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European champions and competition enforcement:

Is DG COMP in ideological denial?

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European champions and merger control;

Improving enforcement in the current framework

By

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ABSTRACT

In the wake of the Alstom restructuring, the French government indicated that current merger control rules do not allow for the development of European champions and called for a change in the rules. This paper argues that such a move may be not be advisable but that enforcement of the current rules should be improved, in particular regarding the assessment of efficiencies and the delineation of the wider public policy considerations that Member States can appeal to in exercising their own control. With respect to efficiencies, the Commission's practice exacerbates the inherent bias of its consumer harm standard against the development of more efficient firms. The identification of transactions that are likely to harm consumers requires the evaluation of the *magnitude* and *likelihood* of efficiencies with respect to a benchmark that is case specific. However, a review of the Commission practice suggests (i) that it has failed to develop a constructive standard for the evaluation of efficiencies, (ii) that the standard of proof that it applies to efficiencies is high and misguided with respect to the extent of pass-through, (ii) that the magnitude of efficiencies is often not assessed in relation to the potential harm and (iii) that a discrete threshold is often applied with respect to the likelihood of efficiencies. An improvement in the assessment of efficiencies along these dimensions would improve enforcement under the existing standard, making it less inimical to the development of efficient firms and would thereby also enhance its political acceptability in relation to the recurring debates on national champions. With respect to the additional oversight over transactions that Member States can exercise, the paper finds that the operation of the merger control framework would be improved if the Commission would pro-actively clarify the wider public policy considerations that can be brought to bear on the transactions under Art 21(4) and impose some transparency requirements on member states that elect to appeal to these public policy grounds to impose additional remedies. The paper also offers some guiding principles for the delineation of these policy grounds.

1. INTRODUCTION

Under the current framework for merger control, the Commission is supposed to prevent transactions that lead to a significant impediment to effective competition (Art 2 of the merger regulation) and this substantive criterion is (unanimously) understood as referring to consumer harm. The implementation of this standard is only subject to the very limited exercise of wider public policy considerations, under Art 21(4) of the merger regulation. These considerations can only lead to stricter enforcement so that the consumers can never be harmed and they can only be brought to bear on a transaction by the Member States. The merger regulation explicitly mentions prudential rules, security and plurality of the press as valid public policy grounds for intervention but allows potentially for others at the discretion of the Commission.

The implementation of these rules is often controversial from the perspective of the development of national or European champions, understood as potentially more efficient (competitive) firms. According to Commissioner Almunia, "competition policy is not about preventing the rise of vibrant and competitive European champions – far from it. On the contrary, enforcement of competition rules – including merger control – is a vital tool for public authorities to create the best possible conditions for firms to do business and to help the economy grow"[1].

In the context of the recent restructuring of Alstom, the French government, or at least its vocal (former) minister, A. Montebourg, disagreed that the application of merger control rules would indeed foster the development of European champions[2]. The French government intervened in the restructuring of Alstom but remained frustrated that the merger control rules would not allow the implementation of the plan that, in its opinion, would have lead to the development of European champions in the energy and transport sectors. The French government thus urged the EU to

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1 Speech delivered at Fordham, Sept 8, 2011, available at http://europa.eu/rapid/press-release_SPEECH-11-561_en.htm?locale=en.

2 This is not an isolated event. Debates on the interplay between merger control and national champions are recurrent Discussion arose just a few months ago about the proposed acquisition of AstraZeneca by Pfizer and in numerous cases in the last few years (including Cadbury/Kraft, HPV/Unicredito, Eon/Endesa, OMV/Mol, Arcelor/Mittal and others). The debate is as old as the Merger Regulation. See for instance the interview of Commissioner Brittan, back in 1991, WSJ, October 14.

change the criteria that it uses to assess transactions. Mr Montebourg is reported as having stated that "The rules have to now change after this story, because we need to make champions" [3]. In addition, the French government widened the scope of the control that it would itself exercise on transactions involving French firms to include sectors linked with energy security, water, transport, electronic communication and public health. The Commission has not challenged the conformity of this extension with Art 21(4) [4].

It is well known that a consumer harm standard is inherently biased against development of more efficient firms (to the extent that this framework excludes transactions in which the profit of more efficient firms compensates for a loss of consumer surplus) but, as shown in this paper, the Commission's practice exacerbates this bias and discontent with the standard should be seen in this light. The reasons for this is that the identification of transactions that are likely to harm consumers requires the evaluation of the *magnitude* and *likelihood* of efficiencies and the relevant benchmark (regarding the magnitude and likelihood of efficiencies) is specific to each case. However, a review of the Commission practice suggests that it has failed to develop a constructive standard for the evaluation of efficiencies, that the standard of proof that it applies to efficiencies is high and sometimes misguided (with respect to pass-through for instance), that the magnitude of efficiencies is often not assessed in relation to the potential harm and that a discrete threshold is often applied with respect to the likelihood of efficiencies. These features are likely to emphasize Type I errors and deny transactions that would benefit consumers because of efficiencies, in addition to those that are denied because consumer surplus falls even

[3] As reported for instance in the Wall Street Journal on June 26, 2014. Commissioner Almunia expressed dissatisfaction at the intervention, describing it as the sign of a "protectionist threat" that he needed to respond to and added that the arguments used by the French government were "not the more reasonable ones" (see MLex, June 24, 2014)

[4] The debate on public policy towards national champions is broader. There is indeed a large policy (and academic literature) on these issues (see for instance, the OECD policy roundtable (2009)), which also concerns state aid and trade policy. With respect to the former, the debate focuses on the promotion of strategic sectors even if existing instruments would appear to be adequate to provide support (as industry wide support is unlikely to be found selective). With respect to the latter, there is an emphasis on retaliation to foreign support, which may however be misplaced and in any event constrained by existing international obligations. The so-called "matching clause" in various state aid guidelines which allows for the existence of support by trading partners as a justification for EU support may be unlawful following the panel ruling on European Communities – Measures affecting trade in commercial vessels, WT/DS301, April 22, 2005. In this case, the panel found that the EU has violated its obligation under the SCM agreement by acting unilaterally in providing subsidies to the European shipbuilding industry in response to what it perceived to be unlawful subsidies granted by Korea.

thought the increase in profits compensates for the loss of consumer surplus. As a result, an improvement in the assessment of efficiencies along the dimensions identified above, would not only improve enforcement under the existing standard but it would also make enforcement less inimical to the development of more efficient firms and thereby enhance its political acceptability in relation to the recurring debate on national champions.

With respect to the wider public policy considerations that can be brought to bear on merger control under Art 21(4) of the merger regulation, the paper observes that the Commission has never clarified the grounds on which additional remedies could be imposed by the member states (besides the positive list of Art 21(4)). The paper briefly discusses the principles that might be used to delineate appropriate public policy grounds. We emphasize the potential capture of merger control by particular interest as an important source of concern and argue that the selection of relevant considerations should take into account the effectiveness of the mechanism and institutions that could be envisaged to implement them to limit the scope for capture. In particular, it would seem important to ensure that any public policy consideration that is chosen can be sufficiently codified. This would ensure that its implementation can be based on cogent evidence, can be transparent and can thereby allow for effective mechanisms of accountability. The paper concludes that the operation of the merger control framework would be improved if the Commission would proactively clarify its policy with respect to the public policy grounds that it would deem appropriate under Art. 21(4) and would impose procedural requirement on Member States electing to appeal to these grounds.

The paper is organised a follows. Section 2 discusses the assessment of efficiencies in the context of the enforcement of a consumer surplus standard and argues that the Commission's practice should be improved. Section 3 discusses the delineation of the wider public policy consideration that can be brought to bear on merger control. The concluding section argues that if the enforcement of the current rules could be made less inimical to the development of more efficient firms, a change in the rules themselves may not warranted.

2. ALLOWING FOR MORE EFFICIENT FIRMS UNDER THE CURRENT FRAMEWORK

This section shows that the way in which the Commission has applied its consumer surplus standard has exacerbated the bias of its policy against the development of more efficient firms. We discuss the significance of the role played by the evaluation of efficiencies when merger control operates with a consumer surplus standard in Section 2.1. In Section 2.2, we review the practice in this respect. Section 2.3 concludes.

2.1. THE ROLE OF EFFICIENCIES IN THE IMPEMENTATION OF A CONSUMER SURPLUS STANDARD

It is useful to describe the consequences of the Commission's choice of substantive criteria in terms of the selection of mergers with different characteristics. This is illustrated in Figure 1. The change in consumer surplus implied by a merger is represented on the vertical axis and the change in welfare on the horizontal axis. Any merger can be represented as a point in this graph and the population of potential mergers belongs to the red ball. The change in welfare is equal to the sum of the change in profit for the merging firms, the change in profit of competitors and the change in consumer surplus. In standard models of horizontal mergers, in the absence of efficiencies, consumer surplus falls, the profits of the merging firms and those of competitors increase but overall welfare falls (as the mere exercise of market power always leads to a fall in welfare). Such mergers are found in the lower left hand quadrant[5]. In all other areas, mergers involve some efficiencies; for mergers above the horizontal line, price falls (consumers gain) and this can only arise following a horizontal merger if there are some efficiencies which are to some extent passed on (so that the fall in marginal cost compensates for the increased margins). For mergers in the lower right hand quadrant, welfare increases and this can also only arise if there

[5] Note that some mergers in this area might not be profitable.

are some efficiencies (because the mere exercise of market power always reduces welfare)[6].

Assuming that the Commission correctly identifies the characteristics of mergers in this simple framework, it will thus allow all mergers in the upper right hand quadrant[7]. Those mergers lead to an increase in consumer surplus and welfare[8]. However, there are mergers that lead to an increase in welfare but not in consumer surplus (in the area hatched in green). Mergers in this area lead to an increase in profit that exceeds the fall in consumer surplus. As noted above, these mergers necessarily involve efficiencies and would increase aggregate profits and, to a greater extent, the profit of the merging firms (as in the presence of efficiencies, the profits of the merging firms is likely to increase by more than the profit of competitors). These efficiency enhancing mergers are deterred or prohibited under the substantive criteria of the Commission. Note however that whether a merger can be characterised as merely increasing welfare (on the bottom right hand quadrant) or increasing both welfare and consumer surplus (on the upper right hand quadrant) also depends on the horizon that is adopted. Indeed, mergers which increase welfare but not consumer surplus typically involve savings in fixed cost that are not passed on to the consumers in the short term. However, the reductions in fixed cost are likely to be eventually passed on through larger increases in capacity, or larger increases in quality[9].

Some useful observations can be made from this figure; first, the assessment of efficiencies by the Commission is a matter of *degree*; mergers in the upper right hand quadrant (allowed by the Commission) and those in the lower right hand quadrant (prohibited by the Commission) all involve efficiencies (and a degree of pass-on) albeit to a different extent. Indeed, in order to allow *any* horizontal merger (in the upper right hand quadrant), the Commission must have a presumption that efficiencies will accrue[10] and will be passed on (over a given horizon). Hence, the

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6 In other words, efficiencies are a necessary and sufficient condition for an increase in welfare and a necessary (but not sufficient) condition for an increase in consumer surplus.

7 Note that some mergers in this quadrant will not be proposed because the increase in profit for the merging firms will not be sufficient. These mergers are likely to be found above the blue line.

8 Note that the Commission might also allow mergers in the upper left hand quadrant. These mergers will be such that overall profits fall. These mergers might still be proposed if the profit of the merging firms increases but by less than the absolute value of the profit of the competitors.

9 See for instance Rubinovitz (2008) for a discussion.

10 The issue is particularly stark when the Commission uses merger simulations and need to define a tolerance for predicted price increases, which reflects its presumption about the reduction in marginal cost that might compensate for this price increase. See also Farrell and Shapiro (2010).

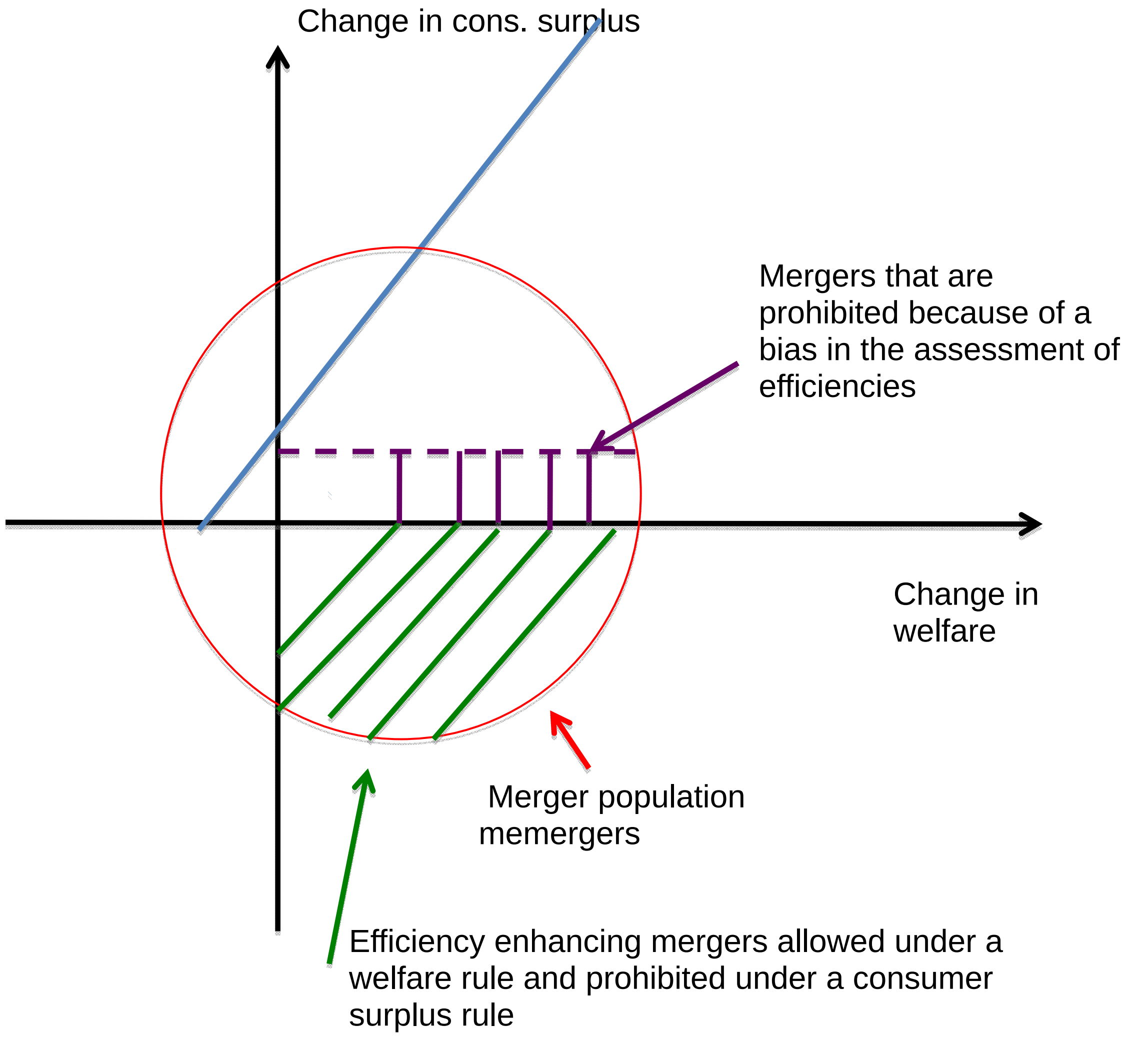
question that the Commission faces is not whether there are efficiencies but whether these efficiencies are large enough (and will be passed on to consumers) to conclude that consumers will not be harmed. The level of efficiency that will be deemed sufficient to conclude that the merger will not reduce consumer surplus will also be merger specific (as it depends on the extent and likelihood of the potential harm that has been identified). The consequence of a bias in the evaluation of efficiencies can also be illustrated: if the Commission has a higher standard of proof with respect to the evaluation of efficiencies than with respect to the evaluation of anti-competitive effects (or displays a downward bias in the evaluation of efficiencies), some mergers that are expected to increase both consumer surplus and welfare will be prohibited. This is illustrated by the area hatched in purple in Figure 1. Hence, the evaluation of efficiencies is both pivotal to the implementation of a consumer surplus standard and the benchmark against which efficiencies have to be assessed is specific to each merger.

The central role that the evaluation of efficiencies should play in the implementation of a consumer surplus standard can also be contrasted with the role that it would play with respect to a total welfare standard. In this instance, the question would be whether a merger falls to the right or the left of the vertical axis. However, at least for those mergers that fall below the horizontal axis, the question would the same for all mergers and merely whether efficiencies are likely to be positive. Indeed, the triage between welfare enhancing and welfare decreasing mergers (when consumers are harmed) depends solely on the existence of efficiencies[11].

Hence, it is clear from the previous discussion that a failure to properly assess efficiencies will widen the discrepancy between the outcome of a consumer surplus standard and that of a total welfare standard (the area hatched in purple on Figure 1). It is thus “important that efficiencies, investment and innovation play a proper role under a consumer surplus standard” (Roeller, 2011). In addition, as discussed above, under a consumer welfare standard, the Commission should in principle evaluate the quantitative significance of efficiencies in all cases (and the threshold value beyond which the case should be cleared will vary from one case to the other).

[11] As efficiencies are a necessary and sufficient condition for an increase in welfare.

Figure 1. Consumer surplus and total welfare standard



2.2. THE COMMISSION'S PRACTICE

In assessing whether the Commission is giving a fair hearing to efficiencies, it is striking to observe that over almost 25 years of enforcement, the Commission has never accepted efficiencies in a way that was instrumental for a final decision[12].

In the five years that followed the adoption of a change in the merger regulation that has arguably given more prominence to efficiencies in 2004, static efficiencies have only been claimed in 6 phase II cases out of 37 and they have been accepted as relevant in 3 of them (see Roeller, 2011)[13]. For period 2009 to 2013,

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[12] Except possibly in the Shell/Nynas/Harburg Refinery (M6360) case, which is however a failing division case. See http://europa.eu/rapid/press-release_IP-13-290_en.htm.

[13] It is puzzling that efficiencies are claimed in such a low proportion of cases. According to Roeller (2011), this arises because parties and their legal advisors are concerned about efficiency

Seabright (2014) reports even lower rates of acceptance. Both Roeller (2011) and Seabright (2014) find that dynamic efficiencies (involving abilities and incentives to innovate) play an even less significant role.

In what follows, we review some of the key decisions in which the Commission reviewed efficiencies since 2005 from a law and economic perspective. In *Inco/Falconbridge* (M4000), a merger between two mining companies, the Commission agreed with the parties that the integration of the parties' mines, mills, smelters and refineries would allow for the optimization of capabilities of these assets, thereby increasing production and lowering cost on a sustainable basis over the longer term. But the Commission found that the efficiencies were not merger specific because they could have been realized in the context of a joint venture and that efficiencies would not be sufficiently passed on because some of the efficiencies would accrue across markets and in particular in market unaffected by the transaction in which the parties faced little competition. However there is no quantification of the extent of pass through and of the extent to which consumers would still benefit over all. In addition, the Commission seems to presume, incorrectly, that the pass-through will be lowest when firms are in quasi-monopoly and increase with the degree of competition. In general, the pass-through actually *falls* with the number of competitors but might increase with the degree of substitution between products[14].

In *Kornas/AD Cartonboard* (M 4057), the Commission found that the parties would achieve significant efficiencies that were likely to be passed on. Rather surprisingly, the Commission acknowledged that an assessment of the efficiencies was difficult in phase I but could conclude on the basis of a superficial analysis[15] that

offenses (such that evidence of efficiencies is used to argue that competitors will be marginalised) or more generally concerned about the fact that claims about efficiencies will send the signal that the parties are not confident with respect to their evidence on the lack of anti-competitive effects.

[14] See for instance Motta (2004) who shows that in a a canonical model of competition with differentiated products, the pass-through falls with the number of firms. In the same model, Neven (2001) shows that the pass-through increases with the degree of substitutability between products. Similar results are reported in the RBB (2014).

[15] "The submission by the parties raises a lot of issues, which cannot be fully assessed within the context of a first phase investigation, ... Nevertheless, it appears realistic to assume that the allocation of production among the increased portfolio of machines will indeed allow the merged entity to increase overall production on the machines…. In light of the above-mentioned term sheet agreement with Tetra Pak and on the general absence of concern about the transaction among customers, the Commission considers that the parties have sufficiently established that this category of efficiencies is likely to occur and be passed on to consumers" (§62-63)

the parties had established to the required standard that efficiencies would be passed on to consumers.

The Commission also dismissed the evidence put forward by the parties in *Western Digital Ireland/Viviti Technologies* (M6203), partly on the ground that pass-through would be insufficient in light of the fact that market would be a duopoly. There again the argument of the Commission is at best incomplete. More generally, the Commission does not seem to realise that the factors (in terms of demand) that lead to anti-competitive effects are the precisely those that lead to a high pass-through[16].

In *Metso/Aker Kvaerner* (M 4187), the Commission acknowledged the claim by the parties (supported by customers) that the merger would enable the parties to better integrate the different parts of a paper mill (in which they had different specialization). However, the Commission dismissed the significance of these efficiencies simply because a majority of customers[17] are reported as having stated that in their view the improvement in quality would not compensate for the risk that prices would increase. One can really wonder whether customers are a reliable source of information and have a sound judgment both on the quantum of efficiencies that would result from the integration plans that are private to the merging firms and the significance of the price increase that would arise (given that in the case at hand, there was a prospect that the merging entity would be in a better position to challenge the market leader).

In *UPM/Myllykowski* (M 6101), the parties submitted extensive evidence of efficiencies that would arise from the reallocation of output across different paper mills. The evidence was developed using methods that the parties routinely implemented to allocate output among their respective portfolio of plants pre merger. The results from these calculations could thus also be validated by past experience. The Commission (§167) however chose to dismiss the efficiencies on the ground that even if they would reduce variable cost, the parties had not provided direct evidence of pass-through. This is (again) misplaced as the Commission should presume that if significant anti-competitive effects have been identified, the pass-through will be

[16] See Froeb, L., S. Tschantz and G. Werden, (2005). The price effect of a merger is stronger when the products of the merging firms are close substitutes. But, as mentioned above, the pass through also increases with the degree of substitution between products (at least in some circumstances). For a discussion of pass-through, see Farrell and Shapiro (2010).

[17] As often, the Commission does not report what the majority was and how many customers responded.

significant (see above). The Commission even questions whether there will be any pass-through ("Under those circumstances it is particularly unclear whether any efficiencies would be passed on to the customers".). This is quite surprising as the circumstance in which efficiencies are not passed-through (like perfect competition with homogenous products) can be seen as intellectual curiosities.

Efficiency claims were subject to greater scrutiny in the *UPS/TNT* (M6570)[18] and *Deutsche Borse/NYSE Euronext* (M 6166) cases. In *UPS/TNT*, the Commission has only validated the efficiencies claimed by the parties with respect to the air network and dismissed those with respect to the integration of the pick up an delivery and long haul terrestrial networks. Still, it is not clear on what ground the Commission decided that the former efficiencies should be considered verifiable and the later not. Both studies were undertaken by implementing the methodologies that the parties routinely used in the optimization of their network (whether air or terrestrial). The Commission also seems to quibble with the level of details of the estimation of efficiencies, despite the fact that the parties had considered that this level of details as sufficient for the purpose of planning the transaction. In any event, for some countries, the parties provided very detailed efficiency calculations that the Commission nevertheless ignored.[19] In addition, the Commission dismisses past experiences of the integration of terrestrial networks on a very general ground, namely that the incremental benefits from economies of density can be expected to fall as the network grows.

In *NYSE/Euronext*, the Commission faced two main efficiency claims, namely that that the merger would lead to a significant reduction in collateral requirements for its clients and that the merger would improve liquidity. The Commission accepted

[18] The decision is not published at the time of writing (July 2014), but the Commission published a summary: Summary of Commission Decision of 30 January 2013 declaring a concentration incompatible with the internal market and the functioning of the EEA Agreement (Case COMP/M.6570 — UPS/TNT Express), OJ, 2014/C 137/05. The Commission stated in that summary that the decision has underestimated the extent of pass-through of efficiencies. This was later corrected. Corrigendum to Summary of Commission Decision of 30 January 2013 declaring a concentration incompatible with the internal market and the functioning of the EEA Agreement (Case COMP/M.6570 — UPS/TNT Express), OJ, 2014/C 187/10

[19] Of course, one cannot help observing that if the Commission had acknowledged the presence of efficiencies in the ground network, customers in unaffected markets (for domestic and standard international services) would have benefitted from the transaction. The Commission would thus have had to consider cross-market efficiencies and might have come to the conclusion that a vast majority of the customers (using both the international express as well as other services) would have benefitted from the transaction. This case actually provides a good example of a situation in which inefficiencies are inextricably linked across markets and in which customers in affected and non affected markets are substantially the same.

the former but significantly reduced the estimated benefits, as it pointed out, rightly, that the benefits should be estimated in terms of the opportunity cost of holding cash or securities posted as collateral (and not merely as the gross value of the reduction in collateral). With respect to the claim on liquidities, the parties provided evidence relating to past mergers. The Commission considered this evidence in detail both in terms of its technical aspects (a regression analysis in which the effect of past mergers was identified) and in terms of its interpretation (whether the circumstances has changed significantly since the past mergers). The latter argument seems genuinely a matter of debate. With respect to the former, the report given by the Commission is (as often) incomplete so that it is difficult to assess the merit of arguments.

In the *Hutchinson 3G/Orange Austria* case (M 6497), the parties claimed that the merger would increase the capacity of the network (and thereby quality)[20]. The Commission dismissed the evidence on the ground that it was not sufficiently precise, without however pointing to the type of evidence that it would consider satisfactory (&412). The Commission also considered that efficiencies would not be merger specific by merely pointing however that alternatives would be plausible (& 417, a very low standard) and noting that parties should have presented evidence on the incremental benefits (relative to the next best alternative). The Commission also questioned whether customers would benefit from the increased capacity (and reduction of congestion) as the merged entity might increase price. This assertion is somewhat odd as one would expect the prices to increase precisely in the presence (and not the absence) of capacity constraints (something that the Commission also acknowledges albeit in a somewhat obfuscated way). Overall, even if the decision indicates that the parties have not provided adequate information, one is also left with the impression that the Commission dismissed whatever was submitted on fairly general grounds.

In addition to horizontal mergers, the Commission has also considered efficiencies in vertical or conglomerate transactions, like *TomTom/Tele Atlas* (M 4854), *Nokia/Navteq* (M 4942) or *Intel/MacAfee* (M5984). These non-horizontal transactions raise another issue with respect to efficiencies as the traditional analytical approach of the Commission in horizontal cases, in which the analysis of anti-competitive effects is separated conceptually from the effect of efficiencies, is not

[20] Faster LTE rollout, network coverage and reduction in scale disadvantages were also argued and dismissed.

appropriate in these cases. In vertical cases, the sources of the efficiency and the potential for anti-competitive effects cannot be neatly disentangled. *Intel/McAfee* is a case in point. This transaction involved the integration between the CPU (hardware) and security software and the parties argued that integration would allow them to develop better solutions than what could be achieved in the context of a looser cooperation (that they had tried before). The anti-competitive effects in this case arise from the potential foreclosure of other security software producers. Of course, to the extent that efficiencies require a tight integration, they will also imply some foreclosure effect and access remedies (for other software producers) would run the risk of jeopardizing the efficiencies (by reducing the scope of integration). That is also to say that parties will be wary of arguing the presence of efficiencies in such cases as it will draw attention to anti-competitive effects and could be turned into an efficiency offense.

2.3. SOME CONCLUSIONS ON EFFICIENCIES

A few conclusions emerge from the previous discussion. First, it is striking that in a number of cases the Commission tends to dismiss (or occasionally approve of) efficiencies on very general grounds. This fairly general discussion does not help in constructing a standard for the evaluation of efficiencies that the parties can anticipate.

Second, the Commission seems to apply a very high standard of proof to the evidence on efficiencies. Crane (2011) concludes that there is indeed a strong asymmetry between the standard that the Commission and the FTC applies to efficiencies, on the one hand, and anti-competitive effects on the other. Gonzales-Diaz (2012) who reviews a number of recent decisions by the Commission reaches the same conclusion[21]. The analysis of the Commission with respect to pass-through is striking in this respect as the Commission seems to rely on presumptions that are misguided.

Third, the Commission has not provided much indication of the sort of evidence that it would consider sufficient to conclude that the relevant criteria

[21] Kokkoris (2012) argues that the OFT has developed a more balanced standard, in particular following the clearance of the Global Radio UK Ltd v GCap Media Plc case for which efficiencies were instrumental. See also Laprévote (2014).

(verifiability, merger specificity or consumer benefit) would be met, in circumstances in which it has rejected efficiencies. One implication of this is that the relevant standard has been defined mostly in a negative rather than positive or constructive way.

Fourth, the Commission tends to consider the significance of efficiencies as a discrete issue. Yet, like anti-competitive effects, efficiencies should be seen in probabilistic[22] way and the quality of the evidence will affect the probability that the Commission attaches to the development of efficiencies (in the same way that the quality of the evidence on the anti-competitive effects affects the assessment of the Commission).

Fifth, with some exceptions, the Commission has not considered the magnitude of the efficiencies (but merely their presence). This is a source of concern in light of the fact that, as mentioned above, efficiencies are a matter of degree in the application of a consumer surplus standard and the relevant benchmark (the required efficiencies to compensate for anti-competitive effects) varies from one case to the other.

Overall, these features are likely to emphasize Type I errors and will exacerbate the inherent bias of a consumer surplus standard against the development of more efficient firms[23]. As result, an improvement in the assessment of efficiencies along the dimensions identified above, would not only improve enforcement under the existing standard but it would also enhance its political acceptability in relation to the recurring debates on national champions. Interesting, it would seem that that the Commission may be actually moving in this direction. Efficiencies have been claimed in a number of important transactions[24] and the Commission has evaluated the submission in greater details than before in at least some instance.

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[22] See Crane (2011) for a discussion of this.

[23] It is also intriguing that the Commission has never acknowledged the existence of efficiency benefits for firms other than the merging partners. Yet, there is a large literature on the spillovers that arise from improvements in technology and research and developments (and indeed stong evidence of these spillovers within industrial clusters – see for instance Spector (2009). This would actually require for the Commission to take into account the efficiency benefits from merger for other firms than the merger partners (competitors as well as suppliers of complements in the context of a localised network). However, it seems that the wording of the merger regulation (in particular Art 2.1) and of the horizontal merger guidelines (in particular § 77) would not prevent the Commission to take them into account.

[24] In addition to those mentioned above, the Commission has also considered efficiencies in the other recent mobile transactions (*Telefonica/Eplus* (M7018), *Hutchinson 3G/Telefonica Ireland* (M 6992)). These decisions are however not yet published at time of writing (July 2014).

3. ENFORCEMENT OF THE PUBLIC INTEREST TEST (ART 21(4))

In this section, we further consider the wider public policy considerations that can be brought to bear on merger control under Art 21(4) of the merger regulation. The regulation explicitly mentions prudential rules, security and plurality of the press as valid public policy grounds for intervention but allows potentially for others at the discretion of the Commission. There have been a number of cases in which the application of Art 21(4) has been at stake, in particular *Lyonnaise des Eaux/Northumbrian water* (M567)*, EDF/London Electricity* (M1346)*, Champalimaud* (M1616)*, Cimpor* (M2054), *Unicredito* (M3894), *Autostrade* (M4249) and *Endesa* (M4110). However in those cases, neither the Commission nor the European courts had an opportunity to express themselves on the public policy considerations[25] that they would find appropriate in the exercise of Art 21(4), beyond the positive list[26]. Even with respect to the elements of the positive list, little guidance has been provided on the scope of their application. This is particularly relevant for public policy considerations as general as public security which could be given very different alternative interpretations (from a focus on national defence to issue involving investments in telecommunication, food or medicine safety).

A number of countries exercise still oversight over transactions involving domestic firms. France introduced an administrative law ("Décret 17391") in 2005 which adds a layer of control with respect to acquisitions affecting defence and national security (broadly understood). This law is often referred to as the Yoghurt Law (as it was adopted when it was rumoured that Danone could be taken over by Pepsi Co, but also when Gemplus, the smart card producer, was acquired by Texas Instrument). This law falls squarely within the exception of Art 21(4) and its scope is wider for acquisitions by non-EU interests. There is limited transparency on the decisions but it is understood that commitments to maintain activities in France have been routinely negotiated (see Neven, 2010). As mentioned above, the scope of the law was extended on 14/5/2014 (and nicknamed as the Alstom law). The UK can

[25] With the exception of *Lyonnaise des Eaux/Northumbrian water and EDF/London Electricity* (as further discussed below)
[26] These cases dealt mostly with the notification requirements of Art 21(4).

intervene on the ground of national security[27]. Germany has a law enacted in 2009 that only applies to non EEA investor[28] and its only ground for intervention is public order and security[29].

One can wonder on what basis these additional public policy considerations could be delineated. Several issues come to mind from an economic perspective. First, one can broadly distinguish between efficiency and equity considerations, while observing that the existing positive list of public policy considerations can be understood in terms of efficiency in a broad sense (as concerns for public security, the diversity of the press and financial stability can be cast in terms of the internalization of external effects). Second, the potential consequences of type I and type II errors may be relevant. For instance, the potential consequences of allowing a transaction that would endanger financial stability (a type I error) may be so high that this consideration cannot be ignored. Third, the potential for capture by particular interests should be explicitly considered as it is arguably the main potential drawback from the implementation of a public interest test (see for instance, Chisholm and Jung (2014) for a discussion of the UK experience). Accordingly, the selection of relevant considerations should take into account the effectiveness of the mechanism and institutions that could be envisaged to implement them. In particular, it would seem important to ensure that any public consideration that is chosen can be sufficiently codified so that its implementation can be based on cogent evidence, can be transparent and thereby allows for effective mechanisms of accountability.

Drawing a list of potential public policy considerations in light of these three criteria is highly fact specific and beyond the scope of this short paper. But is worth pointing to a couple of examples, respectively a public policy consideration that may plausibly fit these criteria and one that does not.

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[27] Following the Pfizer's recent attempt to acquire Astra Zeneca, the question has arisen whether public security could be understood as including the protection of health supplies.

[28] See also Cowen (2014).

[29] In the US, in addition to oversight by regulatory authorities (as discussed below) control is exercised by the Committee on Foreign Investment (CFIUS) under the Foreign Investment and National Security Act. The only public policy ground of intervention is national security (broadly understood to include critical technologies). In 2012, The Committee reviewed 144 transactions, undertook an investigation in 44 cases. One divestment order was imposed on a Chinese investor in a wind park next to a military airfield (CFIUS, Annual report to Congress, December 2013). There are however a number of important cases like *Alcatel/Lucent*, *Dubai Port* or *Fujitsu/Schlumberger* in which the executive intervened on the ground of national security (see Cowen (2014) for a discussion)

Consider first the case of regulated sectors. This is an area in which there are some complementary institutions providing guarantees in terms of transparency and accountability (the national regulators working within the relevant EU framework). The regulators typically operate with a public interest mandate, which is to some extent codified. In the area of utilities, their mandate will for instance focus on investment incentives, exclusionary and exploitative practices and universal service obligations. It is also interesting to observe that merger review in the US is undertaken both by the antitrust authorities (Department of Justice or Federal Trade Commission) operating with a consumer surplus standard and by relevant regulators (for instance, for communications, energy and air transport) operating with a public interest standard[30]. If regulatory objectives were recognised as a valid public policy concern under Art 21(4), European merger control would thus operate in the same way as dual enforcement in the US, where remedies can be negotiated by both the antitrust and the regulatory agencies. Advantages of such a system would seem to include the greater competence of the regulatory agencies in technical matters, and the greater range of tools that they can mobilise[31]. Both dimensions would seem to be particularly relevant for the design of remedies. It is striking to observe from this perspective that according to Kwoka (2013) remedies negotiated by the regulatory agencies tend to perform better then those negotiated by the antitrust agencies. Overall, it would seem that given the existence of regulatory agencies providing guarantees in terms of enforcement, the identification of a rationale for intervention in terms of efficiency, the significance of the issues at stake and the US experience, there is at least a plausible case for considering regulatory objectives as valid ground for intervention under Art 21(4). The Commission has made a step in this direction by considering the objective of water regulation in the UK as a valid ground for intervention (in the *Lyonnaise des Eaux/Northumbrian Water* case) but it has however denied intervention in the *EDF/London Electricity* case that also concerned a regulated utility.

By contrast, consider the concern that is often expressed with respect to the location of research and development centres following an acquisition by foreign interests. There is indeed an intriguing observation with respect to R&D facilities such that there is home bias in the location of R&D, which seems to persist despite

[30] See Kovacic, Mavroidis, Neven (2014)
[31] See Koutsky and Spiwak, (2010) and Frankel (2008)

globalization. For instance, Griffith et al (2004) find that in the chemical, pharmaceutical and service sectors, UK owned multi-national firms have a significantly larger R&D intensity than foreign owned multinationals. Cohen et al (2009) find a strong concentration of R&D and patents in the home countries of the largest firms in the telecom and automobile sector[32]. In turn there is a large literature confirming that R&D might generate localized spillovers so that the relocation of R&D following a foreign acquisition will have negative external effects that may justify a public policy intervention (see Spector, (2009) for a discussion). The recent commitment by Pfizer to maintain 20 % of its R&D activity in the UK (for five years) in the event of an acquisition of AtraZenaca seems to be a response to this public policy concern[33]. Yet, the location of R&D (and the preservation of its spillovers) would not seem to pass muster as an appropriate public policy concern under Art 21(4). First, there is no clear theory behind the observation of a home bias in R&D, there is no explicit theory of how this home bias would operate in the case of an acquisition (and little direct and systematic evidence of such effect from past acquisitions, controlling for the appropriate factors) and, partly as a consequence, no clear methodology to calibrate the external effect that may arise following the acquisition by a foreign interest (so that it would also be difficult to design procedures offering adequate guarantees in terms of transparency and accountability) even if one wishes to do so.

Overall, we conclude that the operation of the merger control framework would be improved if the Commission pro-actively clarified its policy with respect the public policy grounds that it would deem appropriate under Art 21(4). But it would seems to be equally important for the Commission to impose strong procedural requirements, in terms on transparency and accountability, on member states electing to appeal to these public policy concerns. The current situation would appear to be unsatisfactory in this respect even for the public policy ground included in the positive list. As mentioned above, unlike what happens in the US, one is hard pressed to find evidence on the sort of remedies that France has been imposing through the enforcement of its administrative law ("Décret 17391") since 2005.

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[32] See also Stiebale and Reize (2011) and Stiebale (2013) who consider a sample of German firms and find a reduction in R&D expenditures in target firms and increase in R&D expenditures in the home country of the foreign acquirer.

[33] http://www.theguardian.com/business/2014/may/13/pfizer-astrazeneca-uk-job-cuts-mps-hostile

4. CONCLUSION

This paper has argued that an improvement in the Commission's evaluation of efficiencies in mergers would lead to better enforcement (in terms of its own objective) and would also alleviate the concerns of its critics regarding the development of "champions". The paper has also argued that a more precise delineation of the public policy grounds that can be brought to bear on transactions and of the conditions under which these public policy objectives could be activated would be welcome.

The paper has purposely stayed away from the bigger question of whether the standard for the review of mergers should be modified, in favor of a total welfare standard or some public interest test. In our view, such a broad debate may not be worth engaging into because potential benefits would appear meager, and drawbacks, by contrast, may be significant. First, it is not entirely clear that current rules, if properly applied, would frustrate the development of so many efficient firms. There is ample evidence[34] that champions are more likely to emerge from the development of small innovative firms (for which merger control may not be a constraint) than from the development of already large incumbents. In addition, as markets become more global, the potential conflicts between merger control and the development of champions are less likely to arise. Second, the adoption of a more comprehensive standard involves difficult issues of procedures and institutional design. The evaluation of profits (besides consumer harm) is significantly harder than the evaluation of consumer harm and requires detailed information from the merger parties as well as competitors, putting regulators in vulnerable situation (as illustrated by the temporary experiment with a total welfare standard in Canada). Except in some particular circumstances (discussed above), a broader public interest standard would also raise important issues, both conceptual and empirical so that it may be difficult to develop institutions that will be robust to capture to implement it. Hence, one would expect the quality of enforcement (in terms of precision and predictability) of whatever broader standard is chosen to deteriorate significantly by comparison with the current situation.

[34] See for instance Maicent and Navarro (2006)

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