The Guideline: Assessing Efficiencies Gains in Merger Rulings

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It has long been recognized that mergers may give rise to efficiency gains that can reinforce firms' incentives to compete, thereby mitigating or even offsetting their potential negative anticompetitive effects. For instance, a more efficient allocation of production among the firms' plants may lead to significant cost reductions, which may in turn lead to decreases in prices or improvements in the quality of products.

Many examples illustrate the importance of accounting for efficiency gains in merger evaluations, and hence highlight the risk of under- or over-estimating the impact of merger efficiencies.

The issues of how merger regulation should address the question of efficiency, and how it should account for and evaluate efficiency gains, are crucial for all parties involved, namely, the merging firms, third parties and, ultimately, the courts of appeal. When rules are grounded in sound economic arguments and understood by all participants, the risks of approving anticompetitive mergers or prohibiting competitive ones are lowered and the appropriate evaluation of efficiency-related claims requires much less time and effort.

Competition authorities usually follow three steps in evaluating efficiencies during a merger investigation. First, the competition authority decides what constitute efficiency gains that result from a merger, and what do not. Second, based on supporting evidence, the competition authority decides whether or not to validate each of the efficiencies claimed by the merging parties. Several requirements should be cumulatively satisfied for an efficiency to be credited to the merger: it should i) be merger specific ii) be verifiable, i.e., substantiated by reasonable means, and iii) have the potential to offset possible anticompetitive effects that the merger in question may bring about. Finally, whether all, some or none of the claimed efficiencies are credited, the competition authority needs to assess the trade-off between efficiency gains and anticompetitive effects. In other words, it should verify the potential of claimed efficiencies to fully offset possible negative impacts, so that the net effect of the merger is not detrimental to consumers or society in general.

The structure of the Guideline written by Ivaldi and Khimich follows the above logic and provides detailed guidance on each step that the competition authority should follow when evaluating efficiencies. It references the best international practices, including, where possible, examples of relevant cases and technical approaches.

The discussion mainly focuses on efficiencies that may be brought about by horizontal, vertical and conglomerate mergers. However, the efficiency issue can enter the review of any business case that the competition authority may have to handle, notably, any cases involving cooperation between undertakings. We suggest employing this report as a reference document in those cases as well.

The first second chapter of the guideline is devoted to the definition of efficiencies that could come from the supply side (like economies of scale in horizontal mergers), from the demand side (like the role of double marginalization in vertical mergers) or from innovative activities. It also delineates what effects should not be considered as efficiencies.

The second chapter then reviews the requirements that efficiencies must satisfy to be recognized as such by competition authorities. Efficiencies claimed by merging parties should indeed cumulatively satisfy the following requirements: i) merger-specificity, ii) verifiability, and iii) potential to offset the expected anticompetitive effects of the merger. It raises also important questions, in particular the trade-off between static and dynamic efficiencies. It also recalls that econometric methods for estimating cost function can be a useful tool to identify efficiencies.

The third chapter then presents methods that competition authorities can implement to investigate whether credited efficiencies are sufficient to fully eliminate the relevant post-merger anticompetitive effects. It explains that the definition of sufficiency strongly depends on the welfare standard adopted by the competition authority. Basically there are two ways of assessing their sufficiency. First, one can estimate the minimal level of efficiencies (MLE) that would admit countervailing relevant anticompetitive effects. That is to say, if credited efficiencies are larger than the MLE-benchmark, then they could be considered sufficient to offset any anticompetitive effects. In particular, a MLE approach based on the Upward Pricing Pressure (UPP) test is presented. Second, an 'integrated' approach can be employed by means of simulation. It has been extensively used in merger analysis, but can be extended to any type of antitrust cases. Such methods incorporate the credited efficiencies directly into the analysis, thereby assessing the net effects of the merger. They usually require the availability of data, which may be a serious constraint for the competition authority and merging firms, and extensive expertise to properly build the market model and interpret the simulation results, particularly as these results are often sensitive to underlying assumptions Performing a merger simulation can significantly improve the accuracy of the estimates of the impact that a merger could have on prices and other key variables, and may therefore help achieve a higher standard of proof.

The Regional Competition Center for Latin America hopes that this guideline will become a reference for decision makers in competition agencies to assess efficiencies gains while making their rulings. The guideline can be downloaded at http://www.crcal.org/guias-y-estudios/guias/transversales.