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Out-of-Market Efficiencies in Competition Enforcement – Note by Singapore

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More documents related to this discussion can be found at
<https://www.oecd.org/daf/competition/out-of-market-efficiencies-in-competition-enforcement.htm>.

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1. Competition law in Singapore is administered and enforced by the Competition and Consumer Commission of Singapore (“**CCCS**”), a statutory body established under the Competition Act 2004 (“**Competition Act**”). Singapore’s legal framework allows for the recognition of out of market efficiencies when assessing agreements between undertakings, as well as mergers.

1. Exclusion from prohibition against anti-competitive agreements

2. As a starting point, section 34 of the Competition Act prohibits agreements between undertakings, decisions by associations of undertakings or concerted practices which have as their object or effect the prevention, restriction, or distortion of competition within Singapore. However, if such agreements are assessed to have a net economic benefit, they may be excluded from the section 34 prohibition (“**NEB Exclusion**”).¹ An agreement must meet the following three cumulative criteria in order to qualify for the NEB Exclusion:

- Limb 1: The agreement must improve production or distribution, or promote technical or economic progress.
- Limb 2: The agreement must not impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives.
- Limb 3: The agreement must not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question.

3. CCCS provides guidance to businesses in how it will assess claimed efficiencies under Limb 1 of the NEB Exclusion. In the *CCCS Guidelines on the Section 34 Prohibition* (“**Section 34 Guidelines**”), it is noted that efficiency claims must be substantiated in the following manner² – (i) the claimed efficiencies must be objective in nature, (ii) there must normally be a direct causal link between the agreement and the claimed efficiencies, and (iii) the efficiencies must be of a significant value,³ enough to outweigh the anti-competitive effects of the agreement.

4. Paragraph 10.1 of the Section 34 Guidelines states that “*In general, the assessment of benefits flowing from agreements would be made within the confines of each relevant market to which the agreements relate. However, where two (or more) markets are closely related, efficiencies generated in these separate markets may be taken into account*”. Thus, these broad guidelines are intended to cover all objective economic efficiencies,⁴ and it is possible to have valid efficiencies arising within or outside the market affected by the agreement.

¹ Paragraph 9 of the Third Schedule to the Competition Act.

² Paragraph 10.4 of the Section 34 Guidelines.

³ This will be evaluated with reference to the likelihood and magnitude of claimed efficiencies, which will need to be verified.

⁴ Paragraph 10.5 of the Section 34 Guidelines

2. Exclusion from prohibition against mergers that substantially lessen competition

5. Under section 54 of the Competition Act, mergers that have resulted, or may be expected to result, in a substantial lessening of competition (“**SLC**”) within any market in Singapore for goods or services are prohibited. The test for determining whether a merger results in SLC in the relevant market is by comparing the extent of competition with and without the merger.⁵ A merger is more likely to substantially lessen competition if it leads to a significant and sustainable reduction of rivalry between firms over time to the likely detriment of customers.⁶

6. There are two types of possible efficiencies that may arise from a merger. First, there may be efficiencies that increase rivalry, to the extent that it is likely to prevent an SLC occurring in a market.⁷ Such efficiencies are assessed as an integral part of the SLC analysis.⁸ Given that such increase in rivalry would have to manifest itself within the same relevant market where competition is harmed by the merger in order to prevent an SLC, out of market efficiencies are unlikely to fall within this category.

7. The second type is efficiencies arising from a merger that do not increase rivalry, but may outweigh the potential anti-competitive effects of the merger.⁹ Such efficiencies are considered as part of the Net Economic Efficiencies (“**NEE**”) exclusion when the merger is likely to lead to an SLC. In a similar vein to the NEB Exclusion, the section 54 prohibition does not apply to any merger with SLC but has NEE.¹⁰ Within this category, it is possible to have efficiencies within or outside the market affected by the merger. In the specific context of out of market efficiencies, the most likely applicable category would be dynamic efficiencies. This is where there is innovation to change the products or services supplied by the merged entity relative to the pre-merger situation.¹¹ CCCS notes that when the relevant product or service is changing, there may not be a clear market boundary to draw a meaningful distinction between efficiencies arising within or outside a market.

8. Merger parties must quantify the claimed efficiencies in the following areas:¹²

1. They must be demonstrable: Supported with detailed and verifiable evidence,¹³ and preferably based on past experience of operating the business in question as opposed to projections of efficiencies that are generated outside of the usual business planning process.¹⁴

⁵ Paragraph 4.4 of the *CCCS Guidelines on the Substantive Assessment of Mergers* (“**Merger Assessment Guidelines**”).

⁶ Paragraph 4.5 of the Merger Assessment Guidelines.

⁷ Paragraph 6.51 of the Merger Assessment Guidelines.

⁸ Paragraph 6.52 of the Merger Assessment Guidelines.

⁹ Paragraph 8.3 of the Merger Assessment Guidelines.

¹⁰ Paragraph 3 of the Fourth Schedule to the Competition Act.

¹¹ Paragraph 8.7 of the Merger Assessment Guidelines.

¹² Paragraph 8.9 of the Merger Assessment Guidelines.

¹³ Paragraph 8.10 of the Merger Assessment Guidelines.

¹⁴ Paragraph 8.11 of the Merger Assessment Guidelines.

2. They must be merger specific: The claimed efficiencies will be assessed relative to the counterfactual to the merger.¹⁵ In the context of out of market efficiencies, any claim that efficiencies in one market outweigh an expected SLC in another will require clear and compelling evidence.¹⁶
 3. They must be timely: CCCS will place less weight on the efficiencies that are likely to occur further into the future or that are more distantly related to the products and services being purchased and consumed.¹⁷
 4. They must be sufficient in extent: Where cost savings are claimed, these should be quantified. Where dynamic efficiencies are concerned, qualitative evidence should be produced to show that efficiency will occur and is merger specific, and the extent of the efficiency gain.¹⁸
9. In CCCS's experience, out of market efficiencies have typically been raised in the context of notifications to CCCS on airline cooperation agreements, although they are sometimes raised for coordination in other industries. CCCS also recognises that efficiencies are likely to be raised in the context of agreements that contribute to sustainability efforts. These various case examples will be elaborated on below.

3. CCCS Guidance Note for Airline Alliance Agreements

10. The *CCCS Guidance Note for Airline Alliance Agreements* (“**Airline Guidance Note**”) was published in September 2018 to provide airlines with more clarity on the competition assessment of airline alliance agreements in both procedural and substantive areas. Some of the substantive areas include the assessment of whether the NEB Exclusion applies to an airline alliance, and the deliberation of air hub benefits and benefits to consumers.

11. In the Airline Guidance Note, CCCS observed the starting point in the market definition for the provision of scheduled air passenger services for airline alliances to be the origin-destination (“**OD**”) city pair route, as passengers typically want to travel to a specific destination.¹⁹ Thus, the starting point would be to consider if efficiency claims under the NEB Exclusion offset or mitigate competition concerns in an identified OD route.²⁰

12. However, there is scope to accept out of market efficiencies in assessing the NEB Exclusion. As CCCS adopts a total welfare approach which considers the overall economic benefits to Singapore, a network approach may be appropriate if the overall economic benefits to Singapore outweigh the overall harm.²¹ Drawing reference from paragraph 10.1 of the Section 34 Guidelines, CCCS noted that OD routes under the alliance but not where competition concerns are identified, in particular feeder routes, may be considered as

¹⁵ Paragraph 8.12 of the Merger Assessment Guidelines.

¹⁶ Paragraph 8.14 of the Merger Assessment Guidelines.

¹⁷ Paragraph 8.15 of the Merger Assessment Guidelines.

¹⁸ Paragraph 8.16 of the Merger Assessment Guidelines.

¹⁹ Airline Guidance Note, at paragraph 27.

²⁰ Airline Guidance Note, at paragraph 28.

²¹ Airline Guidance Note, at paragraph 29.

“closely related markets”, for the purpose of assessing whether Limb 1 of the NEB Exclusion is substantiated.²² For example, an increase in passenger numbers from a feeder route due to the alliance can result in the airlines being able to carry OD passengers on a trunk route at lower costs under the alliance.

13. Besides feeder routes, CCCS also notes that OD routes within the alliance that are substitutes for each other may also be considered as “closely related markets”, where a decrease in passenger numbers for a particular OD route due to passengers switching to other substitute OD routes can benefit passengers on the first OD route via better seat availability.²³

14. Information that CCCS considers to be helpful in assessing whether Limb 1 of the NEB Exclusion is substantiated includes internal business reports or external market research/consultancy reports showing quantifiable benefits arising from the alliance for specific routes flowing to other routes, or actual benefits (e.g. passenger numbers, frequency, prices) from comparable past alliances flowing to other routes.²⁴

15. In relation to submissions that airline alliances bring about considerable benefits to Singapore’s aviation hub, CCCS considers that it is important to avoid double counting of benefits such as the increase in flights through Singapore, the commitment of the parties to fly through Singapore, promoting Singapore’s tourism or the increase in passenger numbers.²⁵ Any submissions in relation to the enhancement of Singapore’s aviation hub status should be demonstrable and separate from the benefits that arise from efficiencies in air traffic. Instead, CCCS is more likely to consider demonstrable multiplier effects beyond the direct economic contribution of the airline alliance agreements, such as off-airport expenditures directly related to air travel brought about by the airline alliance agreement or consumer spending induced from the additional income earned through either the direct economic activity or off-airport expenditures.²⁶

16. CCCS highlights two contrasting examples of how out of market efficiency assessment was conducted for two airline notification decisions, in relation to the submission that the respective alliances improved Singapore’s aviation hub:

- In the notification for decision filed by Deutsche Lufthansa AG (“LH”) and Singapore Airlines Limited (“SIA”) on their proposed joint venture,²⁷ one of the claimed benefits was the incentivisation of LH to push its connecting traffic (either to or from Europe) through Singapore using the Revenue Share Routes rather than other Asian gateways (like Bangkok, Hong Kong and Kuala Lumpur), resulting in a possible increase of travellers through Singapore²⁸ which would accordingly boost tourism or connecting traffic expenditure in Singapore.²⁹ While CCCS considered the numbers provided by the parties to be optimistic and the benefit to

²² Airline Guidance Note, at paragraph 31.

²³ *Ibid.*

²⁴ Airline Guidance Note, at paragraph 32.

²⁵ Airline Guidance Note, at paragraph 61.

²⁶ Airline Guidance Note, at paragraph 62.

²⁷ CCS 400/001/16: *Application for Decision by Deutsche Lufthansa AG and Singapore Airlines Limited (“SIA/LH Case”)*.

²⁸ SIA/LH Case, at paragraph 130.

²⁹ SIA/LH Case, at paragraph 131.

be contingent on planned increases in service frequency and capacity to be realised,³⁰ CCCS accepted the claimed benefit to be objective in nature (as it was based on the projected increase in passengers estimated to be routed through Singapore as a result of the proposed joint venture), with a higher number of passengers compared to the prevailing numbers that LH carried through Singapore.³¹ CCCS also accepted the parties' submissions on the positive knock-on effect to Singapore's tourism industry. The parties had submitted that if passengers transiting through Singapore were to clear immigration, they could potentially lead to an increase in tourism receipts of about \$1,000 per passenger (based on the Singapore Tourism Board's estimated nights per stay and average daily expenditure rate).³² It should however be noted that these efficiencies were assessed in conjunction with a set of commitments from the parties to increase their passenger flight capacities on the relevant air traffic routes.³³

- In the notification for decision application filed by Emirates and Qantas Airways Limited (“**Qantas**”) on their proposed alliance,³⁴ the applicants submitted that their proposed alliance would result in increased dedicated Qantas' capacity for OD city pairs between Australia and Singapore, with total point to point capacity between Australia and Singapore projected to increase by approximately 42%.³⁵ CCCS did not accept this claim, noting that such benefits cannot be attributed to a direct result of the proposed alliance.³⁶ This was because Qantas had already announced that it would unilaterally terminate its Sydney-Singapore-Frankfurt services, and its Melbourne-Singapore-London Heathrow services and would provide its London Heathrow services via Dubai irrespective of whether the proposed alliance proceeded. In other words, the increase in dedicated capacity would have materialised regardless of whether the applicants proceeded with the proposed alliance.³⁷ The applicants' submissions on benefit to tourism and employment were also noted to be a derivative of other underlying benefits claimed by the applicants in relation to capacity increase and feeder traffic (which were unsubstantiated to begin with).³⁸ In any event, the applicants also could not quantify the likely contributions to GDP and employment in Singapore arising from the proposed alliance, or the increase in inbound tourism to Singapore, such as the likely changes in travelling patterns of passengers.³⁹ It should be noted that the main reason for CCCS to have not accepted these efficiency claims was that the efficiencies were not substantiated, rather than that they were out-of-market efficiencies.

³⁰ SIA/LH Case, at paragraph 141 and 142.

³¹ SIA/LH Case, at paragraph 142.

³² SIA/LH Case, at paragraph 144.

³³ SIA/LH Case, at Annex B.

³⁴ CCS 400/006/12: *Application for Decision by Emirates and Qantas Airways Limited* (“**QF/EK Case**”).

³⁵ QF/EK Case, at paragraph 59.

³⁶ QF/EK Case, at paragraph 61.

³⁷ *Ibid.*

³⁸ QF/EK Case, at paragraph 78.

³⁹ QF/EK Case, at paragraph 79.

4. Other examples of out of market efficiencies assessed by CCCS

17. In 2018, CCCS approved a notification for decision application in relation to a proposed joint venture between several poultry farms to set up a joint venture company (“**Singapore Poultry Hub**”) to perform poultry slaughtering services for each of the applicants, subject to commitments.⁴⁰ In the application, the applicants cited several benefits arising both within the relevant market, and out of market efficiencies. In respect of the latter, the applicants made the following submissions:

- The proposed joint venture would result in better utilisation of land since the slaughtering services would be consolidated at the same location. This would free up land that the specific applicants who had their own in-house slaughtering capabilities were currently using. They estimated the savings in land area to be 1,433.10 sqm.⁴¹
- The proposed joint venture would result in environmental benefits, such as the increased energy efficiency and saving of water that would arise through the employment of upgraded machinery. Generated waste could also be disposed of in a single location, and would aid in the containment of any food contamination or bird-related diseases.⁴²

18. CCCS accepted the submissions on alleviation of land use, noting that the applicants had provided information on the size and value of land currently occupied by three of the five applicants, as well as the size and value of land that the Singapore Poultry Hub would occupy, and the estimated savings in terms of land area.⁴³ CCCS also noted the intensification of land usage by a factor of 4 times, and according to other government agencies this would in turn free up the existing sites that the applicants occupied for re-allocation with higher land intensification to take place.⁴⁴

19. However, CCCS did not accept the submissions on environmental benefits. While CCCS agreed in principle with the applicants that there would be benefits in the containment of waste disposal, the applicants were unable to provide calculations on the estimated savings in water, energy and carbon emissions.⁴⁵ This was because the applicants were still in negotiations with the manufacturer of the machinery and had not yet identified with certainty the machinery which the Singapore Poultry Hub would acquire for its operations.⁴⁶ CCCS was thus unable to conclude whether these savings were objective, would arise directly from the proposed joint venture and whether they were significant in value.⁴⁷

⁴⁰ CCCS 400/005/17: *Application for Decision by Mr. Tan Chin Long, Kee Song Holdings Pte. Ltd., Sinmah Holdings (S) Pte. Ltd., Tong Huat Poultry Processing Factory Pte. Ltd. and Tysan Food Pte. Ltd.* (“**Singapore Poultry Hub Case**”).

⁴¹ Singapore Poultry Hub Case, at paragraph 99.

⁴² Singapore Poultry Hub Case, at paragraph 104.

⁴³ Singapore Poultry Hub Case, at paragraph 115.

⁴⁴ *Ibid.*

⁴⁵ Singapore Poultry Hub Case, at paragraph 120.

⁴⁶ Singapore Poultry Hub Case, at paragraph 105.

⁴⁷ Singapore Poultry Hub Case, at paragraph 120.

5. Guidance Note on Business Collaborations Pursuing Environmental Sustainability Objectives

20. In more recent times, CCCS has aimed to provide clarity to businesses on how CCCS will assess collaborations pursuing environmental sustainability objectives. This is in recognition of Singapore’s climate change goals⁴⁸ which may involve businesses engaging in various forms of collaborations in existing, emerging or even new markets, in pursuit of such environmental sustainability objectives. To that end, CCCS has drafted the *Guidance Note on Business Collaborations Pursuing Environmental Sustainability Objectives* (“**Sustainability Guidance Note**”), which is currently undergoing public consultation. The Sustainability Guidance Note aims to provide guidance on the application of the section 34 prohibition and the NEB Exclusion in the context of environmental sustainability initiatives.

21. As a starting point, the draft Sustainability Guidance Note explains what are considered as environmental sustainability objectives. CCCS notes that the crux of the collaboration would need to be scrutinised. This is a fact-specific exercise that will take into account matters such as the starting point and main focus of the collaboration, and the degree of integration of the different functions required in order to pursue the stated environmental sustainability objective.⁴⁹ The draft Sustainability Guidance Note sets out non-exhaustive examples of what environmental sustainability objectives could be, such as a collaboration between businesses that is primarily intended to develop and produce a more environmentally friendly product, or a joint purchasing collaboration involving a new green solution.⁵⁰

22. The draft Sustainability Guidance Note also provides examples of collaborations pursuing environmental sustainability objectives that would typically not be harmful to competition, such that the NEB Exclusion does not even need to be invoked. These include agreements that do not affect factors of competition, and agreements on activities which none of the parties could do independently.⁵¹

23. As mentioned above, agreements or collaborations which may give rise to competition concerns may be excluded from the section 34 prohibition if they qualify for the NEB Exclusion. One of the factors for consideration is that claimed economic benefits arising from the agreement or collaboration must be substantiated and outweigh the negative effects on competition. The draft Sustainability Guidance Note recognises that agreements pursuing environmental sustainability objectives can give rise to economic benefits for the purposes of the NEB Exclusion, and sets out a non-exhaustive list of such agreements:⁵²

1. Collaborations that adopt cleaner but more costly technologies which reduce greenhouse gas emissions from production processes, or enable more efficient production by consuming less energy or other resources, may be considered as

⁴⁸ The Singapore Green Plan 2030 charts concrete sectoral plans and targets to position Singapore to achieve its long-term net-zero emissions aspiration by 2050.

⁴⁹ Draft Sustainability Guidance Note, at paragraph 2.2.

⁵⁰ Draft Sustainability Guidance Note, at paragraph 2.2 and 2.3.

⁵¹ Draft Sustainability Guidance Note, at paragraph 2.5 to 2.7.

⁵² Draft Sustainability Guidance Note, at paragraph 2.14.

agreements that contribute to improving production or promoting technical progress;

2. Collaborations by businesses to share delivery capacities in order to reduce the number of half-filled delivery vehicles on the road, may be considered as agreements that contribute to improving distribution processes;
 3. Businesses agreeing to jointly create new or improved products which phase out or replace the use of non-sustainable material, and thus improve the quality or variety of products, may be considered as agreements that contribute to improving production or promoting technical progress; or
 4. Businesses collaborating to contribute different technical and commercial expertise to develop a large-scale solution to reduce carbon emissions, may be considered as agreements that contribute to promoting technical or economic progress.
24. The draft Sustainability Guidance Note also highlights that when CCCS assesses the NEB Exclusion for agreements pursuing environmental sustainability objectives, it is more likely to consider benefits beyond just those arising in the relevant market. This is given that environmental sustainability initiatives often seek to reduce negative externalities, or give rise to positive externalities, or both, and correct the market failures associated with such externalities.⁵³ As reductions in negative externalities or generation of positive externalities can benefit the society at large (and not just the direct customers of the businesses), where appropriate, CCCS will take into account economic benefits accruing to Singapore as a whole when assessing agreements pursuing environmental sustainability objectives.⁵⁴

25. CCCS sets out in the draft Sustainability Guidance Note an example of how out of market efficiencies (net economic benefits to Singapore as a whole) may manifest in an agreement pursuing environmental sustainability objectives.⁵⁵ The scenario involves an agreement between certain businesses in Singapore to switch to using an alternative clean fuel that will reduce carbon emissions and yet results in higher production costs which may be passed on as higher prices to consumers. The increased costs to consumers may be outweighed by benefits to Singapore as a whole, which include (i) the expediting of reductions in carbon emissions in Singapore, (ii) the correction of the negative externalities from over-production/consumption of the less-sustainable fuel, and (iii) enabling the large-scale production of clean fuel to supply Singapore and the region.

26. The approach for businesses seeking to avail themselves to the NEB Exclusion for agreements pursuing environmental sustainability objectives is no different from companies seeking to rely on the NEB Exclusion generally for other kinds of agreements. They have to demonstrate that the claimed economic benefits are significant enough to outweigh the anti-competitive effects of the agreement, and must substantiate each benefit claimed by demonstrating the magnitude and the likelihood (i.e., how and when) of achieving such benefits.⁵⁶ The degree of substantiation required would depend on the facts such as the nature of collaboration and the claimed benefit – for example, precise quantification of benefits may not be necessary where harm to competition is clearly

⁵³ Draft Sustainability Guidance Note, at paragraph 2.16.

⁵⁴ *Ibid.*

⁵⁵ Draft Sustainability Guidance Note, at paragraph 2.17.

⁵⁶ Draft Sustainability Guidance Note, at paragraph 2.18.

limited and the likelihood of benefits arising is high.⁵⁷ Claimed benefits must also be objective in nature, and there must normally be a direct causal link between the agreement and the claimed benefit.⁵⁸

27. CCCS also recognises that in some cases, business collaborations pursuing environmental sustainability objectives may involve nascent products, services or technologies and hence entail a degree of uncertainty in terms of the magnitude and timeframe in which the benefits of the collaboration may materialise.⁵⁹ In this regard, CCCS notes that when the relevant product or service is nascent, there may not be a clear boundary of the relevant market to draw a meaningful distinction between efficiencies arising within or outside the market.

⁵⁷ Draft Sustainability Guidance Note, at paragraph 2.19.

⁵⁸ Draft Sustainability Guidance Note, at paragraph 2.15.

⁵⁹ Draft Sustainability Guidance Note, at paragraph 2.20.