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Efficiencies in Merger Control – Note by Hungary

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Antonio CAPOBIANCO
Antonio.Capobianco@oecd.org, +(33-1) 45 24 98 08.

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Hungary

1. Introduction

1. Under the merger control provisions of Chapter VI of the Hungarian Competition Act[1], the Hungarian Competition Authority (Gazdasági Versenyhivatal, GVH) considers the advantages and disadvantages of a concentration when assessing it. Therefore, the assessment of benefits in general is part of every merger, but, as in EU competition law practice, the efficiencies quantified and substantiated by the merging firms are considered in the context of the so-called countervailing effects.

2. Based on the practice of the GVH, only a fact and circumstance that represent a favourable change to end consumers and which would not otherwise be achievable or whose realization is objectively more likely to occur in the market situation that would arise if the concentration were approved, may be considered as an efficiency gain resulting from concentrations.

2. The use of efficiencies in merger control

2.1. Legal frameworks

3. According to Article 30 (1) of Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices (HCA) stipulates that the GVH shall prohibit a concentration where, with a view to the provisions of paragraph (2), the concentration would significantly reduce competition on the relevant market, in particular as a result of the creation or strengthening of a dominant position.

4. Paragraph (2) sets out the criteria for assessing the advantages and disadvantages of a concentration. In the course of such consideration, the following factors shall be examined in particular:

- the structure of the relevant markets, existing or potential competition on the relevant markets, procurement and marketing possibilities, the costs, risks and technical, economic and legal conditions of market entry and exit, the prospective effects of the concentration on competition on the relevant markets;
- the market position and strategy, economic and financial capacity, business conduct, internal and external competitiveness of the undertakings concerned and likely changes to them; the effect of the concentration on suppliers and trading parties.

5. In addition, the GVH has set out, in the form of soft law guidelines, criteria for assessing the countervailing efficiencies of a merger in line with EU competition law practice, which are described in detail below.[2]

[1] Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices

[2] Criteria for assessing the non-coordinative effects of concentrations https://www.gvh.hu/pfile/file?path=/szakmai_felhasznaloknak/osszefonodasok_-_fuziok/Szakmaifelhasznalok_fuziok_horizontalis_hatasok_2010_09_16.pdf&inline=true (only available in Hungarian)

2.2. Assessment

6. A merger may also have efficiency enhancing effects on the merged entity that may counteract possible anticompetitive effects. In the first place, efficiencies that result from a reduction in costs that are directly related to the output of the firm, which are variable or marginal costs in the short run, and secondly, quasi-fixed costs (such as network maintenance costs) that may be variable costs in the longer run and therefore may affect the pricing policy of the firm, may potentially lead to price reductions.

7. It is the responsibility of the merging parties to demonstrate and prove efficiencies. In order for an efficiency claim to be admissible, four cumulative conditions must normally be fulfilled. These are:

1. Efficiencies must be merger-specific, i.e. only those benefits that would not have been achieved without the merger can be taken into account.
2. Efficiencies must be reflected in the price, i.e. it must be shown that the reduced costs result in a reduced price to the consumer. It is important to know how much of the cost reduction is passed on to the consumer; to this end, the expected reduction in the total variable costs of production should be considered.[3]
3. The efficiencies must be quantifiable (verifiable) in some way, it is not sufficient to provide a simple, textual list of reasons for the potential cost reduction.
4. The expected timing of the benefits influences the weight to be given to them: the further into the future the benefits are expected to occur, the smaller the welfare effects and the less certain their occurrence.

8. In addition, of course, the benefits must be substantial enough to outweigh any potential anti-competitive effects. Since the pass-on of efficiency gains to consumers (in the form of lower prices or better products) depends on the competitive constraints that the merged entity will face in the market, the more serious the anticompetitive concerns, the more difficult it is to convincingly demonstrate that they can be outweighed by efficiencies.

9. In addition to the cost reduction benefits discussed above, dynamic efficiencies can in principle also arise, such as positive effects on innovation. In demonstrating these, it is particularly important to show that the specific dynamic efficiencies (e.g. an improvement) are merger-specific.

2.3. Hungarian case law

10. Hungarian competition law practice is not replete with mergers that have been authorised specifically based on efficiency claim. There have been no recent decisions of the GVH in which a concentration has been cleared explicitly based on efficiencies. The lack of such cases is also largely due to the fact that the undertakings did not even make such arguments in the proceedings. In cases where the GVH has raised concerns with the parties, the undertakings have sought to mitigate the adverse effects of the merger by submitting commitment proposals. One of the latest cases where the GVH threatened to

[3] For example, if there is a large cost saving on an input, but the cost weight of the input is small, it will not significantly change the total cost, so it is unlikely to have an impact on the price to the consumer.

prohibit the merger, only a commitment was offered and not an efficiency defence, while challenging the merits of the analysis.[4]

11. The only decision in which the GVH has assessed and rejected the parties' efficiency arguments on the merits was the merger between two fixed telecommunications service providers (Magyar Távközlési Rt./ JÁSZ-TEL Rt.) in 1998. After establishing that the proposed merger would strengthen the dominant position of MATÁV Rt. in the market situation expected to emerge following the liberalisation of the telecommunications market, the GVH examined whether the resulting disadvantage was outweighed by the advantages claimed by the parties to the merger. In this context, the parties referred, inter alia, to the economic operation resulting from economies of scale; the wider range of services offered; the use of modern operational and customer service systems; the increase in the level of service based on MATÁV's resources; the switch to call-time billing one year before the mandatory legal deadline; and the reduction and subsequent termination of the State aid granted to JÁSZ-TEL Rt. under the amended concession contract.

12. The GVH proceeded from the basic principle already mentioned above, that only those facts and circumstances, which also represent a favourable change for the end consumers, can be considered as an efficiency gain resulting from the concentration that would not otherwise be achieved; and which are objectively more likely to be realized in the market situation that would arise if the concentration were approved. In the case, the GVH also took into account that the strengthening of the dominant position as a disadvantage occurs on a national market, while the efficiencies claimed by the parties can essentially only be felt in the operational area of JÁSZ-TEL Rt. In addition, GVH considered that only limited account could be taken of the advantages (change of billing method one year earlier, reduction or elimination of subsidies), which essentially have their effects before market liberalisation. The GVH also did not consider acceptable the reduction in costs resulting from economies of scale or the relative reduction of JÁSZ-TEL's prices to the level of MATÁV's prices, because, although these are obviously beneficial for final customers, the only guarantee that these benefits will be permanent is the constraint resulting from the development of economic competition, which, in any event, cannot be positively affected by the proposed concentration due to the strengthening of the dominant position. Therefore, the GVH could only consider such claims by undertakings as "promises" and not as a real benefit resulting from objective economic developments.

13. In conclusion, the GVH concluded that the efficiencies of the proposed concentration claimed by the merging parties, which would not have been achievable without the concentration, do not outweigh the disadvantages of the merger resulting from the strengthening of MATÁV's dominant position. In view of this, the GVH prohibited the concentration.

3. Summary

14. It can therefore be concluded that the GVH has been open from the outset to considering the efficiency gains put forward by the parties and has applied the assessment principles set out above, although it is not quite recent that a case has arisen where efficiencies could actually be considered.

[4] VJ/158/2008 (Magyar Telekom Nyrt./ViDaNet Kábeltelevíziós Szolgáltató Zrt.). In the case, the court ordered the GVH to initiate a new procedure, in which the parties withdrew their request for clearance of the concentration.

15. This is because the proportion of cases where there are substantive competition concerns is very low, and in the majority of these cases the parties are able to offer commitments that are capable of addressing competition concerns. The practice shows that even after a preliminary position blocking the merger, the parties do not put forward an efficiency claims that the GVH would have to examine.

16. It should also be noted that the extent of efficiencies, and the likelihood of their occurrence, are often difficult to quantify, and this is particularly true for markets which are dynamically evolving and based on new technologies. The most challenging condition may nevertheless be the one requiring merger-specificity for the parties, in particular when the benefits of the merger are invoked in the context of positive effects on innovation. This factor may also explain why undertakings rarely put forward efficiency arguments and prefer to devote their resources to developing commitments.