

**Joint Comments of the American Bar Association’s
Section of Antitrust Law and Section of International Law
on the European Commission’s Draft Guidelines
on the Assessment of Non-Horizontal Mergers
Under the Council Regulation on the
Control of Concentrations Between Undertakings**

The Section of Antitrust Law and the Section of International Law (together, the “Sections”) of the American Bar Association welcome the opportunity to respond to the request of the European Commission (“Commission”) for comments on the draft guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (“Draft Guidelines” or “Guidelines”). The views expressed herein are being presented jointly on behalf of the Sections.* They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association.

The Sections have substantial familiarity with non-horizontal mergers and the approaches adopted by enforcement agencies to analyze the competitive implications of such mergers, particularly in the United States. The Sections have had prior opportunity to give substantial consideration to policy questions and operational issues arising in the

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context of reviews of non-horizontal mergers.¹ The Sections are also aware that the underlying Council Regulation and Treaty and other aspects of the Commission merger control process differ from those in the United States and that some differences in treatment of non-horizontal mergers may be appropriate for that reason. The Sections hope and intend that these comments, from the perspective of the Sections and grounded in our collective experience (both positive and negative), will assist the Commission in its development of guidelines for use in non-horizontal merger inquiries.

The Sections applaud the Commission's efforts in preparing and circulating for comment the Draft Guidelines, particularly as doing so contributes to the increased efficiency, consistency, and transparency of the merger review process and furthers the international discussion of the state-of-the-art thinking of how to analyze non-horizontal mergers. We generally concur with the provisions contained in the Draft Guidelines and believe that their underlying recognition of the benefits obtainable through non-horizontal mergers is useful guidance for the business community.

¹ Indeed, both the Sections and the Antitrust Modernization Commission have commented that the U.S. non-horizontal merger guidelines are out of date and require revision or rescission. See American Bar Association Section of Antitrust Law, *The State of Federal Antitrust Enforcement – 2004* (Jan. 14, 2005), available at http://www.abanet.org/antitrust/at-comments/2005/02-05/state_of_fed_enforc.pdf; Antitrust Modernization Commission, *Report and Recommendations* (Apr. 2007), at 68, available at http://amc.gov/report_recommendation/amc_final_report.pdf (“Significant thinking regarding vertical mergers has taken place since then, but the Guidelines have not been updated or separate guidelines issued to address non-horizontal mergers.”). In addition, the Sections have filed comments in response to the non-horizontal merger guidelines proposed in Canada. See *Joint Comments of the American Bar Association’s Section of Antitrust Law and Section of International Law and Practice on Merger Enforcement Guidelines (Draft for Consultation Mar. 2004) of the Competition Bureau of Canada*, available at http://www.abanet.org/intlaw/committees/business_regulation/antitrust/canadianantitrustcomments.pdf.

We also fully endorse the Commission’s approach “to further develop[] and refine[]” the principles contained in the Guidelines in individual cases and with reference to interpretations “which may be given by the Court of Justice and the Court of First Instance of the European Communities.” (Paragraphs 8-9.) The Commission also notes that it “may revise the notice on non-horizontal mergers from time to time in light of future developments and of evolving insight.” (Paragraph 8.) Again, the Sections support this approach, and encourage the Commission to consider scheduling a specific period for review, e.g., after working with the Guidelines for two years, and including public participation in such a review.

With respect to conglomerate mergers, we encourage the Commission to re-evaluate the need for a separate analytical framework and theories of harm related to such mergers. In the event that the Commission decides not to follow this suggestion, we provide specific commentary regarding the Draft Guidelines’ treatment of conglomerate mergers.

We submit these comments with the objective of focusing on those areas where we believe further clarification or reconsideration might be beneficial. We have organized our comments to follow the organization of the Draft Guidelines.

I. OVERVIEW

The Overview outlines in pragmatic and straightforward fashion a number of well-accepted points regarding non-horizontal mergers. It correctly notes that non-horizontal transactions “are generally less likely to create competition concerns than

horizontal mergers.”² (Paragraph 11.) It also helpfully acknowledges that such mergers “provide substantial scope for efficiencies.” The Draft Guidelines outline some of the reasons why such mergers are often benign or pro-competitive, focusing on the lack of a loss of horizontal competition, the substantial opportunity for efficiencies that non-horizontal mergers present, and the other tangible benefits that can result from vertical integration. (Paragraphs 12-14.) These factors are consistent with the U.S. approach to the analysis of non-horizontal mergers that has been developed over many years, and after periods of what proved to be excessive hostility toward non-horizontal mergers.³ The Sections do believe, nonetheless, that the introductory chapter of the Draft Guidelines could be more explicit in confirming that non-horizontal mergers only infrequently give rise to competitive concerns.

The Commission’s analysis of potential competitive harm from vertical mergers appropriately focuses on the potential for non-coordinated effects through customer and/or input foreclosure, and coordinated effects. The Overview could benefit from more precision in its discussion of foreclosure. For example, paragraph 18’s definition of foreclosure includes within it the concept that foreclosure may be found where a rival’s “access to supplies or markets is *hampered* or eliminated.” (Paragraph 18, emphasis

² *Alberta Gas Chems. Ltd. v. E.I. duPont de Nemours & Co.*, 826 F.2d 1235, 1244 (3d Cir. 1987) (quoting Herbert Hovenkamp, *Merger Actions for Damages*, 35 HASTINGS L. REV. 937, 961 (1984)) (“[O]f all mergers, vertical acquisitions are the most likely to produce efficiencies and the least likely to enhance the market power of the merging firms.”).

³ *See, e.g., Ford Motor Co. v. United States*, 405 U.S. 562 (1972) (requiring automobile manufacturer to divest original equipment spark plug manufacturer based on 10% foreclosure). For a discussion of early vertical merger cases, see DENNIS CARLTON AND JEFFREY PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 636 (2000). *See also* Michael Riordan & Steven Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L.J., 513-68 (1995); David Reiffen & Michael Vita, *Is There New Thinking on Vertical Mergers?*, 63 ANTITRUST L.J. 917-50 (1995).

supplied). A more complete explanation, based as much as possible upon objective criteria, of how the Draft Guidelines address foreclosure resulting from something less than complete elimination of access to supplies or markets would be helpful.

In paragraph 20, the Overview provides important guidance regarding how the Commission will approach its comparison of the competitive conditions that would exist without the transaction with those that would result if the notified transaction is approved. A fundamental issue in performing this type of comparison is to ensure that the “but for” world that the Commission uses is flexible enough to account for potential changes to the market resulting from factors other than the merger itself (e.g., entry, exit, and future market developments). While paragraph 20 discusses the possibility of such flexibility in the comparison, the Sections urge that the Commission should reconsider its implied relegation of the concept to a position of secondary importance. Reflecting the dynamic nature of a counterfactual analysis, the Draft Guidelines could instead note that predictable changes to the marketplace will normally be taken into consideration as a matter of course during the Commission’s analysis of the potential competitive effects of a non-horizontal transaction.⁴

In paragraph 21, the Overview correctly recognizes that the analysis should consider both the possible anticompetitive effects, as well as the efficiencies “identified and substantiated by the parties.” While the Draft Guidelines rightly state that “the effect on competition needs to be assessed in light of efficiencies,” the text could be improved

⁴ See *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 622 (1974) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962)) (“But it is to be remembered that [section] 7 deals in ‘probabilities,’ not ‘ephemeral possibilities.’”).

upon by more clearly articulating that in most cases the pro-and anticompetitive effects are intrinsically interrelated and should, as a consequence be analyzed as part of one unified assessment.

On a more general note, the Sections are concerned that the Draft Guidelines attach insufficient importance to efficiencies and suggest a problematic treatment of those efficiencies in practice. Although the Draft Guidelines state that non-horizontal mergers may provide substantial efficiencies (Paragraph 13) and the effect on competition needs to be in assessed in light of such efficiencies (Paragraphs 50, 76 and 113), the Guidelines nonetheless are overly cautious in stating that cost efficiencies may not always result (Paragraph 53, and note 50), while references to possible dynamic efficiencies are meager at best (Paragraph 50). It would be helpful if the importance of the latter type efficiencies were explained in more detail in the Overview.

Second, the Draft Guidelines suggest in several places that the burden of proof of offsetting efficiencies lies with the merging parties (Paragraphs 21, 50, 76, 113). While the Sections appreciate the evidentiary difficulties that may occur in the context of non-horizontal mergers, they believe that the current text is too one-sided in allocating the burden of proof of efficiencies on the parties, while at the same time leaving too much room for the Commission to discard efficiency claims. The Sections take the view that because non-horizontal mergers are often motivated by efficiency considerations, these should be properly reflected in the methodology of analysis.⁵ Indeed, as it is incumbent

⁵ *United States v. Enova Corp.*, 107 F. Supp.2d 10, 17 (D.D.C. 2000) (“While a so-called ‘horizontal’ merger between two competitors in the same industry automatically increases market concentration by eliminating a competitor, vertical mergers do not in and of themselves decrease

on the Commission to identify whether the merger at hand produces on balance anticompetitive effects, it would be sensible to stipulate that the Commission will conduct a comprehensive analysis based on the evidence provided to it and, only if it arrives at the preliminary conclusion that the merger may be anticompetitive, request the parties to further substantiate their efficiency claims.

Third, the Draft Guidelines should state unequivocally that the mere fact that a merger may increase the efficiency of the merging parties, thereby possibly putting rivals at a disadvantage, will not cause the Commission to intervene.⁶ The Sections believe that the Draft Guidelines are not as clear as they should be on this point (Paragraph 35).

In addition, the Overview does not mention the fact that in many instances, rivals may be able to counteract the effects of the merger by entering into counter-strategies.

the number of competitors in any one market. Indeed, vertical mergers often promote efficiencies by consolidating input and output operations under one umbrella.”) (citations omitted).

Vertical mergers can give rise to a variety of efficiencies. By their nature, vertical mergers may give rise to efficiencies of vertical integration. These can include, inter alia, reduced transactions costs, avoidance of supply uncertainties, and the elimination of double-marginalization. *See, e.g.*, DENNIS CARLTON & JEFFREY PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 501-05 (2d ed. 1994); MASSIMO MOTTA, *COMPETITION POLICY: THEORY AND PRACTICE* 307-13 (2004). Even when a non-horizontal merger lacks a vertical aspect, it may nevertheless give rise to efficiency benefits for downstream purchasers. For example, a merger of producers of complementary products might, depending on the technologies and products at issue, give rise to economies of joint production (also known as economies of scope). In addition, a merger of complementary-products producers may, because of the Cournot complementarities phenomenon, lead the merged entity to choose to charge lower prices to downstream customers than would the independent predecessor firms. The Cournot complements idea is presented in, *e.g.*, Nicholas Economides & Steven C. Salop, *Competition and Integration among Complements, and Network Market Structure*, *JOURNAL OF INDUSTRIAL ECONOMICS* 105-23 (Mar. 1992).

⁶ *See Alberta Gas Chems. Ltd., supra* note 2, at 1245 (“Because of post-merger efficiencies allowing it to purchase the acquiring company’s output at a better price than in the marketplace, the acquired company’s purchasing costs would fall—a procompetitive benefit capable of being passed on via lower prices for its products. Thus, in this scenario, post-merger self-dealing could result in efficiencies reflected in lower prices to the ultimate consumer. Injuries to competitors of this nature should not be compensable under the antitrust law because they do not flow from the anticompetitive effects of a merger.”).

Indeed, the absence of counter-strategies is generally a precondition for competitive harm to occur in the first place, as Paragraph 38 acknowledges. The Draft Guidelines could be improved upon by making clear that the Commission “will” consider counter-strategies (rather than “may” consider them) and adding this precondition to the Overview.

Finally, the Sections believe that the Commission could use these Guidelines as an opportunity to explain the role and relative importance of complaining third parties in the context of non-horizontal merger review. In horizontal mergers, for instance, the opinions of informed, sophisticated customers as to the competitive realities in the market are important sources of evidence in evaluating the potential effects of a proposed horizontal merger, although they must be analyzed with care, particularly where there is a divergence in views expressed by similarly situated customers.⁷ In such cases, although information provided by competitors to the merging parties can be useful, it is understood that competitors are likely to present different perspectives and have frequently have different incentives than do customers, and as a result, such information must be considered carefully. For example, an anticompetitive horizontal merger is often likely to benefit competitors, whereas an efficient procompetitive horizontal merger frequently is likely to be viewed as harmful to competitors of the merging parties.⁸

⁷ See *United States v. Oracle Corp.*, 331 F. Supp.2d 1098, 1167 (N.D. Cal. 2004) (“Drawing generalized conclusions about an extremely heterogeneous customer market based upon testimony from a small sample is not only unreliable, it is nearly impossible. Second, the most persuasive testimony from customers is not what they say in court, but what they do in the market.”); see also *FTC v. Arch Coal, Inc.*, 329 F. Supp.2d 109, 146 (D.D.C. 2004) (“[T]he concern of some customers in the [coal] market that the transactions will lessen competition is not a persuasive indication that coordination among [coal] producers is more likely to occur.”).

⁸ See, e.g., *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 116 (1986) (A competitor's loss of profits due to increased price competition following a merger is not antitrust injury; “[t]o hold that

On the other hand, in the context of vertical combinations, it is our common experience that competitors at one or both levels of competition are likely sources of complaints regarding the effects of the proposed transaction. In such circumstances, a competitor may complain not only about bona fide foreclosure of the nature discussed *infra*, but about ‘foreclosure’ that occurs because the merged entity will become a more effective competitor as a result of the combination; such foreclosure, of course, may not adversely affect consumer welfare, but rather, only the continued viability of one or more potentially inefficient competitors. In the view of the Sections, it would be useful for the Guidelines to clarify the role of complaining competitors and customers in the context of vertical mergers.

II. MARKET SHARE AND CONCENTRATION LEVELS

In Section III of the Draft Guidelines, the Commission establishes a safe harbor based on market share and concentration levels. While the Sections applaud the Commission’s efforts to draft concrete guidance to assist companies in evaluating this risk, the Sections believe that the market share and concentration levels set forth may be too conservative, both qualitatively and quantitatively. In that regard, the Commission might consider emphasizing that these safe harbors should not be interpreted to suggest that vertical mergers that exceed these safe harbor screens pose any threat of harm to competition. In all such situations, there is a need to assess the particular transaction and

the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result.”).

demonstrate that each element of the three-part test set forth in the Draft Guidelines is satisfied.

Finally, the Sections urge the Commission to elaborate more clearly its stated concern about vertical mergers where one party is likely significantly to expand capacity. (Paragraph 25(a).) In most instances, expansion of capacity is an economic good that both enhances competition and benefits consumers, even in the context of a vertical merger. This kind of economic behavior should be encouraged. By enumerating capacity expansion as an exemption to the safe harbor provision, the Commission may unintentionally encourage firms to abandon or delay expansion plans in light of a proposed vertical merger. If there are specific concerns associated with such a combination, e.g., the elimination of a maverick from the market, then the Commission should more clearly articulate this concern to avoid the risk of chilling otherwise procompetitive business combinations.

III. VERTICAL MERGERS

A.1. Input Foreclosure

It is common for firms that are active in a downstream market to become concerned when one of their input suppliers integrates vertically to become a downstream competitor. A typical concern is that the merged entity would refuse unilaterally to supply competing downstream firms with inputs at competitive prices (if at all). The effect of such conduct could be to force downstream competitors to charge higher prices or otherwise compete less aggressively, allowing the merged firm to increase its

downstream prices and profits.⁹ Because such a stratagem involves reducing downstream rivals' access to a factor of production, the Commission's Draft Guidelines refer to such conduct as "input foreclosure."

The Draft Guidelines note that vertical mergers can create efficiencies, including, but not limited to, the elimination of double marginalization.¹⁰ (Paragraph 53.) Such efficiencies may, if realized, cause the downstream component of the newly vertically-integrated firm to face lower input costs. The Draft Guidelines recognize that this effect, standing alone, should not be viewed as an anticompetitive consequence of the merger. The Sections support this exposition, as it demonstrates a proper recognition of the principle that competition law exists to protect competition that enhances consumer

⁹ See, e.g., *United States v. Enova Corp.*, 107 F. Supp.2d 10, 14 (D.D.C. 2000) (merger between natural gas pipeline monopolist and company owning gas-fired electricity producing plants would provide the merged entity with, "both the ability and the incentive to limit the supply of natural gas to competing gas-fired generators, thereby increasing the price of operating gas-fired plants, and in turn raising the price of electricity in California during periods of high demand"); see also *United States v. Lockheed Martin Corp.*, No. 98-CV-00731 (D.D.C. Mar. 23, 1998) (verified complaint) ("Lockheed will have an incentive to refuse to sell, sell inferior quality, or sell on disadvantageous terms, these in-house systems and subsystems to its platform and integrated electronics system competitors or potential competitors. Without access to these critical systems and subsystems, platform and integrated electronics system competitors (and potential competitors) would be seriously disadvantaged in competing for upcoming military programs requiring these systems and subsystems.").

¹⁰ For example, double marginalization is often a concern in situations in which there is an upstream monopolist and a downstream monopolist, with each firm adding a "monopoly markup" on the product or service that it sells. A vertical merger of the two monopolists would eliminate the upstream markup because an integrated firm will find it more profitable to eliminate one of the markups, reduce price, and increase output. See DENNIS CARLTON & JEFFREY PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 398, 400 (4th ed. 2002); and W. KIP VISCUSI, JOHN VERNON & JOSEPH HARRINGTON JR., *ECONOMICS OF REGULATION AND ANTITRUST* 221-23 (3d ed. 2000), for further discussion. The double-marginalization concept is also described, e.g., in MASSIMO MOTTA, *supra* at note 5.

welfare, rather than that of competitors (as the Commission recognizes in paragraph 16).¹¹

The Draft Guidelines also explain that a vertical merger can result in anticompetitive input foreclosure. Such strategies arise when the merged firm acts not to reduce its costs, but to raise downstream rivals' costs. The Sections generally support this attempt to provide greater clarity regarding when input foreclosure may harm competition, but we have some suggestions as to how this analysis may be improved.

First, the Draft Guidelines indicate that the Commission will weigh the anticompetitive potential for input foreclosure against merger-specific efficiencies and countervailing market forces, including the ability of the other downstream firms to switch to alternative sources of supply (Paragraph 48) and the existence of countervailing buyer power (Paragraph 49). We note that these considerations may be more properly considered earlier in the analysis, as part of the question of whether the merged entity would enjoy upstream market power, or whether attempted input foreclosure would be profitable or even feasible.

Second, it should be noted that in circumstances where vertical integration might raise a competitive problem, that potential problem must be assessed in light of the efficiencies that are created by the integration. Only where substantial foreclosure concerns are raised should the Commission require the parties to demonstrate

¹¹ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) (“It is axiomatic that the antitrust laws were passed for ‘the protection of competition, not competitors.’” (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962))).

efficiencies. To assist the parties in identifying such efficiencies, the Draft Guidelines would benefit from clarification as to how the Commission will weigh efficiencies against competitive effects, including which efficiencies will be recognized by the Commission, what criteria will be applied for determining the plausibility of the estimated efficiencies or their claimed magnitudes, as well as how the Commission will assess the magnitude of projected anticompetitive effects from input foreclosure. In particular, it would be helpful to know the extent to which evidence bearing on efficiencies or anticompetitive effects must be quantified and substantiated.

A.2. Customer Foreclosure

As described in the Draft Guidelines, customer foreclosure can occur when a vertically-integrated downstream firm reduces purchases from upstream competitors, as its input needs are mostly supplied by its own upstream affiliate, to such an extent that its rivals are deprived of a customer base sufficient to compete effectively – or at all – in the upstream market.¹² (Paragraph 57.) Under these circumstances, upstream competitors to the vertically-integrated firm may even exit the market. We recommend that the Draft Guidelines provide greater emphasis on the likelihood of efficiencies effects from the internalization of purchases and on the fact that any “foreclosure” that might occur because of shifting to a more efficient source of supply is unlikely to raise competitive concerns, particularly where (i) any negative impact is not likely to occur in the near-term and (ii) firms could adopt counter-strategies to mitigate the potential competitive harm in

¹² See, e.g., *Eli Lilly & Co.*, 120 F.T.C. 243 (1995) (acquisition of pharmacy benefit management provider (PBM) by pharmaceutical company foreclosed competitor pharmaceutical companies from supplying PBM).

the interim. Moreover, we suggest the following specific changes to the discussion of customer foreclosure.

First, the potential detrimental effect of customer foreclosure on consumers in the downstream market may operate through discouraging entry or future investment or encouraging exit. Under such rare circumstances, this effect may take some time to manifest itself, and therefore harm to competition may be difficult to assess when examining the merger. Indeed, the longer the harm may take to manifest itself, the more speculative it is that it will occur at all due to counter-strategies that may be available to competitors in the downstream market. This uncertainty as to potential harm, particularly when combined with the existence of likely consumer benefits resulting from the vertical integration, could lead the Commission to be more reluctant to intervene in situations where the foreclosure is unlikely to manifest itself in the near term. The Sections recommend specifying this in paragraphs 72-73 of the Draft Guidelines.

Second, paragraph 60 of the Draft Guidelines states that “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.” This statement addresses only part of the story: For customer foreclosure to occur, the structure of both the upstream and downstream markets must be such as to support the emergence of market power. If a firm is not already sizeable in the upstream market, it is unlikely to be able to absorb enough demand to impact other competitors. We recommend that the Draft Guidelines specify that customer foreclosure is possible only when (i) the merged firm has the capacity to satisfy most of the internal demand it is not already serving, and (ii)

such capacity represents a substantial expansion in volume as compared to existing output. These characteristics are significant because, after the merger, if supplying the merged entity's downstream demand operates mainly to displace sales to external customers with sales to itself, these external customers will be likely to be able to switch to other upstream competitors to meet their demand and thus support the continued existence of upstream competition.

Third, we recommend that in the discussion of the downstream market, the term "an important customer," which is used to describe where the combination may raise issues, be clarified to refer to an undertaking with enough purchasing volume that its elimination as a customer would impact scale economies for competitors.

Finally, the customer foreclosure discussion does not mention the importance of counter-strategies and switching possibilities and costs in the assessment of the likelihood of customer foreclosure. The Commission recognized the importance of these factors (combined with that of barriers to entry) in its decision No. COMP/M.3440 dated 4 December 2004 EDP/ENI/GDP when it concluded that, after the merger, EDP would have a strong incentive to purchase from GDP the natural gas needed for its power plants, to increase its profits in the upstream market and prevent entry from GDP's competitors. When assessing the customer foreclosure potential of the merger, the Commission stated that "considering the long term supply contracts already in place for the three existing power plants and their take-or-pay obligations, after completion of the opening of the

market, the scope for competition in this market will be limited.”¹³ Moreover, whereas the parties claimed that “the anticompetitive effect of customer foreclosure will be alleviated in the short to medium term by the development of new gas demand for power producers,”¹⁴ the Commission concluded that such demand would be insufficient to offset the customer foreclosure effects. Discussion of these same factors that relate to switching potential and demand could be incorporated into the Guidelines to provide greater transparency.

B. Other Non-Coordinated Effects

This portion of the Draft Guidelines (Paragraph 77) raises the issue of access to commercially sensitive information. This theory has been applied in the United States, and has often been addressed in merger matters through the implementation of firewalls.¹⁵ The last sentence of Paragraph 77 appears to be ambiguous; the Sections urge the Commission to consider clarifying to ensure that it is not read to suggest that increased competitiveness alone is problematic – rather, likely anticompetitive harm to end-consumers must be established.

C. Coordinated Effects

This portion of the Draft Guidelines mandates principles regarding the increased risk of potential coordination resulting from a vertical merger. The Sections believe that

¹³ Commission’s Decision No. COMP/M.3440, dated 4 Dec. 2004 EDP/ENI/GDP, § 511.

¹⁴ EDP/ENI/GDP, § 524.

¹⁵ *See, e.g., Martin Marietta Corp.*, 117 F.T.C. 1039 (1994); *Alliant Techsystems Inc.*, 119 F.T.C. 440 (1995); *Hughes Danbury Optical Sys., Inc.*, 121 F.T.C. 495 (1996).

this portion of the Draft Guidelines could benefit from (i) a clearer statement of the fact that vertical mergers are often more likely to destabilize than to support coordination among market participants,¹⁶ (ii) additional recognition of the procompetitive effects commonly identified in such transactions, and (iii) greater specificity as to the relative weight given to these factors and how the presence or absence of the factors will affect the Commission's enforcement decision.

The theory that a vertical transaction will facilitate coordination in an upstream or downstream market is a reasonable one.¹⁷ As with other portions of the Draft Guidelines, however, the Sections believe that greater exposition on the type of information that the Commission will focus on to test these concerns would be beneficial and provide greater guidance.

Vertical mergers have rarely (if ever) been blocked out of a concern about increased likelihood of coordination at one level. We, therefore, recommend that the Commission explicitly state that it is unlikely to challenge a merger on such grounds unless, at a minimum, the merger clearly impacts the horizontal structure of a market in some significant way. The Draft Guidelines could address this issue by, for example, including a presumption that a transaction is not likely to lead to coordination in most cases. Specifically, this portion of the Draft Guidelines could clarify that a high

¹⁶ For example, vertical integration may create a maverick firm that is disruptive to collusion upstream. See Jeffrey Church, "The Impact of Vertical and Conglomerate Mergers on Competition," a report to Directorate General for Competition, Directorate B Merger Task Force, European Commission, 49 (Sept. 2004).

¹⁷ For a discussion of the various effects of vertical integration on firms' incentives to facilitate collusion, see Volker Nocke & Lucy White, "Do Vertical Mergers Facilitate Upstream Collusion?," Penn Institute for Economic Research, Department of Economics, University of Pennsylvania, PIER Working Paper Archive (2005).

concentration in one market should not lead to a presumption of likely coordination in an adjacent market where that second market is not concentrated.

One of the factors addressed in the Draft Guidelines relating to potential coordination concerns is vertical foreclosure. While, theoretically, vertical foreclosure could make sense where the only benefit achieved is through the facilitation of coordination, as opposed to unilateral pricing behavior, this outcome would seem unlikely. Given the remoteness of such a potential outcome arising, this discussion would best be covered as a footnote to the foreclosure discussion in Section IV.A, rather than as an independent factor in the section relating to coordinated effects.

Finally, the Draft Guidelines do not recognize that vertical integration may have a much greater potential to destabilize the cartel in which the newly-integrated firm competes as it can alter incentives for firms in the market (i.e., reducing the prospects of coordinated effects). This potential for destabilization means that the theoretical effects of a given vertical integration on coordination are ambiguous at best. Explicit acknowledgment of this potentially procompetitive effect would be a useful addition.

IV. CONGLOMERATE MERGERS

In the past thirty years, U.S. practice has focused on examining mergers under a framework that looks only to potential harms to competition from horizontal and/or vertical effects. This is based upon the recognition, widely held by economists, academics, and practitioners, and, indeed, acknowledged in the Draft Guidelines, that conglomerate mergers are less likely to create anticompetitive effects than horizontal

mergers and often feature significant procompetitive efficiencies.¹⁸ Any unaddressed actual harm arising from the conduct of the combined firm could and, in the Sections' view, should be dealt with under Article 82. To the extent that the Commission does not adopt the approach suggested above, clarification of the relationship between Article 82 and the ECMR would be beneficial.

In addition, paragraph 111 of the Draft Guidelines states: "It is only when a sufficiently large fraction of market output is affected by foreclosure that the merger may significantly impede competition. If there remain effective single-product players in either market, competition is unlikely to deteriorate following a conglomerate merger." While it would be difficult to establish for enforcement purposes an economically definitive and general lower bound threshold share of output that would be deemed threatening to competition, the Commission should consider mandating reasonable threshold values that would serve as a safe harbor, below which a conglomerate merger is presumed not to raise competitive concerns.

The inclusion of conglomerate mergers as a separate category also raises an issue in connection with the market share thresholds contained in paragraph 25 of the Draft Guidelines under which HHI thresholds apply to "each of the markets concerned." In the

¹⁸ While early U.S. cases suggested that conglomerate mergers could violate the Section 7 of the Clayton Act, even jurists at that time were skeptical of their economic validity. Today, antitrust enforcers do not challenge conglomerate mergers where there are no horizontal or vertical concerns. *See, e.g., FTC v. Procter & Gamble Co.*, 386 U.S. 568, 587 (1967) (Harlan, J., concurring) ("At the outset, it seems to me that there is a serious question whether the state of our economic knowledge is sufficiently advanced to enable a sure-footed administrative or judicial determination to be made a priori of substantial anticompetitive effect in mergers of this kind. It is clear enough that Congress desired that conglomerate and product-extension mergers be brought under Section 7 scrutiny, but well versed economists have argued that such scrutiny can never lead to a valid finding of illegality.").

conglomerate context, this would appear to suggest that competitive concerns are unlikely in a merger of complementary product suppliers (or of other, non-vertically related suppliers) unless the merged firm would obtain a share exceeding 30% in *each* of the concerned markets. However, the language of the Draft Guidelines suggests that a conglomerate merger could give rise to anticompetitive effects from tying, bundling, or mixed bundling practices when the merging parties have market power in only *one* of the concerned markets (Paragraph 98). Because share and concentration statistics are used as proxies for market power, the correspondence between the share thresholds of Paragraph 25 and the portion of the Draft Guidelines relating to conglomerate mergers is unclear. The Sections therefore recommend that these two portions of the Draft Guidelines be rationalized and clarified.

The Sections are concerned with the Draft Guidelines' focus on the ability of conglomerate mergers to give rise to anticompetitive foreclosure through tying, bundling, and mixed bundling strategies. The Sections believe that the potential for harm from such practices is rare¹⁹ (although it can indeed occur) and, as the Commission itself recognizes (Paragraphs 103, 116), these practices are often procompetitive. At a minimum, if this discussion is retained in the Guidelines, the Sections urge the Commission to recognize clearly this procompetitive potential effect from such practices in the Draft Guidelines. If the Draft Guidelines fail to provide such guidance, they could discourage otherwise procompetitive transactions.²⁰ In addition, we would encourage the

¹⁹ For an overview of the procompetitive benefits of tying and bundling, see DENNIS CARLTON & JEFFREY PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 302-06 (3d ed. 2000).

Commission to specify the timeframe within which the competitive harm would have to occur for the Commission to consider that the predicted harm can be viewed to result from the transaction.

The Draft Guidelines consider briefly the potential that coordinated effects might be facilitated by certain conglomerate mergers. According to the Draft Guidelines, if such a merger leads to the exclusion of rivals in a relevant market, this reduction in the number of competitors might increase the potential for tacit coordinated conduct among the remaining suppliers in that market. Assuming the exclusion occurs as described, this would be an entirely conventional (horizontal) theory of anticompetitive effects. However, the Sections believe that a second theory of harm discussed in the Draft Guidelines warrants further clarification. According to paragraph 118, “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 coordination, but may prefer instead to live under the shelter of the increased price level.” This paragraph appears to say that when rivals are not excluded outright but, instead, incur reduced market shares as a result of anticompetitive foreclosure by the merged firm, the merged firm might be able profitably to maintain higher than pre-merger prices in the second market because it would know that the disadvantaged firms would price similarly, for fear that their attempts to regain share through price competition would be met with even

²⁰ This suggested approach would be consistent in spirit with the prevailing practice in the United States to refrain from challenging vertical mergers simply because they create the precursor conditions to practices such as tying, which can be (and are) analyzed separately as conduct violations under Sections 1 and 2 of the Sherman Act. This policy has the dual effect of deterring anticompetitive tying while at the same time avoiding the creation of barriers to socially-desirable and efficient vertical mergers.

sterner foreclosure efforts from the merged entity. The Commission should consider outlining the specific factual or theoretical considerations that would raise concerns that such outcomes could occur.

CONCLUSION

The Sections appreciate the opportunity to submit these comments and hope that they are helpful to the Commission as it finalizes its Guidelines.