

ROLE OF EFFICIENCY CLAIMS IN ANTITRUST PROCEEDINGS FOR THE COLOMBIAN NATIONAL COMPETITION AUTHORITY (SIC)

JORGE TRUJILLO
JUAN CARLOS ROA

ABSTRACT

In light of the efficiency claims made to the Superintendence of Industry and Commerce (SIC), the authority's perspective is discussed considering a main break point in time (Law 1340 of 2009). The different dispositions in the Colombian law regarding economic efficiencies for mergers are presented chronologically, in order to perceive the SIC's different positions, major variations and trends over time. A discussion of the relevance of efficiency claims in mergers is analyzed through various cases, and a comparative scheme of the SIC approach with the FTC and the EU Commission approaches.

Key words: *efficiency claims, Superintendence of Industry and Commerce, mergers*

Warning remark: The views expressed herein are those of the writer and do not necessarily represent the views of the Authority (SIC) itself or any individual Officer.

EL ROL DE LA EXCEPCIÓN DE EFICIENCIA EN LOS PROCEDIMIENTOS DE COMPETENCIA DESLEAL PARA LA AUTORIDAD DE COMPETENCIA EN COLOMBIA (SIC)

RESUMEN

Considerando las excepciones de eficiencia adelantadas frente a la Superintendencia de Industria y Comercio, la perspectiva de la autoridad se discute, considerando un punto de quiebre en el tiempo: la ley 1340 de 2009. Las diferentes disposiciones de la ley colombiana relativas a las eficiencias económicas para integraciones empresariales se presentan de manera cronológica, para percibir las diferentes posiciones de la SIC, y las más grandes variaciones y tendencias a través del tiempo. Se discute la relevancia de la excepción de eficiencia en integraciones empresariales en diferentes casos, y se hace un esquema comparativo entre el acercamiento de la SIC y el de los tratados de libre comercio y la Unión Europea.

Palabras clave: excepción de eficiencia, Superintendencia de Industria y Comercio, Integraciones Empresariales

In light of the efficiency claims made to the Superintendence of Industry and Commerce (herein from SIC), the authority's perspective is discussed considering a main break point in time (Law 1340 of 2009). The different dispositions in the Colombian law regarding economic efficiencies for mergers are presented chro-

nologically, in order to perceive the SIC's different positions, major variations and trends over time. A discussion of the relevance of efficiency claims in mergers is analyzed through various cases, and a comparative scheme of the SIC approach with the FTC and the EU Commission approaches.

1. ROLE OF EFFICIENCY IN THE SIC BEFORE LAW 1340 OF 2009

The first Colombian competition law (Law 155 of 1959) is a general disposition that sketches in a broad way competition principles and prohibitions, but do not mention economic efficiencies as an exception or part of the structural analysis in mergers. Its Article 4 empowers the Superintendent to block a merger request when through technical studies he demonstrates "it tends to produce an undue restriction of competition". This shows that since the birth of competition in the Colombian legal system (1959), until 1992 with the enactment of Decree 2153, economic efficiency was a nonexistent concept. Article 51 of Decree 2153 of 1992, stated that the SIC should refrain from blocking a merger based on the condition of Article 4 of Law 155 of 1959: "when the undertakings can demonstrate that that the beneficial effects of the operation to consumers exceed the possible negative impact on competition, and that such effects cannot be achieved by other means, the authority can refrain from blocking the operation. Beneficial effects shall be transferred to consumers".

In furtherance of the foregoing the SIC in 2003, gave systematic interpretation to these items through the "Circular Única" (Sole Circular), considering that Article 51 had to be treated as an exception in mergers analysis. This concept was derived from the Civil Procedure Code enforced at the time, through its Article 175 which states that "It is for the parties to prove the factual standards that establish the legal effect they seek".

The consequences of that position were consecrated in Circular 002 of 2003, that even though it was repealed that year, it reflected the position of the SIC regarding the scope of Article 51:

“2.3.2. Clause of efficiency

The Superintendent of Industry and Commerce can refrain from blocking mergers, consolidations, or acquisitions that will be reported under the terms of Article 4 of Law 155 of 1959 when the undertakings can demonstrate significant improvements in efficiency, so that results in cost savings cannot be achieved by other means, and to ensure that those efficiencies will not result in a reduction in market supply”.

A careful analysis of this provision suggests that several conditions must be demonstrated and quantified in full by the undertakings, so that the SIC can consider the application of the exception in its final decision:

- a) The operation should produce economic efficiencies. That is, as a result of the merger, the industry uses fewer resources to produce the same output while maintaining the same quality level; or uses the same amount of resources and increases the output, maintaining the same quality level.
- b) Efficiencies should produce cost savings for merged companies. This is whether the operation allows companies to achieve economies of scale by reducing costs through specialization of production plants, improvements in logistics or lower fixed costs, research and developments, management synergies and other costs.
- c) Efficiencies should be meaningful. In that order, the benefits derived from efficiencies must be sufficiently representative so they outweigh negative effects. Within the criterion of significance it has to evaluate the probability that efficiencies can actually materialize. It also has to show the effect that the

operation would have on consumers and how it protects their interests.

- d) Efficiencies cannot be achieved by other means. In that respect, it must be shown that efficiencies could not be achieved by different mechanisms, other than the merger, which turns out to produce lower anticompetitive effects as well.
- e) There must be an effective mechanism to ensure that the supply of goods or services will not be reduced as a result of the operation. To measure this effect, it is necessary to analyze: the way the obligation is to be complied, the instruments provided to ensure compliance, and the verification mechanisms.

The former SIC trend and position, where economic efficiencies are seen as an exception, is observed in in the following SIC cases:

1.1 CASE 1: ETERNIT

Through resolution 14002 of 2002, the merger request between ETERNIT COLOMBIANA S.A., ETERNIT ATLÁNTICO S.A., ETERNIT PACÍFICO S.A. (owned by the company MEXALIT S.A.) y COLOMBIT S.A. was decided.

In development of such a request, the parties filed a description of projected merger efficiencies derived from the operation in case it was cleared, estimated in COP\$100.063 million, equivalent according to the parties to 7.97% of the annual gross sales of the undertakings.

The efficiencies argued by the parties were:

- Specialization and optimization of the different production lines and reducing purchasing costs of raw materials.
- Shipping logistics savings for trade adjustment.
- Increased volumes of flat plates.
- Increased volumes of PVC pipe.
- Increased volumes of asbestos cement pipe.
- Savings in administrative and commercial expenses.

The SIC disagreed with such efficiency claims, filed under the scope of Article 51 of Decree 2153, because:

1. For any of efficiencies it was not explained why it is not possible that these savings were achievable by other means.
2. None of the efficiencies identified by the petitioners justifies and explains the amount that would be obtained by the savings generated (one by one).
3. Regarding the cost reduction in purchased of raw materials, the SIC found that this effect was the result of the dominant position and not an economic efficiency.
4. Finally regarding the savings that met the requirements of sufficient evidence, it was found that they could not be considered significant.

Therefore, the SIC found that none of the efficiencies comply with the requirements of Article 51 of Decree 2153, and blocked the projected merger transaction.

1.2 CASE 2: MEXICHEM - PAVCO

Through Resolution 21345 of 2007, the merger request between PAVCO S.A. and RALCO S.A was decided.

The operation under study corresponds to vertical merger, where in both markets primary or “upstream” as secondary or “downstream” the undertakings have important market shares, high levels of concentration and presence of barriers to entry. MEXICHEM pretends to enter the next level in the value chain through the acquisition of the leader of that market (PAVCO), which would result on a competitive advantage over other market participants, because guarantees for itself the supply of the main raw material at a manufacturing cost.

The SIC decided to block the proposed transaction, because despite merger efficiencies were observed, these not counteracted the negative effect on the market. The SIC considered that *“to ensure compliance with the provision contained in Article 51 of Decree 2153 of 1992, the Office believes that recognized efficiencies should be sufficient to override the likely harm to consumers and competition in the relevant market that would result in case the operation take place, so, the greater the potential adverse effects on competition as a result of operation, the higher efficiency must be recognized arising therefrom, to conclude their significance. Therefore, this case is framed within the clause of Article 51 of Decree 2153.”*

Given the above, it was considered that the efficiencies described in the operation were not sufficient to proceed by the exception, so although the merger was blocked, remedies were imposed on the proposed transaction in a posterior Decision (Resolution 29151 of 2007) of the SIC that cleared the transaction.

2. ROLE OF EFFICIENCY AFTER LAW 1340 OF 2009

With the enactment of law 1340 of 2009 that amended Article 51 of Decree 2153 of 1992, the criteria described in resolution 4861 of 2004 was applied, to establish the following:

“The SIC may not block merger operations when the undertakings can demonstrate that the beneficial effects of the operation to consumers exceed the possible negative impact on competition, and that such effects cannot be achieved by other means. It also has to ensure that it will not result in a constraint of supply in the market.

In this case, the undertakings shall express a commitment that the beneficial effects will be passed on to consumers.

The SIC may abstain to block a merger; when independently of the national market share of the merged entity, external market conditions guarantee free competition in the country.”

In this sense, the SIC has the duty to evaluate economic efficiencies in the market to establish the existence of the efficiency exception, under the scope of Law 1340 of 2009, which maintains the same principles of Decree 2153 of 1992 regarding efficiency, but also adds expressly a requirement to the undertakings to prove that the benefit of the efficiencies (i) exceeds the anticompetitive effect; (ii) will be transferred to consumers, and (iii) are granted through external market conditions.

After this authority approach, the burden of proof for efficiencies relies in the parties, taking into account that they should claim them as an exception. But the competition authority has a posterior proactive approach in the sense, throughout its economic analysis and criteria, to conclude if the exception is framed within the disposition.

Even though the methodology used by the competition authority in terms of efficiency was publicly established only until the issuance of the MERGER GUIDELINES in 2012, the efficiency approach of the SIC follow the same line since 2009 (Law 1340 of

2009). It is considered that if from the structural merger analysis is concluded that an undue restriction to competition takes place, an efficiency analysis has to be the next step. The SIC considers that efficiencies are produced in two ways: supply side efficiencies and demand side efficiencies, and the method for determining whether efficiency is present in a merger, follows that criteria.

Article 191 of the MERGER GUIDELINES defines that “*The supply side efficiencies occur when, as a result of the merger between firms, the merged entity can offer their products at a lower cost*”.

The main examples in this type of efficiency are:

- Cost savings: Refers to the technical, administrative and accounting aspects.
- Double marginalization: When in a vertical mergers a level of efficiency is achieved through the integration of two or more productive stages avoiding a double marginalization or double benefit (to the producer, distributor or marketer).
- Increase incentives for investing: When as a result of a merger, the merged entity has the incentives to invest in new products, new technologies or new marketing strategies. This applies when companies do not want to incur in that investment because it can benefits its competitors.
- Repositioning of a product: When the merged entity and its competitor reposition a product, giving the consumers a broader variety of products.

The demand side efficiency is also explained in Article 191 of the Merger Guidelines, when as “*a result of a merger, an increase in the incentive for consumers is generated, to purchase products offered by the integrated entity due to the achievement of greater productivity, efficiency, quality and service*”. The main examples in this type of efficiency are:

- The network effects: arise when consumers of services offered through a platform, are more concerned about the network when the number of users who use that network increases. Merger can improve the competitiveness of a network offering its services to more users and improving them.
- Price effects: When as a result of a merger a price reduction occurs in the direct product, and as a consequence of that, an increase in the demand of that product and in its complementary products arises.
- One-stop shopping: Effect produced when, after a merger the consumer only has to deal with one company to purchase its products.

In every case regarding a demand or supply side efficiency, a quantitative analysis should support and demonstrate the operation. After this is evaluated, the merger is cleared through a remedy, or otherwise blocked.

2.1 CASE 3: SOCIEDAD PORTUARIA REGIONAL DE BUENAVENTURA S.A.

Following the former approach, the SIC decided the case of SOCIEDAD PORTUARIA REGIONAL DE BUENAVENTURA S.A through Resolution 0255 of 2010. In this case SOCIEDAD PORTUARIA REGIONAL DE BUENAVENTURA S.A., MARI-TRANS S.A., GRANPORTUARIA BUENAVENTURA LTDA., TERMINAL ESPECIALIZADO DE CONTENEDORES DE BUENAVENTURA S.A., ELEQUIP S.A. and NAUTISERVICIOS S.A. projected a merger to operate a Port, establishing that the efficiencies on structural elements were sufficient, and consequently requested the merger to be approved through the efficiency exception. The analysis of the Authority was as follows:

The parties filed a petition on the grounds of an implementation of an operational model of integration that will be operated by one of the parties. This model has as a main purpose put together efforts, knowledge, resources, and equipment, in order to be channeled by the operator. As a result of the operation the operator would result in charge of the different operations: land, water and transportation of containers in the deck and in different zones of the terminal where merchandise is stocked.

The first analysis made by the SIC was to calculate the market share of the undertakings, which resulted in a very concentrated relevant market, with a post-merger 85.7% market share. Concluding that by clearing the merger, the result would've had been a dominant position of the merged entity.

The main issue was whether the merged entity operation fit into the efficiency exception established in Article 12 of Law 1340 of 2009. And the analysis was to measure if the possible anticompetitive effects would be compensated by the efficiency derived from the merged entity. Once it was proved that the efficiency could not be obtained by a different mean and that the productivity would increase with the operation between 42% and 50%, the SIC give clearance to the merger under the grounds of economic efficiencies.

3. FTC APPROACH ON EFFICIENCIES

The FTC MERGER GUIDELINES addresses efficiencies in a unilateral effects context, a coordinated effects context and as merger-generated efficiencies. Each one should generate specific conditions for the efficiency to take place. In the unilateral effects context *“incremental cost reductions may reduce or reverse any increases in the merged firm’s incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect Price”*; in the coordinated effects

context “*incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. Even when efficiencies generated through a merger enhance a firm’s ability to compete, however, a merger may have other effects that may lessen competition and make the merger anticompetitive*”; and as a merger generated efficiency, two inefficient competitors will create a more efficient competitor.

Conditions in the 2010 MERGER GUIDELINES are established for the undertakings in order to file a merger claim under the efficiency scope:

- a) Efficiencies are a direct result from the conduct in question.
- b) Efficiencies need to be framed under the clarity principle: they cannot be speculative, vague or if they cannot be verified by reasonable means.
- c) The conduct in question will not result in a constraint of supply in the market.
- d) The benefit of the efficiencies exceeds the anticompetitive effect. “*The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies*”.
- E) Efficiencies rarely justify a merger to monopoly or near-monopoly.

The burden of proof regarding efficiency claims in mergers relies in the undertakings, which has to substantiate the magnitude and likelihood of the asserted efficiency, how it would improve competition and how it would be achieved.

4. E.C. APPROACH ON EFFICIENCIES

Efficiencies in the EC are framed in the concept established under article 102 of abuse of dominant position, where companies are

“entitled to compete on the merits” (DENIS WAELBROEK), considering that “*Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between member states. Such abuse may, in particular, consist in:*

(a) directly or indirectly imposing unfair purchase or selling prices or unfair trading conditions;

(b) limiting production, market or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them in a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subjects of such contracts.”

The efficiency claim is shown on Article 101(3), where strict conditions have to be demonstrated by the undertakings in order to justify the conduct in question:

- a) Efficiencies are a direct result from the conduct in question
- b) The achievement of the efficiency effects cannot be achieved by other means, than through the conduct in question.
- c) Beneficial effects will be passed on to consumers.
- d) Competition is not eliminated as a result of the conduct.

The decision of the Court in the *Microsoft v Commission* case notes that the burden of proof regarding efficiency claims relies on the dominant undertaking and not on the Commission, before the administrative procedure is over, as “*to raise any plea of objective justification and to support it with arguments and evidence. It then falls to the Commission, where it proposes to make*

a finding of an abuse of a dominant position, to show that the arguments and evidence relied on by the undertaking cannot prevail and, accordingly, that the justification put forward cannot be accepted.”

CONCLUSIONS

The SIC approach in efficiency claims regarding merger procedures, has significantly develop in the last 5 years. A relevant step was the issuance of the Merger Guidelines in 2012, which compiles in a broad manner the types of efficiencies that should be taken into account when analyzing mergers. However a further step is necessary in order promote transparency and clarity when assessing efficiencies: The issuance of Efficiency Guidelines that comprise the minimum empirical evidence required, dynamic and static efficiencies, welfare standards, burden of proof, and a development of the supply side and demand side efficiencies modelled on the 2012 MERGER GUIDELINES (Sections 190 - 200).

The SIC's approach regarding efficiencies is more in line with the EC approach than with the FTC approach, but it includes the additional requirement to the defense that “*external market conditions guarantee free competition in the country*”. Hence, being efficiencies considered as an exception under Law 1340 of 2009, it is important that an amendment of article 12 of the law is assessed, so that efficiency claims are no longer framed as an exception under the presumption of illegality followed by a strict burden of proof, but as part of the mergers structural analysis.

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