK Limited in August 2008, OFT found that in the London market, the merger of the two owners of commercial radio stations was likely to give rise to efficiencies sufficient to outweigh the risk of anticompetitive effects. The decision noted, however, that the analysis of unilateral effects in London was 'a marginal case, where efficiencies were merely required to tip the balance to be decisive, rather than needing to carry the burden' against a compelling risk of anticompetitive effects. This was in part because the parties' products were not close substitutes and in many respects even complementary. The effect of this was that certain efficiencies, such as the elimination of double mark-ups, were those associated with vertical or conglomerate mergers and not horizontal ones. In the merger of the only two national, door-to-door distributed phone directories in the Netherlands (*De Telefoongids/Gouden Gids*), the NMa decided after a Phase II investigation that the benefit to advertisers of the integration of the two directories would be significant, since advertisers of only one directory would gain the audience of the other, and overlap advertisers would only have to advertise in one directory post-merger. This effect would outweigh any post-merger price increases which could reasonably be expected by the parties.
27 Horizontal Merger Guidelines, para 82.
28 See Commission Statistics at the website http://ec.europa.eu/comm/competition/mergers/statistics.pdf.
29 Article 6(1)(2), ECMR.
30 Remedies Notice (2008), para 81; Recital 30, ECMR.
31 Case COMP/M.5406 (*IPIC/MAN Ferrostaal AG*); Case COMP/M.5467 (*RWE/Essent*).
32 Remedies Notice (2008), para 2. See Case COMP/M.5114 (*Pernod Ricard/V&S*), para 118.
33 Remedies Notice (2008), para 21.
34 Remedies Notice (2008), para 12.
35 Remedies Notice (2008), para 22.
36 Remedies Notice (2008), para 23. See Case COMP/M.5224 (*EdF/British Energy*), para 161; Case COMP/M.5046 (*Friesland Foods/Campina*), paras 1786, 1837–1838, 1866–1868.
37 Remedies Notice (2008), para 32. See Case COMP/M.5190 (*Nordic Capital/ConvaTec*), para 77; Case COMP/M.5224 (*EdF/British Energy*), para 198; Case COMP/M.5384 (*BNP Paribas/Fortis*) Date: 03/12/2008, para 156; Case COMP/M.5009 (*Randstad/ Vedior*), paras 68–71.
38 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.
39 Remedies Notice (2008), paras 32–38.
40 See Commission statistics at the website http://ec.europa.eu/comm/competition/mergers/statistics.pdf.
41 Case COMP/M.5335 (*Lufthansa/SN Holding (Brussels Airlines)*).
42 Case COMP/M.5153 (*Arsenal/DSP*).
43 Case T-102/96 *Gencor v Commission* [1999] ECR II-753, para 319.
44 Aeriel Ezrachi, 'Behavioural Remedies in EC Merger Control: Theory and Practice', Oxford Competition Academy (8 July 2005).
45 Case COMP/M.5335 (*Lufthansa/SN Holding (Brussels Airlines)*). 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).
46 Remedies Notice (2008), paras 44–46. See, for example, Case COMP/M.3687 (*Johnson & Johnson/Guidant*), para 360.
47 Case COMP/M.2337 (*Nestlé/Ralston Purina*).
48 Merger Remedies Study, para 144.
49 Case T-87/05, *EDP v Commission* [2005] ECR II-3745, paras 60–74.
50 Remedies Notice (2008), para 7.
51 Article 19 of the Implementing Regulation (EC) No. 802/2004 of 7 April 2004, [2004] OJ L133/1.
52 Article 10(1) and (3), ECMR.
53 Case T-87/05, *EDP v Commission* [2005] ECR II-3745, paras 162–163; Case T-212/03 (*MyTravel Group v Commission*), not yet published, paras 126–127.
54 See, for example, Case COMP/M.4187 (*Metso/Aker Kvaerner*); Case COMP/M.4000 (*Inco/Falconbridge*).
55 Remedies Notice (2008), para 50–51.
56 Remedies Notice (2008), para 71.
57 Remedies Notice (2008), para 72.
58 Remedies Notice (2008), para 74.
59 Case COMP/M.5046 (*Friesland Foods/ Campina*).
60 Case COMP/M.5096 (*RCA/MAV Cargo*).
61 Case COMP/M.4746 (*Deutsche Bahn/English Welsh & Scottish Railway Holdings (EWS)*).

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