

May 10th 2007

Position Paper on the Draft Commission Notice on the assessment of Non-Horizontal Mergers

Executive Summary

<u>Subject</u>	<u>Business Perspective</u>	<u>AmCham EU Position</u>
<i>Efficiencies</i>	Non-horizontal mergers provide substantial scope for efficiencies which are not present in horizontal mergers, such as internalisation of double mark-ups and Cournot effects.	AmCham EU believes that the Commission should assume that non-horizontal mergers create efficiencies unless the contrary is demonstrated, rather than assessing those efficiencies in the light of the cumulative conditions spelled out in the Notice on Horizontal Mergers.
<i>The concept of foreclosure</i>	Non-horizontal mergers will cause competitive harm only where rivals of the merging company are (a) forced to exit the market, (b) unable to achieve similar efficiencies and (c) unable to re-enter the market. No competitive harm should be found where the merger simply affects competitors, but not competition.	AmCham EU believes that the Commission should make clear that there will be no “anticompetitive foreclosure” if rivals are merely “disadvantaged” by significant efficiencies generated by the merger, even if they “may” be led to compete less “effectively”.
<i>Safe Harbours</i>	Non-Horizontal mergers lead to input foreclosure if the new entity not only has market power in the upstream market, but also enjoys a strong position in the downstream market; and lead to customer foreclosure if the new entity not only has market power in the downstream market, but also enjoys a strong position in the upstream market.	AmCham EU believes that the Commission should adopt a “minimum market share threshold” approach, by making clear that non-horizontal mergers are unlikely to create competition concerns, unless in situations where the new entity achieves at least 30% share in each of the markets concerned.
<i>Timing and Recoupment</i>	In a Non-Horizontal merger context, the overall anti-competitive effect of a merger is not immediate and direct, but remote and indirect, and hence competition concerns occur only in exceptional circumstances.	AmCham EU believes that the Commission should fully incorporate in the Notice the jurisprudence of the European Court of Justice with respect to the need to demonstrate that the harm to consumers must take place in the ‘relatively near future’ before a conclusion of competitive harm can be made.

Introduction

1. The American Chamber of Commerce to the European Union (AmCham EU) is the voice of companies of American parentage committed to Europe towards the institutions and governments of the European Union. It aims to ensure an optimum business and investment climate in Europe. AmCham EU facilitates the resolution of EU – US issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Total US investment in Europe amounts to €702 billion, and currently supports over 4.1 million jobs.
2. AmCham EU welcomes the Commission’s initiative to provide guidelines on how it will assess non-horizontal mergers. AmCham EU believes that one of the main goals of effective merger control enforcement should be to better align this enforcement with some of the objectives of the Lisbon Agenda, namely the stimulation of competitiveness, innovation and growth. Accordingly, AmCham EU welcomes the Draft Commission Notice (the “Draft Notice”) statements according to which non-horizontal mergers are generally less likely to create competition concerns than horizontal mergers. However, AmCham EU strongly believes the Commission should signal more clearly and explicitly that non-horizontal mergers will only create competition problems in exceptional circumstances, and that intervention in this area can only take place after a particularly careful, and multi-step analysis supported by substantial evidence demonstrating harm to consumers. In the absence of such explicit guidance on that point, there is a real risk that competition authorities (who often rely on Commission guidelines in their enforcement practices) will intervene too often and/or too significantly in transactions that most of the time are either neutral to competition or pro-competitive, thereby restricting competitiveness, innovation and growth.

Efficiencies

3. AmCham EU supports the Draft Notice’s observations on the importance of taking efficiencies into account in vertical and conglomerate merger analysis. However, it is regrettable that the Draft Notice suggests in paragraph 51 that these efficiencies will only be taken into account if stringent cumulative conditions are met. As noted by the Draft Notice, non-horizontal mergers provide substantial scope for efficiencies, such as internalisation of double mark-ups and Cournot effects, which are not present in horizontal mergers. AmCham EU fears that by imposing the same stringent conditions for proving efficiencies that are required in horizontal merger assessment, from a practical perspective, it will be only in very exceptional circumstances that those efficiencies will be taken into account in the assessment of non-horizontal mergers. Since non-horizontal mergers, by their very nature, are less likely to

raise competition concerns than horizontal ones, AmCham EU believes it would be more appropriate to assume that non-horizontal mergers create efficiencies unless the contrary is demonstrated. Such an approach would guarantee that efficiencies will play a real substantive role in non-horizontal merger assessment.

4. In addition, the Draft notice should resolve the question of whether the European Commission, when dealing with non-horizontal mergers, is in fact applying what has been termed an “efficiency offence”. AmCham EU believes that the European Commission should not apply such a theory in non-horizontal merger control.¹ Thus, the Draft notice should clearly articulate that efficiencies such as the elimination of double marginalisation or Cournot effects will not be viewed as causing competitive harm, unless a number of conditions are fulfilled. The party that alleges the competitive harm must be able to demonstrate that rivals are not only forced, as a result of the merged entity’s efficiencies, to exit the market, but that rivals are also unable to implement strategies to achieve similar efficiencies, and unable to re-enter the market if some of them have been forced to exit the market.
5. If for efficiencies to be proved, strict conditions must be simultaneously met, companies will be at risk of being restricted or even prevented from pursuing non-horizontal mergers that generate efficiencies, and final consumers will be at risk of being denied the benefits of pro-competitive mergers. For instance, if it were sufficient to show that efficiencies would ‘marginalise’ or ‘disadvantage’ rivals (as opposed to forcing rivals to exit the market place) to justify a finding of competitive harm, merger control would deny final consumers the immediate beneficial effects of reduced prices that are often inherent to non-horizontal mergers (efficiencies put greater pressure on rivals to reduce their prices), only to prevent the occurrence of effects that are difficult to establish and quantify on an objective basis, namely the fact that rivals of the merged entity would be ‘disadvantaged’ or ‘marginalised’. In short, the Commission should avoid sending any guidance that suggests that the protection of competitors should take precedence over the likely benefits for consumers.

The concept of foreclosure

6. Accordingly, it is very important to clarify that non-horizontal mergers will only cause competitive harm in situations where as a result of the merger, the merging companies would likely be able to profitably increase the price charged to consumers. AmCham EU submits that this should only be possible in the circumstances described above (exit, no counter-strategies, no re-entry).

¹ In this respect, AmCham EU suggests that the Draft Notice should confirm the position of former Commissioner of Competition Mario Monti regarding this issue who stated the he “would like to refute the assertion that the European Commission, when dealing with conglomerate mergers, is in fact applying what has been dubbed an “efficiency offence” (see *Antitrust in US and Europe*, General Counsel Roundtable, American Bar Association, November 14, 2001).

Paragraph 18 of the Draft Notice refers, in this respect, to the concept of ‘anticompetitive foreclosure’. However, the Draft Notice defines anticompetitive foreclosure as foreclosure as a result of which the merging companies [...] may be able to profitably increase the price charged to consumers.²

7. Moreover, when elaborating on the concept of foreclosure from non-coordinated effects in the vertical context (paragraph 28), the Draft Notice explains that as a result of “foreclosure” (i.e. not as a result of “anticompetitive foreclosure”) which results from rivals being merely “disadvantaged” and consequently led to compete “less effectively”, the merging companies “may” be able to profitably increase the price charged to consumers. This suggests that according to the Draft Notice, competitive harm could be found even under such vague and subjective circumstances. Rather, the Draft Notice should specify that there will be no ‘anticompetitive foreclosure’ if rivals are merely ‘disadvantaged’ by the significant efficiencies generated by the merger, even if they therefore ‘may’ be lead to compete less ‘effectively.’
8. Similarly, when elaborating upon the concept of foreclosure from non-coordinated effects in the context of conglomerate mergers (paragraph 92), the Draft Notice explains that tying and bundling ‘may’ lead to a reduction in actual or (even) potential rivals’ ability or ‘incentive’ to compete. Amcham EU does not believe it would be appropriate or useful to define such an important concept as foreclosure in such vague and subjective terms.
9. In the presence of less than objective criteria, there is a significant risk that competition authorities will wrongly conclude the existence of competitive harm as a result of a non-horizontal merger in a situation where the merger simply affects competitors, but not competition. Hence, this would create the risk that the sound principles set forth in paragraph 16 of the Draft Notice, according to which ‘it is the impact on effective competition that matters, not the mere impact on competitors at some of level of the supply chain’, will not be followed.

Safe Harbors

10. The Draft Notice proposes to introduce a safe harbor provision pursuant to which the Commission is unlikely to find concern in non-horizontal mergers if the share of the new entity in each of the markets concerned is below 30% (‘maximum market share threshold’). AmCham EU believes that guidance would be more effective and useful if the Commission would provide that it is unlikely to find concern in a non-horizontal merger, unless the new entity has

² AmCham EU believes that the party which alleges that a non-horizontal merger is incompatible with the common market should demonstrate, on the basis of convincing evidence, that a merger is likely to allow to profitably increase the price charged to the customer. The use of the verb ‘may’ reflects therefore too much uncertainty in this respect.

relevant market shares ('minimum market share thresholds') in all relevant markets (upstream and downstream markets in vertical mergers, tying and tied markets in conglomerate mergers) that may be impacted by the merger. In the absence of minimum market share thresholds, mergers that are very unlikely to raise competitive concerns (for instance a vertical merger with market shares of 5% in an upstream market, and a 32% share in the downstream market, or a conglomerate merger with a market share of 35% in the tying market, and 1% market share in the tied market) would not benefit from the safe harbour provisions currently contemplated in the Draft Notice.

11. Since non-horizontal mergers are less likely to create competition concerns than horizontal mergers, AmCham EU encourages the Commission to clarify that in general, for a vertical merger to create competitive concerns in the form of input foreclosure, the new entity should not only have market power in the upstream market, but should enjoy a strong position in the downstream market as well. Analogously, for a vertical merger to create competitive concerns in the form of consumer foreclosure, the new entity should not only have market power in the downstream market, but should enjoy a strong position in the upstream market as well. Accordingly, AmCham EU proposes that the Commission should explain that non-horizontal mergers are unlikely to create competition concerns, unless in situations where the new entity achieves at least 30% share in each of the markets concerned.
12. Paragraph 42 of the Draft Notice notes that (in case of input foreclosure), the greater the market share of the merged entity downstream, the greater the base of sales on which to enjoy increased margins, and Paragraph 69 notes that the incentive to engage in customer foreclosure depends on the extent to which the upstream division of the merged entity can benefit from possibly higher price levels in the upstream market [...]. However, both paragraphs critically omit to note that input foreclosure is unlikely to be profitable unless the entity has significant shares on the downstream market and that customer foreclosure is unlikely to be profitable unless the entity has significant shares in the upstream market.
13. This is because, for input foreclosure, in the absence of significant shares in the downstream market, it will be too difficult, risky and unlikely for the entity to try to create market power in the downstream market by reducing sales or not selling to downstream rivals. If the entity has a modest downstream position, the entity will not have the necessary incentive to attempt to raise its rivals' costs, since it will not likely be able to recoup its lost profits or sales revenues via increasing prices or expanding sales in the downstream market. For customer foreclosure, in the absence of significant shares in the upstream market, it will be very unlikely that the entity will be able to sell all of its capacity to the customer operating downstream and thereby foreclose upstream rivals to serve that customer. The same reasoning is valid for conglomerate mergers as well.

Timing and recoupment

14. AmCham EU agrees with the Draft Notice's observations in paragraph 21, according to which, in a non-horizontal merger context, the more immediate and direct the overall anti-competitive effect of a merger, the more likely the Commission is to raise competition concerns. Therefore, it would be useful to explicitly confirm that the longer and more indirect the overall anti-competitive effect of a merger, the less likely the Commission is to raise competition concerns. This clarification would be all the more relevant in the light of the fact that, as the Commission itself admits in paragraph 72, "the negative impact on consumers may take sometime to materialize".
15. Moreover, according to the case law of the European Court of Justice, the analysis of conglomerate mergers in particular is a prospective analysis in which, first, the consideration of a lengthy period of time in the future and, secondly, the conduct necessary to give rise to a significant impediment to effective competition mean that usually the chains of cause and effect are dimly discernible, uncertain and difficult to establish.⁶ It would be useful for the Commission to confirm this fact in the Notice on non-horizontal merger assessment, for purposes of signaling to other competition authorities who may be less familiar with the jurisprudence of the European Court of Justice, that pursuing theories of harm in a conglomerate merger context is arduous, and that the burden of proving competitive harm resulting from a non-horizontal merger is, under EC competition law (and should be pursuant to any other competition legislation), quite substantial .
16. To facilitate reaching robust conclusions of competitive harm resulting from non-horizontal mergers, AmCham EU believes that a future Notice should more fully incorporate the jurisprudence of the European Court of Justice with respect to the need to demonstrate that the harm to consumers will take place in the 'relatively near future'. In the absence of this requirement, AmCham EU fears that non-horizontal merger control would become too speculative, since the further away in time the predicted anticompetitive effects are alleged to take place, the more difficult it becomes to exclude the possibility that other external factors may interfere and invalidate the prediction or which would cause the prediction to be confirmed but for other reasons than the reasons posited in the non-horizontal merger assessment. In this respect, AmCham EU finds that Paragraph 72 of the Draft Notice, which suggests that the Commission will be willing to reach conclusions of competitive harm even if the negative impact on consumers may take 'some time' to materialise, is at odds with the requirement to demonstrate that the harm must take place 'in the relatively near future'.

6 Case C-12/03 P, *Commission v. Tetra Laval BV*, ECR I-000, paragraph 44.

17. The potential competitive harm that may result from non-horizontal mergers in most cases will take place as a consequence of the merged entity incurring a short term loss or sacrifice which, if the merger leads to foreclosure, the merged entity will be able to more than recover in the longer term.³ In the case of potential input foreclosure, the entity loses sale opportunities if it strategically decides not to supply its downstream rivals or risks missing sale opportunities if it increases the price of the input product to its downstream rivals. In case of a potential customer foreclosure, the upstream entity misses sales opportunities as a result of a strategic decision to sell only to its large downstream subsidiary, and the downstream entity loses the potential benefits of sourcing from other upstream firms. In the case of potential tying or mixed bundle in a conglomerate context, the merged entity will also risk losing revenue as a result of potential customer decisions not to purchase the tied products or as a result of the additional discount provided in a mixed bundling scenario. If the conduct or strategy is unlikely to be profitable, the merged entity will have little incentive to engage in such a conduct or strategy.
18. AmCham EU believes that a non-horizontal merger cannot lead to anticompetitive effects unless it can be demonstrated that the sacrificed profits will be recouped. The possibility of recoupment should be calculated on a net present value basis. The ability of the merged entity should not be qualified as "one element" that "may" be relevant in the analysis, or a possible "defence" only. It should constitute an essential condition of a finding of harm in a non-horizontal merger context. Unless the merged entity is able to recoup its losses on a net present value basis (e.g. by raising its prices in the long-run or by deterring potential entrants), the post merger behavior (refusal to supply, price increases, heavy discounting) or strategy would make little sense. In case of mixed bundling, if the entity is not able to recoup its losses, mixed bundling would entail only benefits for the consumer.

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³ Arguably, this is not the case when the theory of harm is based on a theory of non-strategic mixed bundling. When mixed bundling is allegedly "non-strategic", it is rational for the merged entity to engage in mixed bundling quite independently of any expectation of competitor foreclosure. This theory of harm assumes that the strategy is immediately profitable, and does not rely on exit and/or recoupment to work.