



## DRAFT COMMISSION NOTICE

### Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings

#### Draft - for the purpose of public consultation

#### I. INTRODUCTION

- 1 Article 2 of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings<sup>1</sup> (hereinafter: the “Merger Regulation”) provides that the Commission has to appraise concentrations within the scope of the Merger Regulation with a view to establishing whether or not they are compatible with the common market. For that purpose, the Commission must assess, pursuant to Article 2 (2) and (3), whether or not a concentration would significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position, in the common market or a substantial part of it.
- 2 This document develops guidance as to how the Commission assesses concentrations<sup>2</sup> where the undertakings concerned are active on distinct relevant markets<sup>3</sup>. In this document, these concentrations will be called “non-horizontal mergers”.

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<sup>1</sup> Council Regulation (EC) No 139/2004 of 20 January 2004, Official Journal L 24, 29.01.2004, p. 1.

<sup>2</sup> The term *concentration* used in the Merger Regulation covers various types of transactions such as mergers, acquisitions, takeovers, and certain types of joint ventures. In the remainder of this Document, unless otherwise specified, the term “merger” will be used as a synonym for concentration and therefore cover all the above types of transactions.

<sup>3</sup> Guidance on the assessment of mergers involving undertakings which are actual or potential competitors on the same relevant market (“horizontal mergers”) is given in the Commission Notice: Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings. OJ C 31, 05.02.2004, pages 5-18 (“Notice on Horizontal Mergers”).

- 3 Two broad types of non-horizontal mergers can be distinguished: vertical mergers and conglomerate mergers.
- 4 Vertical mergers involve companies operating at different levels of the supply chain. For example, when a manufacturer of a certain product (the “upstream firm”) merges with one of its distributors (the “downstream firm”), this is called a vertical merger<sup>4</sup>.
- 5 Conglomerate mergers are mergers between firms that are in a relationship, which is neither purely horizontal (as competitors in the same relevant market) nor vertical (as suppliers or customers)<sup>5</sup>. In practice, the focus of the present guidelines is on mergers between companies that are active in closely related markets (e.g. mergers involving suppliers of complementary products or products that belong to the same product range).
- 6 The general guidance already given in the Notice on horizontal mergers is also relevant in the context of non-horizontal mergers. The purpose of the present document is to concentrate on the competition aspects that are relevant to the specific context of non-horizontal mergers. In addition, it will set out the Commission’s approach to market shares and concentration thresholds in this context.
- 7 In practice, mergers may entail both horizontal and non-horizontal effects. This may for instance be the case where the merging firms are not only in a vertical or conglomerate relationship, but are also actual or potential competitors of each other in one or more of the relevant markets concerned<sup>6</sup>. In such a case, the Commission will appraise horizontal, vertical and/or conglomerate effects in accordance with the guidance set out in the relevant notices<sup>7</sup>.
- 8 The guidance set out in this document draws and elaborates on the Commission's evolving experience with the appraisal of non-horizontal mergers under Regulation No 4064/89 since its entry into force on 21 September 1990, the Merger Regulation presently in force as well as on the case-law of the Court of Justice and the Court of First Instance of the European Communities. The principles contained here will be applied and further developed and refined by the Commission in individual cases. The

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<sup>4</sup> In the present Document, the terms “downstream” and “upstream” are used to describe the (potential) commercial relationship that the merging entities have with each other. Generally the commercial relationship is one where the “downstream” firm purchases the output from the “upstream” firm and uses it as an input in its own production, which it then sells on to its customers. The market where the former transactions take place is referred to as the intermediate market (upstream market). The latter market is referred to as the downstream market.

<sup>5</sup> The distinction between conglomerate mergers and horizontal mergers may be subtle, e.g. when a conglomerate merger involves products that are weak substitutes for each other. The same holds true for the the distinction between conglomerate mergers and vertical mergers. For instance, products may be supplied by some companies with the inputs already integrated (vertical relationship), whereas other producers leave it to the customers to select and assemble the inputs themselves (conglomerate relationship).

<sup>6</sup> For instance, in certain markets upstream or downstream firms are often well-placed potential entrants. See, e.g., in the electricity and gas sector, Case COMP/M.3440 - EDP/ENI/GDP (2004). The same may hold for producers of complementary products. See, e.g., in the liquid packaging sector, Case COMP/M.2416 - TetraLaval/Sidel (2001).

<sup>7</sup> Guidance on the assessment of mergers with a potential competitor is given in the Notice on horizontal mergers, in particular at paragraphs 58 to 60 thereof.

Commission may revise the notice on non-horizontal mergers from time to time in the light of future developments and of evolving insight.

- 9 The Commission's interpretation of the Merger Regulation as regards the appraisal of non-horizontal mergers is without prejudice to the interpretation which may be given by the Court of Justice or the Court of First Instance of the European Communities.

## II. OVERVIEW

- 10 Effective competition brings benefits to consumers, such as low prices, high quality products, a wide selection of goods and services, and innovation. Through its control of mergers, the Commission prevents mergers that would be likely to deprive customers of these benefits by significantly increasing the market power of firms. An "increase in market power" in this context refers to the ability of one or more firms to profitably increase prices, reduce output, choice or quality of goods and services, diminish innovation, or otherwise influence parameters of competition<sup>8</sup>.
- 11 Non-horizontal mergers are generally less likely to create competition concerns than horizontal mergers.
- 12 First, unlike horizontal mergers, vertical or conglomerate mergers do not entail the loss of direct competition between the merging firms in the same relevant market<sup>9</sup>. As a result, the main source of anti-competitive effect in horizontal mergers is absent from vertical and conglomerate mergers.
- 13 Second, vertical and conglomerate mergers provide substantial scope for efficiencies. A characteristic of vertical mergers and certain conglomerate mergers is that the activities and/or the products of the companies involved are *complementary* to each other.<sup>10</sup> The integration of complementary activities or products within a single firm may produce significant efficiencies and be pro-competitive. For instance, in vertical mergers, efforts to increase sales at one level (e.g. by lowering price, or by stepping up innovation) will benefit sales at the other level. Depending on the market conditions, integration may increase the incentive to carry out such efforts. In particular, after the vertical integration, lowering the mark-up downstream may lead to increased sales not only downstream but also upstream and vice versa. This is often referred to as the "internalisation of double mark-ups".
- 14 Integration may also decrease transaction costs and allow for a better co-ordination in terms of product design, the organisation of the production process, and the way in

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<sup>8</sup> In this Document, the expression "increased prices" is often used as shorthand for these various ways in which a merger may result in competitive harm. The expression should be understood to also cover situations where, for instance, prices are decreased less, or are less likely to decrease, than they otherwise would have without the merger and where prices are increased more, or are more likely to increase, than they otherwise would have without the merger.

<sup>9</sup> Such a loss of direct competition can, nevertheless, arise where one of the merging firms is a potential competitor in the relevant market where the other merging firm operates. See paragraph 7 above.

<sup>10</sup> In this document, products or services are called "complementary" (or "economic complements") when they are worth more to a customer when used or consumed together than when used or consumed separately. Also a merger between upstream and downstream activities can be seen as a combination of complements which go into the final product. For instance, both production and distribution fulfil an indispensable role in getting a product to the market.

which the products are sold. Similarly, mergers which involve products belonging to a range of products that are generally sold to the same set of customers (be they complementary products or not) may give rise to customer benefits such as one-stop-shopping.

- 15 However, there are circumstances in which non-horizontal mergers may significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position. This is essentially because a non-horizontal merger may change the ability and incentive to compete on the part of the merging companies and their competitors in ways that cause harm to consumers.
- 16 In the context of competition law, the concept of “consumers” encompasses intermediate and ultimate consumers<sup>11</sup>. When intermediate customers are actual or potential competitors of the parties to the merger, the Commission focuses on the effects of the merger on the customers to which the merged entity and those competitors are selling. Consequently, the fact that a merger affects competitors is not in and of itself a problem. It is the impact on effective competition that matters, not the mere impact on competitors at some level of the supply chain<sup>12</sup>.
- 17 There are two main ways in which non-horizontal mergers may significantly impede effective competition: non-coordinated effects and coordinated effects<sup>13</sup>.
- 18 Non-coordinated effects may principally arise when non-horizontal mergers give rise to *foreclosure*. In this document, the term “foreclosure” will be used to describe any instance where actual or potential rivals’ access to supplies or markets is hampered or eliminated as a result of the merger, thereby reducing these companies’ ability and/or incentive to compete. As a result of such foreclosure, the merging companies – and, possibly, some of its competitors as well – may be able to profitably increase the price<sup>14</sup> charged to consumers. These instances will be referred to as “anticompetitive foreclosure”.
- 19 Coordinated effects arise where the merger changes the nature of competition in such a way that firms that previously were not coordinating their behaviour, are now significantly more likely to coordinate and raise prices or otherwise harm effective competition. A merger may also make coordination easier, more stable or more effective for firms, which were coordinating prior to the merger.
- 20 In assessing the competitive effects of a merger, the Commission compares the competitive conditions that would result from the notified merger with the conditions

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<sup>11</sup> See Article 2(1)(b) of the Merger Regulation.

<sup>12</sup> One example of this approach can be found in the case COMP/M.3653 Siemens/VA Tech (2005), in which the Commission assessed the effect of the transaction on the two complementary markets for electrical rail vehicles and electrical traction systems for rail vehicles, which combine into a full rail vehicle. While the merger allegedly reduced the independent supply of electrical traction systems, there would still be several integrated suppliers which could deliver the rail vehicle. The Commission thus concluded that even if the merger had negative consequences for independent suppliers of electrical rail vehicles “sufficient competition would remain in the relevant downstream market for rail vehicles”

<sup>13</sup> See Section II of the Notice on Horizontal Mergers.

<sup>14</sup> For the meaning of the expression “increased prices” see footnote 8.

that would have prevailed without the merger<sup>15</sup>. In most cases the competitive conditions existing at the time of the merger constitute the relevant comparison for evaluating the effects of a merger. However, in some circumstances, the Commission may take into account future changes to the market that can reasonably be predicted. It may, in particular, take account of the likely entry or exit of firms if the merger did not take place when considering what constitutes the relevant comparison. The Commission may take into account future market developments that result from expected regulatory changes.<sup>16</sup>

- 21 In its assessment, the Commission will consider both the possible anti-competitive effects arising from the merger and the pro-competitive effects stemming from efficiencies identified and substantiated by the parties. The Commission examines the various chains of cause and effect with a view to ascertaining which of them is the most likely. The more immediate and direct the overall anti-competitive effect of a merger, the more likely the Commission is to raise competition concerns.
- 22 This document describes the main scenarios of competitive harm and sources of efficiencies in the context of vertical mergers and, subsequently, in the context of conglomerate mergers.

### III. MARKET SHARE AND CONCENTRATION LEVELS

- 23 Non-horizontal mergers pose no threat to effective competition unless the merged entity has market power in at least one of the markets concerned.
- 24 Market shares and concentration levels provide useful first indications of the market power and the competitive importance of both the merging parties and their competitors.<sup>17</sup>
- 25 The Commission is unlikely to find concern in non-horizontal mergers, be it of a coordinated or of a non-coordinated nature, where the market share post-merger of the new entity in each of the markets concerned is below [30%]<sup>18</sup> and where the post-merger HHI is below [2000]. In practice, it will not extensively investigate such mergers, except where special circumstances such as, for instance, one or more of the following factors are present:
  - (a) a merger involves a company that is likely to expand significantly in the near future, e.g. because of a recent innovation;

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<sup>15</sup> By analogy, in the case of a merger that has been implemented without having been notified, the Commission would assess the merger in the light of the competitive conditions that would have prevailed without the implemented merger.

<sup>16</sup> This may be particularly relevant in cases where effective competition is expected to arise in the future as a result of market opening. See e.g. Case COMP/M.3696 - E.ON/MOL (2005), at points 457 to 463.

<sup>17</sup> See also Section III of the Notice on Horizontal Mergers. The calculation of market shares depends critically on market definition (see Commission notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372/5, 9 December 1997). Special care must be taken in contexts where vertically integrated companies supply products internally.

<sup>18</sup> In analogy to the indications given in Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, Official Journal L 336, 29.12.1999, pages 21-25.

- (b) there are significant cross-shareholdings or cross-directorships among the market participants;
  - (c) one of the merging firms is a firm with a high likelihood of disrupting coordinated conduct;
  - (d) indications of past or ongoing coordination, or facilitating practices, are present.
- 26 The Commission will use the above market share thresholds and HHI levels as an initial indicator of the absence of competition concerns. However, they do not give rise to a legal presumption. The Commission is of the opinion that presenting market share and concentration levels above which there are competition concerns is less appropriate in this context. Indeed, market power in at least one of the markets concerned is a necessary condition for competitive harm, not a sufficient condition<sup>19</sup>.

#### IV. VERTICAL MERGERS

- 27 This section sets out the Commission’s framework of analysis in the context of vertical mergers. In its assessment, the Commission will consider both the possible anti-competitive effects arising from vertical mergers and the pro-competitive effects stemming from efficiencies identified and substantiated by the parties.

##### A. Non-coordinated effects: foreclosure

- 28 A vertical merger may significantly impede effective competition through non-coordinated effects mainly when it gives rise to foreclosure. Foreclosure may discourage entry or expansion of rivals or encourage their exit. Foreclosure thus can be found even if the foreclosed rivals are not forced to exit the market: it is sufficient that the rivals are disadvantaged and consequently led to compete less effectively. As a result of such foreclosure, the merging companies – and, possibly, some of its competitors as well – may be able to profitably increase the price charged to consumers<sup>20</sup>.
- 29 Two forms of foreclosure can be distinguished. The first is where the merger is likely to raise the costs of downstream rivals by restricting their access to an important input (input foreclosure). The second is where the merger is likely to foreclose upstream rivals by restricting their access to a sufficient customer base (customer foreclosure)<sup>21</sup>.

##### 1. Input foreclosure

- 30 A merger may significantly impede effective competition through input foreclosure where, post-merger, the new entity would be likely to restrict access to the products or services that it would have otherwise supplied absent the merger, thereby raising its downstream rivals’ costs by making it harder for them to obtain supplies of the input

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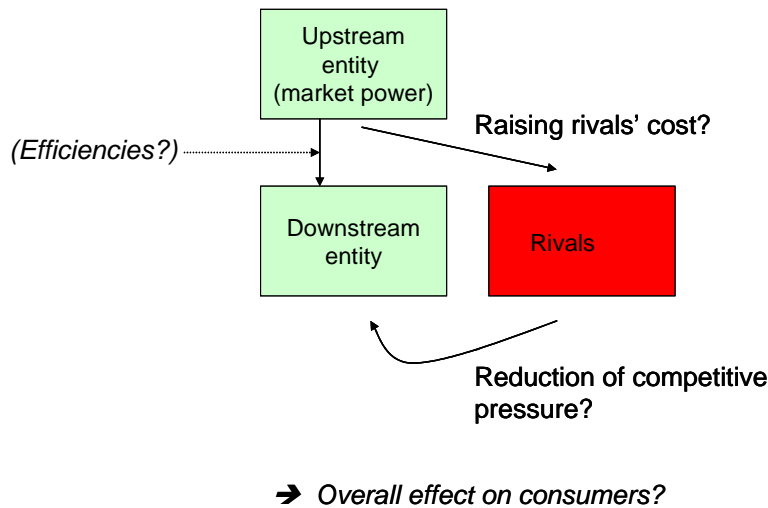
<sup>19</sup> See Sections III and IV.

<sup>20</sup> For the meaning of the expression “increased prices” see footnote 8. For the meaning of “consumers”, see paragraph 16.

<sup>21</sup> See Merger Regulation, Article 2(1)(b), referring to “*access to supplies*” and “*access to [...] markets*”, respectively.

under similar prices and conditions as absent the merger. This may lead the merged entity to profitably increase the price charged to consumers. Any efficiencies resulting from the merger, however, may lead the merged entity to reduce price, so that the overall likely impact on consumers is neutral or positive. A graphical presentation of this mechanism is provided in Figure 1.

*Figure 1 - Input foreclosure*



- 31 In assessing the likelihood of an anticompetitive input foreclosure scenario, the Commission examines, first, whether the merged entity would have, post-merger, the ability to substantially foreclose access to inputs, second, whether it would have the incentive to do so, and third, whether a foreclosure strategy would have a significant detrimental effect on competition downstream. In practice, these factors are often examined together since they are closely intertwined.

*A. Ability to foreclose access to inputs*<sup>22</sup>

- 32 Input foreclosure may occur in various forms. The merged entity may decide not to deal with its actual or potential competitors in the vertically related market. Alternatively, the merged firm may decide to restrict supplies and/or to raise the price it charges in supplying competitors and/or to otherwise make the conditions of supply less favourable than they would have been absent the merger.<sup>23</sup> Further, the merged entity may opt for a specific choice of technology within the new firm which is not compatible with the technologies chosen by rival firms.<sup>24</sup> Foreclosure may also take more subtle forms, such as the degradation of the quality of input supplied. In its

<sup>22</sup> The term “inputs” is used here as a generic term and may also cover services, access to infrastructure and access to intellectual property rights.

<sup>23</sup> See e.g. Case COMP/M.1693 - Alcoa/Reynolds (2000).

<sup>24</sup> See, e.g., Case COMP/M.2861 - Siemens/Drägerwerk/JV (2003).

assessment, the Commission may consider a series of alternative or complementary possible strategies.

- 33 Input foreclosure may raise competition problems only if it concerns an important input for the downstream product. This is the case, in particular, when the input concerned represents a significant cost factor relative to the price of the downstream product. Irrespective of its cost, an input may also be sufficiently important for other reasons. For instance, the input may be a critical component without which the downstream product could not be manufactured or effectively sold on the market<sup>25</sup>, or it may represent a significant source of product differentiation for the downstream product<sup>26</sup>. It may also be that the cost of switching to alternative inputs is relatively high.
- 34 For input foreclosure to be a concern, the vertically integrated firm resulting from the merger must have market power in the upstream market. It is only in these circumstances that the merged firm can be expected to have a significant influence on the conditions of competition in the upstream market and thus, possibly, on prices and supply conditions in the downstream market.
- 35 The merged entity would only have the ability to foreclose downstream competitors if, by reducing access to its own upstream products or services, it could negatively affect the overall availability of inputs for the downstream market in terms of price or quality. This may be the case where the remaining upstream suppliers are less efficient, offer less preferred alternatives, or lack the ability to expand output in response to the supply restriction, for example because they face binding capacity constraints or, more generally, face decreasing returns to scale<sup>27</sup>. Also, the presence of exclusive contracts between the merged entity and independent input providers may limit the ability of downstream rivals to have adequate access to inputs.
- 36 When determining the extent to which input foreclosure may occur, it must be taken into account that the decision of the merged entity to rely on its upstream division's supply of inputs may also free up capacity on the part of the remaining input suppliers from which the downstream division used to purchase before. In fact, the merger may merely realign purchase patterns among competing firms.
- 37 When competition in the input market is oligopolistic, a decision of the merged entity to restrict access to its inputs reduces the competitive pressure exercised on remaining input suppliers, which may allow them to raise the input price they charge to non-integrated downstream competitors. In essence, input foreclosure by the merged entity may expose its downstream rivals to independent suppliers with increased market

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<sup>25</sup> For instance, an engine starter can be considered a critical component to an engine (Case T-210/01, *General Electric v. Commission* [2005], ECR II-000).

<sup>26</sup> For instance, personal computers are often sold with specific reference to the type of microprocessor they contain.

<sup>27</sup> For instance, in Case COMP/M.2322 - CRH/Addtek (2001; case withdrawn), the merger involved an upstream dominant supplier of cement and a downstream producer of pre-cast concrete products, both active in Finland. Imports of cement from the Baltic countries were capacity constrained, whereas imports from Russia at that time were deemed not to be of sufficient quality to be a real alternative to the merged entity's supply of cement.

power<sup>28</sup>. This increase in third-party market power will be greater the lower the degree of product differentiation between the merged entity and other upstream suppliers and the higher the degree of upstream concentration. However, the attempt to raise the input price may fail when independent input suppliers, faced with a reduction in the demand for their products (from the downstream division of the merged entity or from independent downstream firms), respond by pricing more aggressively<sup>29</sup>.

- 38 In its assessment, the Commission may consider, on the basis of the information available, whether there are effective and timely counter-strategies that the rival firms would be likely to deploy. Such counterstrategies include the possibility of changing their production process so as to be less reliant on the input concerned or sponsoring the entry of new suppliers upstream.

#### *B. Incentive to foreclose access to inputs*

- 39 The incentive to foreclose depends on the degree to which foreclosure would be profitable. The vertically integrated firm will take into account how its supplies of inputs to competitors downstream will affect not only the profits of its upstream division, but also of its downstream division. Essentially, the merged entity faces a trade-off between the profit lost in the upstream market due to a reduction of input sales to (actual or potential) rivals and the profit gain from expanding sales downstream or, as the case may be, being able to raise price in that market.
- 40 The trade-off is likely to depend on the level of profits the merged entity obtains upstream and downstream. Other things constant, the lower the margins upstream, the lower the loss from restricting input sales. Similarly, the higher the downstream margins, the higher the profit gain from increasing market share downstream at the expense of foreclosed rivals<sup>30</sup>.
- 41 The incentive for the integrated firm to raise rivals' costs further depends on the extent to which downstream demand is likely to be diverted away from foreclosed rivals and the share of that diverted demand that the downstream division of the integrated firm can capture<sup>31</sup>. This share will normally be higher the less capacity constrained the merged entity will be relative to non-foreclosed downstream rivals and the more the products of the merged entity and foreclosed competitors are close substitutes<sup>32</sup>.

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<sup>28</sup> The analysis of the likely effect of the removal of a competitive constraint is similar to the analysis of non-coordinated effects with horizontal mergers (See Section IV of the Notice on Horizontal Mergers)

<sup>29</sup> Also the nature of the supply contracts between upstream suppliers and the downstream independent firms may be important in this respect. For instance, when these contracts use a price system combining a fixed fee and a per-unit supply price, the effect on downstream competitors' marginal costs may be affected less than when these contracts involve only per-unit supply prices.

<sup>30</sup> It has to be considered that upstream and downstream margins may change as a result of the merger. This may impact upon the merged entity's incentive to engage in foreclosure.

<sup>31</sup> See, e.g. Case COMP/M.3943 - Saint-Gobain/BPB (2005), point 78. The Commission noted that it would be very unlikely that BPB, the main supplier of plaster board in the UK, would cut back on supplies to rival distributors of Saint-Gobain, in part because expansion of Saint-Gobain's distribution capacity was difficult.

<sup>32</sup> For instance, in Case COMP/M.2322 - CRH/Addtek (2001; case withdrawn), the merger involved an upstream dominant supplier of cement and a downstream producer of pre-cast concrete products in Finland. As national Finnish regulations for the construction sector had led to a substantial standardisation of pre-cast concrete products in Finland, the Commission considered that many

- 42 The incentive to foreclose actual or potential rivals may also depend on the extent to which the downstream division of the integrated firm can be expected to benefit from higher price levels downstream as a result of a strategy to raise rivals' costs. The greater the market shares of the merged entity downstream, the greater the base of sales on which to enjoy increased margins<sup>33</sup>.
- 43 In its assessment of the likely incentives of the merged firm, the Commission may take into account various considerations such as the ownership structure of the merged entity<sup>34</sup>, the type of strategies adopted on the market in the past<sup>35</sup> or the content of internal strategic documents such as business plans.
- 44 In addition, when the adoption of a specific course of conduct by the merged entity is an essential step in foreclosure, the Commission examines both the incentives to adopt such conduct and the factors liable to reduce, or even eliminate, those incentives, including the possibility that the conduct is unlawful. Conduct may be unlawful *inter alia* because of competition rules or sector-specific rules at the EU or national levels. This appraisal, however, does not require an exhaustive and detailed examination of the rules of the various legal orders which might be applicable and of the enforcement policy practised within them<sup>36</sup>. Moreover, the illegality of a conduct may be likely to provide significant disincentives for the merged entity to engage in such conduct only in certain circumstances. In particular, the Commission will consider, on the basis of a summary analysis: (i) the likelihood that this conduct would be clearly, or highly probably, unlawful under Community law<sup>37</sup>, (ii) the likelihood that this illegal conduct could be detected<sup>38</sup>, and (iii) the penalties which could be imposed.

### *C. Overall likely impact on effective competition*

- 45 A merger will raise competition concerns because of input foreclosure only if it would significantly impede effective competition in the downstream market.

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customers would switch to the merged entity in case of a relative increase in the price of those competitors facing higher costs for cement.

<sup>33</sup> It must be noted that the less the merged firm can target a specific downstream market, the less it is likely to raise its prices for the input it supplies, as it would have to incur opportunity costs in other downstream markets. In this respect, the extent to which the merged entity can price discriminate when the merged entity supplies several downstream markets and/or ancillary markets may be taken into account (e.g. for spare parts).

<sup>34</sup> For instance, in cases where two companies have joint control over a firm active in the upstream market, and only one of them is active downstream, the company without downstream activities may have little interest in foregoing input sales. In such cases, the incentive to foreclose is likely to be smaller than when the upstream company is fully controlled by a company with downstream activities. See e.g. Case COMP/M.3440 - EDP/ENI/GDP (2004).

<sup>35</sup> The fact that, in the past, a competitor with a similar market position than the merged entity has stopped supplying inputs may demonstrate that it is commercially rational to adopt such a strategy (See e.g. Alcan/Pechiney, M. 3225 (2004), at point 40).

<sup>36</sup> Case C-12/03 P, Commission v. Tetra Laval BV, ECR I-000, paragraphs 74-76. Case T-210/01, General Electric v. Commission [2005], ECR II-000, at paragraph 73.

<sup>37</sup> Case T-210/01, General Electric v. Commission [2005], ECR II-000, specifically at points 74-75 and 311-312.

<sup>38</sup> For instance, in Case M.3696 E.ON/MOL (2005), points 433 and 443-446, the Commission attached importance to the fact that the national Hungarian regulator for the gas sector indicated that in a number of settings, although it has the right to control and to force market players to act without discrimination, it would not be able to obtain adequate information on the commercial behaviour of the operators. See also Case COMP/M.3440 - EDP/ENI/GDP (2004), point 424.

- 46 First, such anticompetitive foreclosure may occur when a vertical merger allows the merging parties to increase the costs of downstream rivals in the market thereby leading to an upward pressure on their sales prices<sup>39</sup>. Significant harm to effective competition normally requires that the foreclosed firms play a sufficiently important role in the competitive process on the downstream market. The higher the proportion of rivals which would be foreclosed on the downstream market, the more likely the merger can be expected to result in a significant price increase in the downstream market and, therefore, to significantly impede effective competition therein. Despite a relatively small market share compared to other players, a specific firm may play a significant competitive role compared to other players<sup>40</sup>, for instance because it is a close competitor of the vertically integrated firm<sup>41</sup>.
- 47 Second, effective competition may be significantly impeded by raising barriers to entry to potential competitors. A vertical merger may foreclose potential competition on the downstream market when the merged entity would be likely not to supply potential downstream entrants, or only on less favourable terms than absent the merger. The mere likelihood that the merged entity would carry out a foreclosure strategy post-merger may also create a strong deterrent effect on potential entrants<sup>42</sup>. Effective competition on the downstream market may be significantly impeded by raising barriers to entry, in particular if input foreclosure would entail for such potential competitors the need to enter at both the downstream and the upstream level in order to compete effectively on either market. The concern of raising entry barriers is particularly relevant in those industries that are opening up to competition or are expected to do so in the foreseeable future<sup>43</sup>.
- 48 If there remain sufficient credible downstream competitors whose costs are not likely to be raised, for example because they are themselves vertically integrated<sup>44</sup> or they are capable of switching to adequate alternative inputs, competition from those firms may constitute a sufficient constraint on the merged entity and therefore prevent output prices from rising above pre-merger levels.

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<sup>39</sup> Where downstream prices are not likely to increase in the short run, foreclosed rivals may still lose significant sales to the merged entity. As a result of lower revenue streams, foreclosed rivals may be restricted in their ability to invest so as to further compete downstream, to the detriment of consumers in the future (See, for related concerns, the section on customer foreclosure)

<sup>40</sup> See e.g. Case COMP/M.3440 - EDP/ENI/GDP (2004).

<sup>41</sup> A vertical merger may also allow an upstream supplier to exercise its market power more effectively. For example, a downstream buyer may be willing to pay a high price from an upstream monopolist if the latter does not subsequently sell additional quantities to a competitor. But once the terms of supply are fixed with one downstream firm, the upstream supplier may have an incentive to increase its supplies to other downstream firms, thereby making the first purchase unprofitable. Since downstream firms will anticipate this kind of opportunistic behavior, the upstream supplier will be unable to fully exploit its market power. Vertical integration may restore the upstream supplier's ability to commit not to expand input sales as this would harm its own downstream division.

<sup>42</sup> See Case COMP/M.3696 - E.ON/MOL (2005), at point 662 et seq.

<sup>43</sup> See paragraph 20. It is important that regulatory measures aimed at opening a market are not rendered ineffective through the merger of vertically-related incumbent with market power thereby potentially closing off the market, or eliminating each other as potential entrants.

<sup>44</sup> See e.g. Case COMP/M.3653 - Siemens / VA Tech (2005), at point 164.

- 49 The effect on competition on the downstream market must also be assessed in light of countervailing factors such as the presence of buyer power<sup>45</sup> or the likelihood that entry upstream would maintain effective competition<sup>46</sup>.
- 50 Further, the effect on competition needs to be assessed in light of efficiencies identified and substantiated by the merging parties<sup>47</sup>. The Commission may decide that, as a consequence of the efficiencies that the merger brings about, there are no grounds for declaring the merger incompatible with the common market pursuant to Article 2(3) of the Merger Regulation. This will be the case when the Commission is in a position to conclude on the basis of sufficient evidence that the efficiencies generated by the merger are likely to enhance the ability and incentive of the merged entity to act pro-competitively for the benefit of consumers, thereby counteracting the adverse effects on competition which the merger might otherwise have.
- 51 When assessing efficiencies in the context of non-horizontal mergers, the Commission applies the principles already set out in Section VII of the Notice on Horizontal Mergers. In particular, for the Commission to take account of efficiency claims in its assessment of the merger, the efficiencies have to benefit consumers, be merger-specific and be verifiable. These conditions are cumulative<sup>48</sup>.
- 52 Vertical mergers may entail some specific sources of efficiencies, the list of which is not exhaustive.
- 53 A vertical merger may allow the merged entity to internalise any pre-existing double mark-ups resulting from both parties setting their prices independently pre-merger<sup>49</sup>. Depending on the market conditions, reducing the combined mark-up (relative to a situation where pricing decisions at both levels are not aligned) may allow the vertically integrated firm to profitably expand output on the downstream market<sup>50</sup>.
- 54 A vertical merger may further allow the parties to better coordinate the production and distribution process, and therefore to save on inventories costs.
- 55 More generally, a vertical merger may align the incentives of the parties with regard to investments in new products, new production processes and in the marketing of products. For instance, whereas before the merger, the upstream entity might have been reluctant to invest in the sales force of the downstream entity when such investment would also have benefited the sale of other upstream firms' products, the merged entity does not face such incentive problems.

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<sup>45</sup> See Section V on countervailing buyer power in the Notice on Horizontal Mergers.

<sup>46</sup> See Section VI on entry in the Notice on Horizontal Mergers.

<sup>47</sup> See Section VII on efficiencies in the Notice on Horizontal Mergers.

<sup>48</sup> See, more specifically, paragraphs 79 to 88 of the Notice on Horizontal Mergers.

<sup>49</sup> See also paragraph 13 above.

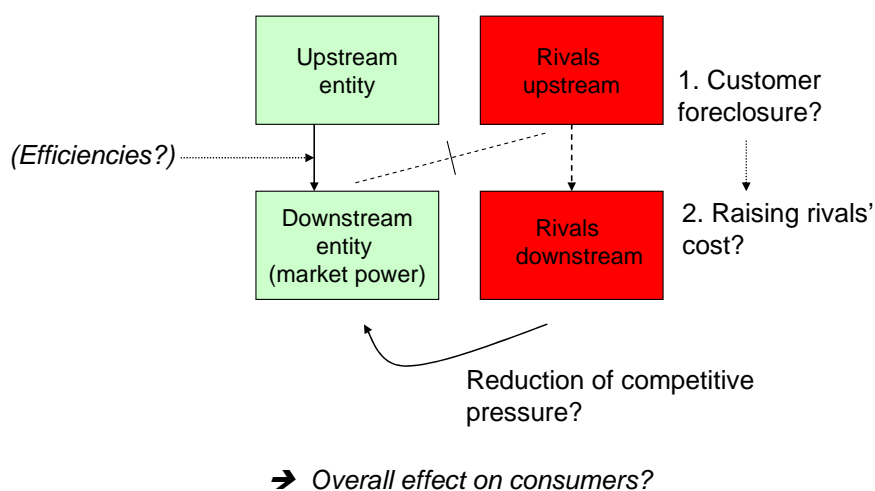
<sup>50</sup> It is important to recognise, however, that the problem of double mark-ups is not always present or significant pre-merger, for instance because the merging parties had already concluded a supply agreement with a price mechanism providing for volume discounts eliminating the mark-up. Besides, a merger may not fully eliminate the double mark-up when the supply of the input is capacity constrained and there is an important alternative use for the input. In such circumstances, the internal use of the input entails an opportunity cost for the vertically integrated company: using more of the input internally to increase output downstream means selling less in the alternative market. As a result, the incentive to use the input internally and increase output downstream is less than when there is no opportunity cost.

56 The above mentioned efficiencies may not always be merger specific in that vertical cooperation or vertical agreements may, short of a merger, achieve similar benefits with less anti-competitive effects.

## 2. Foreclosing access to customers

57 Customer foreclosure may occur when a supplier integrates with an important customer in the downstream market<sup>51</sup>. Because of this downstream presence, the merged entity may foreclose access to a sufficient customer base to its actual or potential rivals in the upstream market (the input market) and reduce their ability or incentive to compete. In turn, this may raise downstream rivals' costs by making it harder for them to obtain supplies of the input under similar prices and conditions as absent the merger. This may allow the merged entity profitably to establish higher prices on the downstream market. Any efficiencies resulting from the merger, however, may lead the merged entity to reduce price, so that there is overall not a negative impact on consumers. A graphical presentation of this mechanism is provided in Figure 2.

*Figure 2 - Customer foreclosure*



58 In assessing the likelihood of an anticompetitive customer foreclosure scenario, the Commission examines, first, whether the merged entity would have the ability to foreclose access to downstream markets by reducing its purchases from its upstream rivals, second, whether it would have the incentive to reduce its purchases upstream, and third, whether a foreclosure strategy would have a significant detrimental effect on consumers in the downstream market.

### *A. Ability to foreclose access to downstream markets*

<sup>51</sup> See footnote 4 for the definition of “downstream” and “upstream”.

- 59 A vertical merger may affect upstream competitors by increasing their cost to access downstream customers or by restricting access to a significant customer base. Customer foreclosure may take various forms. For instance, the merged entity may decide to source all of its internal needs from its upstream division and, as a result, may stop purchasing from its upstream competitors. It may also reduce its purchases from upstream rivals, or purchase from those rivals on less favourable terms than it would have done absent the merger<sup>52</sup>.
- 60 When considering whether the merged entity would have the ability to foreclose access to downstream markets, the Commission examines whether there are sufficient economic alternatives in the downstream market for the upstream rivals (actual or potential) to sell their output<sup>53</sup>. For customer foreclosure to be a concern, it must be the case that the vertical merger involves an undertaking which is an important customer in the downstream market<sup>54</sup>. If, on the contrary, there is a sufficiently large customer base, at present or in the future, that is likely to turn to independent suppliers, the Commission is unlikely to raise competition concerns on that ground<sup>55</sup>.
- 61 Customer foreclosure can lead to higher input prices only if there are significant economies of scale or scope in the input market<sup>56</sup>. It is only in such circumstances that the ability to compete of upstream rivals, be they actual or potential, can be impaired.
- 62 In the presence of economies of scale or scope, customer foreclosure may render entry upstream by potential entrants unattractive by significantly reducing the revenue prospects of potential entrants. When customer foreclosure effectively results in entry deterrence, input prices may remain at a higher level than otherwise would have been the case, thereby raising the cost of input supply to downstream competitors of the merged firm.
- 63 Customer foreclosure can also lead to higher input prices when existing upstream rivals operate at or close to their minimum efficient scale. To the extent that customer foreclosure and the corresponding loss of output for the upstream rivals increases their variable costs of production, this may result in an upward pressure on the prices they charge to their customers operating in the downstream market.
- 64 Further, when customer foreclosure primarily impacts upon the revenue streams of upstream rivals, it may significantly reduce their ability and incentive to invest in cost reduction, R&D and product quality<sup>57</sup>. This may reduce their ability to compete in the long run and possibly even cause their exit from the market.

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<sup>52</sup> For instance, in cases involving distribution, the merged entity may be less likely to grant access to its outlets under the same conditions as absent the merger.

<sup>53</sup> The loss of the integrated firm as a customer is normally less significant if that firm's pre-merger purchases from non-integrated firms are a small share of the available sales base for those firms. In that case, sufficient alternative customers are more likely to be available. The presence of exclusive contracts between the merged entity and other downstream firms may limit the ability of upstream rivals to reach a sufficient sales volume.

<sup>54</sup> See e.g. Case COMP/M.2822 - ENBW/ENI/GVS (2002) at points 54-57.

<sup>55</sup> See e.g. Case COMP/M.81 - VIAG / Continental Can (1991), point 51.

<sup>56</sup> A production process exhibits economies of scale or scope when the increased scale or scope of production leads to a reduction in unit cost. This includes, for example, also network effects.

<sup>57</sup> An input supplier foreclosed from an important customer may prefer to stay out of the market if it fails to reach some minimum viable scale following the investment. Such minimum viable scale may be

- 65 In its assessment, the Commission may take into account the existence of different markets corresponding to different uses for the input. If a substantial part of the downstream market is foreclosed, an upstream supplier may fail to reach efficient scale and may also operate at higher costs in the other market(s). Conversely, an upstream supplier may continue to operate efficiently scale if it finds other uses or secondary markets for its input without incurring significantly higher costs.
- 66 In its assessment, the Commission may consider, on the basis of the information available, whether there are effective and timely counter-strategies, sustainable over time, that the rival firms would be likely to deploy. Such counterstrategies include the likelihood that upstream rivals decide to price more aggressively to maintain sales levels in the downstream market, so as to mitigate the effect of foreclosure<sup>58</sup>.

*B. Incentive to foreclose access to downstream markets*

- 67 The incentive to foreclose depends on the degree to which it is profitable. The merged entity faces a trade-off between the possible costs associated with not procuring products from upstream rivals and the possible gains from doing so, for instance, because it allows the merged entity to raise price in the upstream or downstream markets.
- 68 The costs associated with reducing purchases from rival upstream suppliers are higher, when the upstream division of the integrated firm is less efficient than the foreclosed suppliers. Such costs are also higher if the upstream division of the merged firm is capacity constrained or rivals' products are more attractive due to product differentiation.
- 69 The incentive to engage in customer foreclosure further depends on the extent to which the upstream division of the merged entity can benefit from possibly higher price levels in the upstream market arising as a result of upstream rivals being foreclosed. The incentive to engage in customer foreclosure also becomes higher, the more the downstream division of the integrated firm can be expected to enjoy the benefits of higher price levels downstream resulting from the foreclosure strategy. In this context, the greater the market shares of the merged entity's downstream operations, the greater the base of sales on which to enjoy increased margins<sup>59</sup>.
- 70 When the adoption of a specific conduct by the merged entity is an essential step in foreclosure, the Commission examines both the incentives to adopt such conduct and

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achieved, however, if a potential entrant has access to a broader customer base including customers in other relevant markets. See Case No. COMP/M. 1879 – Boeing/Hughes (2000); Case No. COMP/M.2978 - Lagardère/Natexis/VUP (2003);

<sup>58</sup> For instance, in Case COMP/M.1879 – Boeing/Hughes (2000), point 100, it was considered, among several other factors, that in view of the high fixed costs involved, if competing satellite launch vehicle providers were to become less cost-competitive relative to the merged entity, they would try to cut prices in order to salvage volume and recoup at least part of their fixed costs rather than accept losing a contract and incur a higher loss. The most likely impact would therefore be greater price competition rather than market monopolisation.

<sup>59</sup> If the vertically integrated firm partially supplies inputs to downstream competitors it may benefit from the ability to expand sales, or as the case may be, to increase input prices.

the factors liable to reduce, or even eliminate, those incentives, including the possibility that the conduct is unlawful<sup>60</sup>.

*C. Overall likely impact on effective competition*

- 71 Foreclosing rivals in the upstream market may have an adverse impact in the downstream market and harm consumers. By denying competitive access to a significant customer base for the foreclosed rivals' (upstream) products, the merger may reduce their ability to compete in the foreseeable future. As a result, rivals downstream are likely to be put at a competitive disadvantage, for example in the form of raised input costs. In turn, this may allow the merged entity profitably to reduce the overall output on the downstream market, thus leading to price increases.
- 72 The negative impact on consumers may take some time to materialise when the primary impact of customer foreclosure is on the revenue streams of upstream rivals, reducing their incentives to make investments in cost reduction, product quality or in other competitive dimensions so as to remain competitive.
- 73 It is only when a sufficiently large fraction of upstream output is affected by the revenue decreases resulting from the vertical merger that the merger may significantly impede effective competition on the upstream market. If there remain a number of upstream competitors that are not affected, competition from those firms may be sufficient to prevent prices from rising in the upstream market and, consequently, in the downstream market. Sufficient competition from these non-foreclosed upstream firms requires that they do not face barriers to expansion e.g. through capacity constraints or product differentiation<sup>61</sup>. When the reduction of competition upstream affects a significant fraction of output downstream, the merger is likely, as with input foreclosure, to result in a significant increase of the price level in the downstream market and, therefore, to significantly impede effective competition<sup>62</sup>.
- 74 Effective competition on the upstream market may also be significantly impeded by raising barriers to entry to potential competitors. This may be so in particular if customer foreclosure would entail for such potential competitors the need to enter at both the downstream and the upstream level in order to compete effectively on either market. In such a context, customer foreclosure and input foreclosure may thus be part of the same strategy. The concern of raising entry barriers is particularly relevant in those industries that are opening up to competition or are expected to do so in the foreseeable future<sup>63</sup>.
- 75 The effect on competition must be assessed in light of countervailing factors such as the presence of countervailing buyer power<sup>64</sup> or the likelihood that entry would maintain effective competition in the upstream or downstream markets<sup>65</sup>.

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<sup>60</sup> The analysis of these incentives will be conducted as set out in para 44 above.

<sup>61</sup> The analysis of such non-coordinated effects bears similarities with the analysis of non-coordinated effects in horizontal mergers (See Section IV of the Notice on Horizontal Mergers).

<sup>62</sup> See paragraph 45-48 of the present Notice.

<sup>63</sup> It is important that regulatory measures aimed at opening a market are not rendered ineffective through vertically-related incumbent companies merging and thereby closing off the market, or eliminating each other as potential entrants.

<sup>64</sup> See Section V on countervailing buyer power in the Notice on Horizontal Mergers.

76 Further, the effect on competition needs to be assessed in light of efficiencies identified and substantiated by the merging parties<sup>66</sup>.

## **B. Other non-coordinated effects**

77 The merged entity may, by vertically integrating, gain access to commercially sensitive information regarding the upstream or downstream activities of rivals<sup>67</sup>. For instance, by becoming the supplier of a downstream competitor, a company may obtain critical information, which allows it to price less aggressively in the downstream market to the detriment of consumers<sup>68</sup>. It may also put competitors at a competitive disadvantage, thereby dissuading them to enter or expand in the market.

## **C. Coordinated effects**

78 As set out in Section IV of the Notice on Horizontal Mergers, a merger may change the nature of competition in such a way that firms that previously were not coordinating their behaviour, are now significantly more likely to coordinate and raise prices or otherwise harm effective competition. A merger may also make coordination easier, more stable or more effective for firms which were coordinating prior to the merger<sup>69</sup>.

79 Market coordination may arise where competitors are able, without entering into an agreement or resorting to a concerted practice within the meaning of Article 81 of the Treaty, to identify and pursue common objectives, avoiding the normal mutual competitive pressure by a coherent system of implicit threats. In a normal competitive setting, each firm constantly has an incentive to compete. This incentive is ultimately what keeps prices low, and what prevents firms from jointly maximising their profits. Coordination involves a departure from normal competitive conditions in that firms, are able to sustain prices in excess of what independent short term profit maximisation would yield. Firms will refrain from undercutting the high prices charged by their competitors in a coordinated way because they anticipate that such behaviour would jeopardise coordination in the future. For coordinated effects to arise, the profit that firms could make by competing aggressively in the short term ("deviating") has to be less than the expected reduction in revenues that this behaviour would entail in the longer term, as it would be expected to trigger an aggressive response by competitors ("a punishment").

80 Coordination is more likely to emerge in markets where it is relatively simple to reach a common understanding on the terms of coordination. In addition, three conditions are necessary for coordination to be sustainable. First, the coordinating firms must be able to monitor to a sufficient degree whether the terms of coordination are being adhered to. Second, discipline requires that there is some form of credible deterrent mechanism that can be activated if deviation is detected. Third, the reactions of outsiders, such as

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<sup>65</sup> See Section VI on entry in the Notice on Horizontal Mergers.

<sup>66</sup> For the assessment of efficiencies in a vertical context, see Section V.A.1 above.

<sup>67</sup> See Case COMP/M.1879 – Boeing/Hughes (2000); Case COMP/M.2510 – Cendant/Galileo, point 37; Case COMP/M.2738 – Gees/Unison, point 21; Case COMP/M.2925 – Charterhouse/CDC/Telediffusion de France, point 37-38; Case COMP/M.3440 – EDP/ENL/GDP (2004).

<sup>68</sup> See e.g. Case COMP/M.2822 - ENBW/ENI/GVS (2002), at point 56; Case COMP/M.3440 - EDP/ENI/GDP (2004), points 368-379; Case COMP/M.3653 - Siemens/VA Tech (2005) points 159-164.

<sup>69</sup> See Case COMP/M.3101 – Accor/Hilton/Six Continents, points 23-28.

current and future competitors not participating in the coordination, as well as customers, should not be able to jeopardise the results expected from the coordination<sup>70</sup>.

#### *Reaching terms of coordination*

- 81 A vertical merger may make it easier for the firms in the upstream or downstream market to reach a common understanding on the terms of coordination.
- 82 For instance, when a vertical merger leads to foreclosure<sup>71</sup>, it results in a reduction in the number of effective competitors in the market. Generally speaking, a reduction in the number of players makes it easier to coordinate among the remaining market players.
- 83 Vertical mergers may also increase the degree of symmetry between firms active in the market<sup>72</sup>. This may increase the likelihood of coordination by making it easier to reach a common understanding on the terms of coordination. Likewise, vertical integration may increase the level of market transparency, making it easier to coordinate among the remaining market players.
- 84 Further, a merger may involve the elimination of a maverick in a market. A maverick is a supplier that for its own reasons is unwilling to accept the co-ordinated outcome and thus maintains aggressive competition. The vertical integration of the maverick may alter its incentives to such an extent that co-ordination will no longer be prevented<sup>73</sup>.

#### *Monitoring deviations*

- 85 Vertical integration may facilitate coordination by increasing the level of market transparency between firms through access to sensitive information on rivals or by making it easier to monitor pricing. Such concerns may arise, for example, if the level of price transparency is higher downstream than upstream. This could be the case when prices to final consumers are public, while transactions at the intermediate market are confidential. Vertical integration may give upstream producers control over final prices and thus base co-ordination on those prices.
- 86 When it leads to foreclosure, a vertical merger may also induce a reduction in the number of effective competitors in a market. A reduction in the number of players may make it easier to monitor each other's actions in the market.

#### *Deterrent mechanisms*

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<sup>70</sup> See Case T-342/99, *Airtours v Commission*, [2002] ECR II-2585, paragraph 62.

<sup>71</sup> Foreclosure would have to be shown by the Commission along the lines of Part A of this section.

<sup>72</sup> See Case COMP/M.2389 – *Shell/DEA*; Case COMP/M.2533 – *BP/EON*.

<sup>73</sup> The incentive of a vertically integrated firm to participate in coordination at the upstream level may be increased when such a course of action is in line with a strategy of raising downstream rivals' cost, which, in turn, may confer market power to the merged entity's downstream division. Alternatively, coordination downstream may avoid that downstream competitors turn to other, possibly less attractive sources of supply.

- 87 Vertical mergers may further improve the scope for ensuring that coordinating firms find it in their best interest to adhere to the terms of coordination. For instance, a vertical integrated company may be in a position to more effectively punish rival companies when they chose to deviate from the terms of coordination, because it is either a crucial customer or supplier to them<sup>74</sup>.

#### *Reactions of outsiders*

- 88 Vertical mergers may reduce the scope for outsiders to destabilise the coordination by increasing barriers to enter the market or otherwise limiting the ability to compete on the part of outsiders to the coordination.
- 89 A vertical merger may also involve the elimination of a disruptive buyer in a market. If upstream firms view sales to a particular buyer as sufficiently important, they may be tempted to deviate from the terms of co-ordination in an effort to secure their business. Similarly, a large buyer may be able to tempt the co-ordinating firms to deviate from these terms by concentrating a large amount of its requirements on one supplier or by offering long term contracts. The acquisition of such a buyer may increase the risk of co-ordination in a market.

## **V. CONGLOMERATE MERGERS**

- 90 Conglomerate mergers are mergers between firms that are in a relationship which is neither purely horizontal (as competitors in the same relevant market) nor vertical (as supplier and customer). In practice, the focus is on mergers between companies that are active in closely related markets<sup>75</sup> (e.g. mergers involving suppliers of complementary products or of products which belong to a range of products that is generally purchased by the same set of customers for the same end use).
- 91 Whereas it is acknowledged that conglomerate mergers in the majority of circumstances will not lead to any competition problems, in certain specific cases there may be harm to competition.

### **A. Non-coordinated effects: foreclosure**

- 92 The main concern in the context of conglomerate mergers is that of foreclosure. The combination of products in related markets may confer on the merged entity the ability and incentive to leverage<sup>76</sup> a strong market position from one market to another by means of tying or bundling or other exclusionary practices<sup>77</sup>. Tying and bundling as

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<sup>74</sup> For instance, in Case COMP/M.2322 - CRH/Addtek (2001; case withdrawn), the merger involved an upstream dominant supplier of cement and a downstream producer of pre-cast concrete products, both active in Finland. The Commission held that the new entity would be able to discipline the downstream rivals by using the fact that they would be highly dependent on cement supplies of the merged entity. As a result, the downstream entity would be able to increase the price of its pre-cast concrete products while making sure that the competitors would follow these price increases and avoiding that they turn to cement imports from the Baltic states and Russia.

<sup>75</sup> See also Form CO, Section IV, 6.3 (c).

<sup>76</sup> There is no received definition of “leveraging” but, in a neutral sense, it is being able to increase sales of a product in one market (the “tied market” or “bundled market”), by virtue of the strong market position of the product to which it is tied or bundled (the “tying market” or “leveraging market”).

<sup>77</sup> These concepts are defined further below.

such are common practices that often have no anticompetitive consequences. Companies engage in tying and bundling in order to provide their customers with better products or offerings in cost-effective ways. Nevertheless, in certain circumstances, these practices may lead to a reduction in actual or potential rivals' ability or incentive to compete. This may reduce the competitive pressure on the merged entity allowing it to increase prices.

- 93 In assessing the likelihood of such a scenario, the Commission examines, first, whether the merged firm would have the ability to foreclose its rivals, second, whether it would have the economic incentive to do so and, third, whether a foreclosure strategy would have a significant detrimental effect on competition, thus causing harm to consumers<sup>78</sup>. In practice, these factors are often examined together as they are closely intertwined.

*A. Ability to foreclose*

- 94 The most immediate way in which the merged entity may be able to use its market power in one market to foreclose competitors in another is by conditioning sales in a way that links the products in the separate markets together. This is done most directly either by bundling or tying.
- 95 “Bundling” relates to the way products are offered and priced by the merged entity. One can distinguish in this respect between pure bundling and mixed bundling. In the case of pure bundling the products are only sold jointly. With mixed bundling the products are still available separately, but the sum of the stand-alone prices is higher than the bundled price<sup>79</sup>. Rebates, when made dependent on the purchase of other goods, are a form of mixed bundling<sup>80</sup>.
- 96 “Tying” occurs when customers that purchase one good (the tying good) are required also to purchase another good from the producer (the tied good). Tying can take place on a technical or contractual basis. For instance, technical tying occurs when the tying product is designed in such a way that it only works with the tied product (and not with the alternatives offered by competitors). Contractual tying entails that the customer when purchasing the tying good undertakes only to purchase the tied product (and not the alternatives offered by competitors).
- 97 The specific characteristics of the products may be relevant for determining whether any of these means of linking sales between separate markets are available to the merged entity. For instance, pure bundling is very unlikely to be possible if products are not bought simultaneously or by the same customers<sup>81</sup>. Similarly, technical tying is only an option in certain industries.
- 98 Foreclosure is unlikely to give rise to concern if the new entity, prior to it engaging in exclusionary practices, has no market power in any of the markets concerned. The effects of bundling or tying can only be expected to be substantial when at least one of the merging parties' products is viewed by many customers as particularly important

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<sup>78</sup> See Case T-210/01, *General Electric v Commission*, [2005], ECR II-000, para. 327, 362-363, 405; Case COMP/M.3304 - *GE/Amersham* (2004), point 37.

<sup>79</sup> The distinction between mixed bundling and pure bundling is not necessarily clear-cut. Mixed bundling may come close to pure bundling when the prices charged for the individual offerings are high.

<sup>80</sup> Accordingly, mixed bundling is sometimes also referred to as multiproduct rebates.

<sup>81</sup> See, e.g., Case COMP.M.3304 – *GE/Amersham* (2004), point 35.

and there are few relevant alternatives for that product, e.g. because of product differentiation<sup>82</sup> or capacity constraints on the part of rivals.

99 Further, for foreclosure to be a potential concern it must be the case that there is a large common pool of customers for the individual products concerned. The more customers tend to buy both products (instead of only one of the products), the more demand for the individual products may be affected through bundling or tying. Such a correspondence in purchasing behaviour is more likely to be significant when the products in question are complementary.

100 Generally speaking, the foreclosure effects of bundling and tying are likely to be more pronounced in industries where there are economies of scale and the demand pattern at any given point in time has dynamic implications on the conditions of supply in the market in the future. Notably, where a supplier of complementary goods has market power in one of the products (product A), the decision to bundle or tie may result in reduced sales by the non-integrated suppliers of the complementary good (product B). If further there are network externalities at play<sup>83</sup> this will significantly reduce these rivals' scope for expanding sales of product B in the future. Alternatively, where entry into the market for the complementary product is contemplated by potential entrants, the decision to bundle by the merged entity may have the effect of deterring such entry. The limited availability of complementary products with which to combine may, in turn, discourage potential entrants to enter market A.

101 It can also be noted that the scope for foreclosure tends to be smaller where the merging parties cannot commit to making their tying or bundling strategy a lasting one, for example through technical tying or bundling which is costly to reverse.

102 In its assessment, the Commission considers, on the basis of the information available, whether there are effective and timely counter-strategies that the rival firms may deploy. One such example is when a strategy of bundling would be defeated by single-product companies combining their offers so as to make them more attractive to customers<sup>84</sup>. Bundling is further less likely to lead to foreclosure if a company in the market would purchase the bundled products and profitably resell them unbundled. In addition, rivals may decide to price more aggressively to maintain market share, mitigating the effect of foreclosure<sup>85</sup>.

103 Customers may have a strong incentive to buy the range of products concerned from a single source (one-stop-shopping) rather than from many suppliers, e.g. because it saves on transaction costs ("portfolio effect"). However, the fact that the merged entity will have a broad range of products does not, as such, raise competition concerns.

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<sup>82</sup> For instance, in the context of branded products, particularly important products are sometimes referred to as 'must stock' products. See, e.g., Case COMP/M.3732 – Procter&Gamble/Gillette (2005), point 110.

<sup>83</sup> When a product features network externalities, this means that customers or producers derive benefit from the fact that other customers or producers are using the same products as well. Examples include communication devices, specific software programmes, products requiring standardisation, and platforms bringing together buyers and sellers.

<sup>84</sup> See, e.g., Case COMP/M.3304 – GE/Amersham (2004), point 39.

<sup>85</sup> See, e.g., Case COMP/M.1879 – Boeing/Hughes (2000), point 100; Case COMP/M.3304 – GE/Amersham (2004), point 39. The resulting loss of revenues may, however, in certain circumstances, have an impact on the ability of rivals to compete. See Section C.

### *B. Incentive to foreclose*

- 104 The incentive to foreclose rivals through bundling or tying depends on the degree to which this strategy is profitable. The merged entity faces a trade-off between the possible costs associated with bundling or tying its products and the possible gains from expanding market shares in the market(s) concerned or, as the case may be, being able to raise price in those market(s) due to its market power.
- 105 Pure bundling and tying may entail losses for the merged company itself. For instance, if a significant number of customers is not interested in buying the bundle, but instead prefers to buy only one product (e.g. the product used to leverage), sales of that product (as contained in the bundle) may significantly fall. Furthermore, losses on the leveraging product may arise where customers who, before the merger, used to “mix and match” the leveraging product of a merging party with the product of another company, decide to purchase the bundle offered by rivals or no longer to purchase at all<sup>86</sup>.
- 106 In this context it may thus be relevant to assess the relative value of the different products. By way of example, it is unlikely that the merged entity would be willing to forego sales on one highly profitable market in order to gain market shares on another market where turnover is relatively small and profits are modest.
- 107 However, the decision to bundle and tie may also increase profits by gaining market power in the tied goods market, protecting market power in the tying goods market, or a combination of the two (See Section C. below).
- 108 When the adoption of a specific conduct by the merged entity is an essential step in foreclosure, the Commission examines both the incentives to adopt such conduct and the factors liable to reduce, or even eliminate, those incentives, including the possibility that the conduct is unlawful<sup>87</sup>.

### *C. Overall likely impact on prices and choice*

- 109 Bundling or tying may result in a significant reduction of sales prospects faced by single-component rivals in the market. The reduction in sales by competitors is not in and of itself a problem. Yet, in particular industries, if this reduction is significant enough, it may lead to a reduction in rivals’ ability or incentive to compete. This may allow the merged entity to subsequently acquire market power (in the market for the tied or bundled good) and/or to maintain market power (in the market for the tying or leveraging good).
- 110 In particular, foreclosure practices may deter entry by potential competitors.. They may do so for a specific market by reducing sales prospects for potential rivals in that market to a level below minimum viable scale. In the case of complementary products, deterring entry in one market through bundling or tying may also allow the merged entity to deter entry in another market if the bundling or tying forces potential competitors to enter both product markets at the same time rather than entering only one of them or entering them sequentially. The latter may have a significant impact in

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<sup>86</sup> See, e.g., Case COMP/M.3304 – GE/Amersham (2004), point 59.

<sup>87</sup> The analysis of these incentives will be conducted as set out in para 44 above.

particular in those industries where the demand pattern at any given point in time has dynamic implications on the conditions of supply in the market in the future.

- 111 It is only when a sufficiently large fraction of market output is affected by foreclosure resulting from the merger that the merger may significantly impede effective competition. If there remain effective single-product players in either market, competition is unlikely to deteriorate following a conglomerate merger. The same holds when few single-product rivals remain, but these have the ability and incentive to expand output.
- 112 The effect on competition needs to be assessed in light of countervailing factors such as the presence of countervailing buyer power<sup>88</sup> or the likelihood that entry would maintain effective competition in the upstream or downstream markets<sup>89</sup>.
- 113 Further, the effect on competition needs to be assessed in light of the efficiencies identified and substantiated by the merging parties<sup>90</sup>.
- 114 Many of the efficiencies identified in the context of vertical mergers may, *mutatis mutandis*, also apply to conglomerate mergers involving complementary products.
- 115 Notably, when producers of complementary goods are pricing independently, they will not take into account the positive effect of a drop in the price of their product on the sales of the other product. Depending on the market conditions, a merged firm may internalise this effect and may have a certain incentive to lower margins if this leads to higher overall profits (this incentive is often referred to as the “Cournot effect”). In most cases, the merged firm will make the most out of this effect by means of mixed bundling, i.e. by making the price drop conditional upon whether or not the customer buys both products from the merged entity.<sup>91</sup>
- 116 Specific to conglomerate mergers is that they may produce cost savings in the form of economies of scope (either on the production or the consumption side), yielding an inherent advantage to supplying the goods together rather than apart<sup>92</sup>. For instance, it may be more efficient that certain components are marketed together as a bundle rather than separately. Value enhancements for the customer can result from better compatibility and quality assurance of complementary components. Such economies of scope however are necessary but not sufficient to provide an efficiency justification for bundling or tying. Indeed, benefits from economies of scope frequently can be realised without any need for technical or contractual bundling.

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<sup>88</sup> See Section V on countervailing buyer power in the Notice on Horizontal Mergers.

<sup>89</sup> See, e.g., Case COMP/M.3732 – Procter&Gamble/Gillette (2005), point 131. See also Section VI on entry in the Notice on Horizontal Mergers.

<sup>90</sup> See Section VII on efficiencies in the Notice on Horizontal Mergers.

<sup>91</sup> It is important to recognise however that the problem of double mark-ups is not always present or significant pre-merger. In the context of mixed bundling, it must further be noted that while the merged entity may have an incentive to reduce the price for the bundle, the effect on the prices of the individual products is less clear cut. The incentive for the merged entity to raise its single product prices may come from the fact that it counts on selling more bundled products instead. The merged entity’s bundle price and prices of the individually sold products (if any) will further depend on the price reactions of rivals in the market.

<sup>92</sup> See, e.g., Case COMP/M.3732 – Procter&Gamble/Gillette (2005), point 131.

## **B. Co-ordinated effects**

- 117 Conglomerate mergers may in certain circumstances facilitate anticompetitive co-ordination in markets, even in the absence of an agreement or a concerted practice within the meaning of Article 81 of the Treaty. The framework set out in Section IV of the Notice on Horizontal Mergers also applies in this context. In particular, co-ordination is more likely to emerge in markets where it is fairly easy to identify the terms of co-ordination and where such co-ordination is sustainable.
- 118 One way in which a conglomerate merger may influence the likelihood of a coordinated outcome in a given market is by reducing the number of effective competitors to such an extent that tacit coordination becomes a real possibility. Also when rivals are not excluded from the market, they may find themselves in a more vulnerable situation. As a result, foreclosed rivals may choose not to contest the situation of co-ordination, but may prefer instead to live under the shelter of the increased price level.
- 119 Further, a conglomerate merger may increase the extent and importance of multi-market competition. Competitive interaction on several markets may increase the scope and effectiveness of disciplining mechanisms in ensuring that the terms of co-ordination are being adhered to.