

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

ROUNDTABLE ON THE ROLE OF EFFICIENCY CLAIMS IN ANTITRUST PROCEEDINGS

-- Note by the Delegation of Sweden --

This note is submitted by the delegation of Sweden to the Competition Committee FOR DISCUSSION under Item XII at its forthcoming meeting to be held on 24-25 October 2012.

JT03327595

Complete document available on OLIS in its original format

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

ROUNDTABLE ON THE ROLE OF EFFICIENCY CLAIMS IN ANTITRUST PROCEEDINGS

-- Note by Sweden --

Introduction

1. In the last 5-10 years Sweden has seen increased use of formal economic theory and quantitative methods in its competition law enforcement. The shift towards economics has in turn resulted in increased attention to efficiency rationales, both in the area of merger control and in antitrust enforcement. This contribution will discuss the role that efficiency claims have played in some recent Swedish merger cases.

1. Efficiencies that offset incentives to raise prices

2. With increased emphasis on merger simulations and first-order approaches such as UPP (Upward Pricing Pressure), the balancing of some types of efficiencies vis-à-vis competitive harm has in principle become more straightforward. The role of marginal cost efficiencies is for example quite transparent in the unilateral effects models commonly used for merger simulations and UPP-calculations. As shown by Gregory Werden in his 1996 paper “A Robust Test for Consumer Welfare Enhancing Mergers Among Sellers of Differentiated Products”,¹ information about current margins and diversion ratios is enough to calculate the marginal cost efficiencies required to offset the increase in market power resulting from a merger. These offsetting efficiencies are sometimes called the Compensating Marginal Cost Reduction (the CMCR).

3. As a rule of thumb, the CMCR can be approximated by $m \times d$, the merging parties’ percentage markup (m) multiplied by the diversion ratio between the parties (d).² In the fully symmetric case, the CMCR can be expressed exactly as $\frac{m \times d}{1-d}$.³ In either formulation, efficiencies expressed as CMCRs are relatively straightforward to calculate. Moreover, they circumvent a major difficulty traditionally associated with evaluating efficiencies, which is that of determining the degree of pass-on to consumers. In order to calculate the CMCRs, there is no need to estimate pass-through by determining the curvature of

¹ Werden, Gregory J., 1996, “A Robust Test for Consumer Welfare Enhancing Mergers Among Sellers of Differentiated Products”, *The Journal of Industrial Economics*, Vol. 44, No. 4 (Dec., 1996), pp. 409-413.

² The CMCR used here is the marginal cost reduction, as a percentage of the *price* (and not as a percentage of the marginal cost), which results in the same price pre- and post-merger. The approximation of CMCR is accurate when diversion ratios are low and when there is symmetry between merging firms in terms of markups and diversion ratios. It is an exact measure of CMCR when the efficiency is one-sided, i.e. when the marginal cost reduction only accrues to one firm.

³ This requires symmetry between the merging firms in terms of markups, diversion ratios, and marginal cost reductions.

demand, since the merging parties by construction keep to their original pricing.⁴ Nor is there a need to estimate how non-merging competitors would react to price changes.

2. The evaluation of efficiency claims in a recent merger

4. The Competition Authority has applied the UPP-approach and calculated CMCRs in the context of four recent merger assessments: *Office Depot/Svanströms* (2011), *Arla/Milko* (2011), *Cloetta/Leaf* (2012) and *Eniro/Teleinfo* (2012). The *Office Depot* and *Cloetta* mergers were cleared in phase I, whereas the assessment in *Arla* focused on a complicated counterfactual analysis due to insolvency issues. In the case of *Eniro* however, the question of merger efficiencies and CMCRs played a more central role.

5. The *Eniro/Teleinfo* merger involved the acquisition by Sweden's largest directory enquiry service provider of a maverick competitor focused solely on directory services via telephone and sms. The Competition Authority obtained data on diversion in that segment from second-choice questions posed in a survey commissioned by the Authority, and obtained margins from the parties themselves. For a more detailed discussion of this merger, see the Swedish contribution to the OECD 2012 Roundtable on Market Definition.⁵

6. Having presented sparse information of efficiency gains in the notification, the merging parties submitted more evidence and more detailed calculations at a late stage in phase II. The claimed efficiencies were of the same magnitude as the CMCRs and consequently, if accepted in their entirety, could have had the potential to offset the static incentives to raise prices.

7. Merger control in Sweden is adjudicative rather than administrative. In order to block a merger the Competition Authority has to make an application for summons to the Stockholm City Court requesting that the transaction be prohibited. A decision to leave the merger without further actions may not be appealed however. In its assessment of efficiencies the Authority applies the EU's horizontal merger guidelines, meaning that in order to take efficiencies into account they need to benefit consumers, be merger-specific and be verifiable. The first criterion, benefitting consumers, is integrated with the consumer welfare standard of the UPP-approach, so the same method that is used to evaluate costs in the UPP-analysis can be used to evaluate the efficiency claims. In practice this amounts to identifying what constitutes marginal cost with respect to the relevant product-offering decisions (normally the pricing decisions).

8. The second and third criteria however - specificity and verifiability - are much more difficult to evaluate in a short amount of time. In the *Eniro* case, the detailed efficiency calculations presented did not form part of the original filing, nor were they backed up by internal documents. This implied that the Competition Authority had to evaluate the calculations without access to underlying source evidence. In the end, the Authority therefore concluded that the criteria of merger-specificity and verifiability had not been met. When the Competition Authority announced its intention to issue an application for summons requesting that the transaction be prohibited, the parties decided to abandon the merger.

3. Incorporating different types of synergies in the assessment

9. More generally, the experience of the Competition Authority in many of its merger assessments is that marginal cost efficiencies tend to be presented to the Authority as an afterthought, and do not appear

⁴ If the CMCRs are greater than the claimed efficiencies, which implies that there is upward pricing pressure, pass-through and demand curvature could become relevant in order to determine the size of the price increase however.

⁵ DAF/COMPWD (2012) 23.

to constitute the primary business rationale behind the merger. Instead, the pro-competitive business rationale, as it is presented in internal documents, tends to center on synergies that are more difficult to quantify and to incorporate in the standard models, such as marketing synergies and complementarities in R&D.

10. Since the Competition Authority weighs the results from its quantitative analysis with all the other evidence obtained in the investigation in order to make a comprehensive assessment, this potential discrepancy need not result in over-enforcement, but it puts the burden on the merging parties to show, using cogent and convincing evidence, how any such non-standard efficiencies would counterweigh incentives to raise prices.

11. In order to reach its enforcement objectives the Competition Authority looks carefully at efficiency rationales, but at the end of the day the burden of proof has to rest with the merging parties – as they alone have access to all the information concerning the rationale of the merger.