

**Response dated 11 May 2007 to the**

**Commission of the European Communities**

**DG Competition**

**Consultation on the  
Draft Guidelines on the assessment of non-horizontal mergers  
under Council Regulation (EC) No 139/2004  
published on 13 February 2007**



**FRESHFIELDS BRUCKHAUS DERINGER**

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**FRESHFIELDS BRUCKHAUS DERINGER'S COMMENTS ON THE  
EUROPEAN COMMISSION'S DRAFT GUIDELINES ON THE  
ASSESSMENT OF NON-HORIZONTAL MERGERS  
UNDER THE EC MERGER REGULATION**

**1. INTRODUCTION**

1.1 Freshfields Bruckhaus Deringer welcomes the opportunity to comment on the European Commission's Draft Guidelines on the assessment of non-horizontal mergers (the *Draft Guidelines*) published on 13 February 2007.

1.2 Our comments are based on our substantial experience of advising parties during European (and national) merger control proceedings. The comments contained in this paper are those of Freshfields Bruckhaus Deringer. They do not necessarily represent the views of any of our clients.

1.3 We welcome the Commission's publication of clear, economic effects based guidance on the potentially anti-competitive and pro-competitive effects of vertical and conglomerate mergers. We believe that the final guidelines will assist businesses and legal practitioners in the substantive analysis of these types of mergers. Our specific comments on the Draft Guidelines are described in Sections 2-5 below. For ease of reference, a summary of our suggestions is provided in the **Annex**.

**2. NON-HORIZONTAL MERGERS: POTENTIAL COMPETITION CONCERNS**

2.1 We strongly welcome Commissioner Kroes's statement that "*the majority of vertical and conglomerate mergers do not raise problems*"<sup>1</sup> and the corresponding statements in the Draft Guidelines that "*non-horizontal mergers are generally less likely to create competition concerns than horizontal mergers*" (paragraph 11).

2.2 The Draft Guidelines clearly recognise the fundamental differences between non-horizontal mergers and horizontal mergers – namely that non-horizontal mergers do not involve a loss of direct competition but commonly provide substantial scope for economic efficiency and benefits to consumers. Given these differences, we suggest that the statement in paragraph 11 could either be strengthened to read "*non-horizontal mergers are **much** less likely to create competition concerns than horizontal mergers*" (for the reasons set out in paragraphs 12-14) or amended to read "*non-horizontal mergers have significant scope to create efficiencies and are rarely anti-competitive*" (in line with the ICN Merger Guidelines Workbook, Worksheet H).

2.3 Further, we suggest that the Draft Guidelines should also acknowledge the key differences between horizontal and non-horizontal mergers by more fully reflecting the principles on burden and standard of proof in non-horizontal merger cases established by the Court of First Instance (*CFI*) and European Court of Justice (*ECJ*), that is:

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<sup>1</sup> DG Comp press release, 13 February 2007.

- (a) in a prospective analysis of the effects of a non-horizontal merger, the Commission must show that the concentration will “*in all likelihood*” significantly impede effective competition in the “*relatively near future*”<sup>2</sup>; and
- (b) the quality of the evidence required on the part of the Commission to establish a credible theory of harm should be particularly high.<sup>3</sup>

### **3. EFFICIENCIES**

3.1 We welcome the statements in the Draft Guidelines that “*vertical and conglomerate mergers provide substantial scope for efficiencies*” (paragraph 13). We note the subsequent statements that “*the Commission will consider both the possible anti-competitive effects arising from the merger and the pro-competitive effects stemming from efficiencies*” (paragraph 21) and “*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...*” (paragraph 50).

3.2 Businesses will be reassured that the Commission recognises, in line with prevailing economic thinking, the pro-competitive benefits that often flow from these types of “non-horizontal” merger situations and the resulting benefits to consumers, such as lower prices or improved quality. In addition to recognising that non-horizontal mergers can generally be expected to be pro-competitive, we welcome the fact that the Draft Guidelines provide illustrations of when and how particular efficiencies may arise in specific cases. The benefit of these statements will be further enhanced by more Commission decisions clearly setting out when such efficiencies can be sufficiently demonstrated to benefit consumers, be merger-specific and be verifiable in order to outweigh anti-competitive effects.

3.3 We note that the beginning of Section V (Conglomerate Mergers) appears to slightly downplay the positive effect of efficiencies. In order to achieve consistency with the remainder of the draft, we suggest that a reference to the “*pro-competitive effects stemming from efficiencies*” is included in paragraph 91, in a similar way to the statement in paragraph 27 on vertical mergers.

### **4. MARKET POWER**

4.1 The role of market power in identifying when non-horizontal mergers may result in anti-competitive effects is clearly central to the analysis<sup>4</sup>. In particular, the level of market power that is required to be held by the parties in order to create competitive harm is a critical question.

4.2 We note that the use of “*market power*” as a necessary (but not sufficient) condition for competitive harm reflects the approach of other competition authorities

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<sup>2</sup> See, for example, ECJ Case C-12/03 P, *Commission/Tetra Laval* at paragraph 24 and CFI Case T-210/01, *General Electric/Commission* at paragraph 65.

<sup>3</sup> See, for example, ECJ Case C-12/03 P, *Commission/Tetra Laval* at paragraph 44 and CFI Case T-210/01, *General Electric/Commission* at paragraph 66.

<sup>4</sup> Paragraph 23, Draft Guidelines “*Non-horizontal mergers pose no threat to effective competition unless the merged entity has market power in at least one of the markets concerned*”.

(and the ICN Merger Guidelines Workbook). However, other authorities (notably the UK's Competition Commission) refer to the need for “*a substantial level of market power*”<sup>5</sup> in order to create competition concerns. This reference to a substantial level of market power appears to align with previous Commission decisions that have referred to the need for “*dominance*”<sup>6</sup> or “*sufficient market power*”<sup>7</sup> in order to be able to implement an anti-competitive foreclosure strategy. Accordingly, unless Commission policy has changed, we suggest that the Guidelines should clarify that there is generally a need for “substantial” market power in one market in order for competition concerns to arise.

4.3 We welcome the use of market share and HHI thresholds as guidelines for when parties may have a sufficient degree of “market power” for concerns to arise. However, given the relatively conservative thresholds proposed, we suggest that either the thresholds could be cited as clear “*safe-harbours*”, rather than “*initial indicators of the absence of competition concerns*”, or the Commission should consider raising the thresholds. In particular:

- (a) although the 30% figure has been used by analogy to Commission Regulation (EC) No 2790/1999 (the ***Verticals Block Exemption***), we note that:
  - (i) vertical mergers are likely to produce greater efficiencies than agreements between separate undertakings<sup>8</sup>. Accordingly, there is a strong argument that mergers should benefit from a more generous safe-harbour; and
  - (ii) in the Verticals Block Exemption, 30% provides a legally binding threshold against illegality for an agreement (rather than just an indicator of an absence of concerns). In addition, the 30% threshold itself has no judicial backing and represents a policy decision of the

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<sup>5</sup> “*Merger References: Competition Commission Guidelines*”, June 2003 (paragraph 3.64).

<sup>6</sup> For example, see *Telia/Sonera* (COMP M.2803, 10 July 2002): “*The competitive concerns in this regard can be limited to markets (i) that are vertically related to another market where either Telia or Sonera have a dominant position (condition 1) and (ii) where the other party is present (condition 2)*” and *AOL/Time Warner* (COMP M.1845, 11 October 2000): “*A company holding a dominant position in the market for the licensing of music publishing rights required for on-line delivery would be in a position to play the gatekeeper’s role dictating the conditions for the delivery of music via the Internet by refusing to license or threatening to withhold the rights*”.

<sup>7</sup> For example, see *Hilton/Accor/Forte/Travel Services JV* (COMP M.2197, 16 February 2001): “*There may only be a risk of foreclosure in the GDS [Global Distribution System] and travel agency markets if it were shown that the parents have sufficient market power in the hotel market*”.

<sup>8</sup> As the Guidelines explain, such efficiencies include “internalisation of double mark-ups” (paragraph 13), better coordination of the production and distribution process (paragraph 54) and aligning incentives for investment in new products and processes (paragraph 55). We note the Commission’s view that these efficiencies may not always be merger specific (paragraph 56) but suggest that these efficiencies are more likely to occur over a longer period and will have a greater beneficial impact in the case of a merger between the undertakings concerned.

Commission following public consultation on a number of other options (including a market share threshold of 40%<sup>9</sup>); and

- (b) 30% is a relatively conservative threshold given that the Commission accepts that the majority of non-horizontal mergers “do not raise concerns”, particularly given that recital 32 ECMR cites 25% as an “*indication*” of a combined market share that is not liable to impede effective competition for *all* types of concentration - including horizontal mergers.

4.4 In relation to market power, we also have the following suggestions by way of drafting comments:

- (a) **definition of market power:** paragraph 10 of the Draft Guidelines states that “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”; we have two comments on this definition: first, the drafting of paragraph 10 should make it clear that the requirement that the action be profitable should apply not just to an increase in price but also to the other ways in which the possession of market power may be demonstrated; second, it is not clear what the expression “or otherwise influence parameters of competition” refers to.<sup>10</sup> We are unclear what additional means there exist of influencing the parameters of competition other than those identified in paragraph 10? We would suggest either deleting this last expression or clarifying it;
- (b) **customer foreclosure:** in paragraph 60 of the Draft Guidelines, the Commission discusses the need for the merger to involve an “*important customer*” whilst Figure 2 refers to the need for “*market power*” downstream. Given previous statements in the Draft Guidelines about the need for market power,<sup>11</sup> we assume these concepts are synonymous in the context of customer foreclosure. We assume also that the need to show that the vertical merger involves an “*important customer*” (which equates to the holding of market power in the relevant procurement market) should be contrasted with the

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<sup>9</sup> See “Commission Green Paper on Vertical Restraints in EC Competition Policy”, 22 January 1997 (paragraph 287 “*the current block exemptions....could be amended so as to apply only where each party has less than, for instance, 40% market share..*”) and “Communication from the Commission on the application of the Community competition rules to vertical restraints”, 30 September 1998 (Section IV “*for certain vertical restraints in the light of significant efficiencies a block-exemption up to 40% market share, which is the level at which a risk of dominance starts, can be envisaged*”).

<sup>10</sup> We note that this expression is reminiscent to that proposed (but not subsequently adopted) in the Commission’s Proposal for a Council Regulation on the control of concentrations between undertakings COM(2002)711 [OJ] 2003 C20/6, which stated: “*For the purpose of this Regulation, one or more undertakings shall be deemed to be in a dominant position if, with or without coordinating, they hold the economic power to influence appreciably and sustainably the parameters of competition, in particular, prices, production, quality of output, distribution or innovation, or appreciably to foreclose competition.*”

<sup>11</sup> See, for example, paragraph 23 (“*non-horizontal mergers pose no threat to effective competition unless the merged entity has market power*”) and paragraph 26 (“*market power...is a necessary condition for competitive harm...* ”).

requirements to show *separately* market power upstream *and* that the merged entity supplies an “*important input*” in order for input foreclosure to be possible.<sup>12</sup> This could usefully be clarified in the text;

- (c) ***conglomerate mergers:*** paragraph 98 of the Draft Guidelines states that “*foreclosure is unlikely to give rise to concern if the new entity ... has no market power*”. Given previous statements in the Draft Guidelines<sup>13</sup>, we suggest this statement is strengthened to read “*in order to be able to foreclose competitors, the new entity must have market power in one of the markets concerned*”; and
- (d) ***footnote reference:*** as a minor point, we assume that Footnote 19 should read “see Sections IV and V”.

## 5. HARM TO COMPETITORS

5.1 We welcome the Commission’s statements in paragraph 16 of the Draft Guidelines that the “*Commission focuses on the effects of the merger on the customers*” and “*the fact that a merger affects competitors is not in and of itself a problem*”. We would question whether some other statements in the Draft Guidelines are fully consistent with this principle. In particular, we suggest that the Commission should make clear that, in order to ensure that it is the welfare-enhancing, competitive process that is protected (rather than competitors per se), it is necessary to show that a likely impact on consumers would result from the non-horizontal merger. This issue arises clearly with respect to the following examples:

- (a) ***foreclosure:*** the final sentence of paragraph 28 states that “*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*”. We suggest that it should be a necessary condition (rather than a possibility) for such foreclosure (i.e. where rivals are disadvantaged rather than forced to exit the market) to be demonstrated as likely to harm consumers in order for the Commission to find a significant impediment to effective competition; and
- (b) ***vertical mergers – other non-coordinated effects:*** paragraph 77 includes, as a possible harm arising from access to commercially sensitive information, “*it may also put competitors at a competitive disadvantage..*”. We question whether this effect (in and of itself) should be sufficient (absent a consumer detriment) for a finding of competitive harm and would suggest that the Draft Guidelines acknowledge the need for the Commission to demonstrate in such cases that the merger is likely to lead to an ability profitably to increase prices downstream on a sustainable basis.

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<sup>12</sup> The guidelines should clarify that demonstrating market power in relation to the supply of the relevant input is insufficient to establish the ability to foreclose downstream competitors where that input is not an “*important input*” for the downstream product (paragraph 33).

<sup>13</sup> See note 11 above.

## **6. CONCLUSION**

6.1 We would like to emphasise again that we strongly welcome the Commission's publication of clear, economic effects based guidance for businesses involved in vertical and conglomerate mergers.

6.2 We would be happy to provide any further explanation of the points raised in this response, either in a meeting or otherwise. Please contact Thomas Wessely (+32 (0)2 504 7027) or Sarah Jensen (+44 (0)20 7832 7092) if such further discussion would be helpful.

**Freshfields Bruckhaus Deringer**  
**11 May 2007**

## Annex: Summary of comments and recommendations

Recommendation	Response reference
<b>Potential competition concerns</b>	
1. The statement in paragraph 11 should either be strengthened to read “ <i>non-horizontal mergers are <b>much</b> less likely to create competition concerns than horizontal mergers</i> ” or amended to read “ <i>non-horizontal mergers have significant scope to create efficiencies and are rarely anti-competitive</i> ”.	Paras. 2.1-2.2
2. The guidelines should reflect the principles on burden and standard of proof in terms of a likely effect on competition in the near future and the need to adduce particularly high quality evidence to establish a credible theory of harm in these cases.	Para 2.3
<b>Efficiencies</b>	
3. A reference to the “ <i>pro-competitive effects stemming from efficiencies</i> ” should be included in paragraph 91, in a similar way to the statement in paragraph 27 on vertical mergers.	Paras. 3.1-3.3
<b>Market power</b>	
4. The guidelines should clarify that there is generally a need for “substantial” market power in one market for competition concerns to arise.	Para 4.2
5. Given the conservative thresholds proposed, the market share/HHI levels could either be cited as sound “ <i>safe-harbours</i> ”, rather than “ <i>initial indicators of the absence of competition concerns</i> ”. Alternatively, the Commission should consider raising the thresholds.	Paras. 4.1-4.3
6. The definition of an “ <i>increase in market power</i> ” in paragraph 10 should be amended to read “ <i>the ability of one or more firms to profitably: increase prices, reduce output, choice or quality of goods and services or diminish innovation</i> ”.	Para. 4.4(a)
7. The need for market power to be established in the downstream procurement market to demonstrate customer foreclosure should be stated expressly. It should also be clarified whether the references to “ <i>important customer</i> ” in paragraph 60 and the need for “ <i>market power</i> ” downstream (Figure 2) are synonymous and, assuming they are, it might usefully be noted that this differs from input foreclosure (where the requirements for market power and for an “ <i>important input</i> ” are separate and must each be shown).	Para. 4.4(b)

Recommendation	Response reference
8. The statement in paragraph 98 should be strengthened to read “ <i>in order to be able to foreclose competitors, the new entity must have market power in one of the markets concerned</i> ”.	Para. 4.4(c)
9. Footnote 19 should read “ <i>see Sections IV and V</i> ”.	Para. 4.4(d)
<b>Harm to competitors</b>	
10. It should be made clear (for example around paragraph 16) that, in order to ensure that it is the welfare-enhancing competitive process that is protected (rather than competitors per se), it is necessary to show that a likely adverse impact on consumers would result from the non-horizontal merger.	Para. 5.1
11. It should be a necessary condition (rather than a possibility) for the foreclosure effect referred to in paragraph 28 (i.e. where rivals are disadvantaged rather than forced to exit the market) to be demonstrated to harm consumers, in order for the Commission to find a significant impediment to effective competition.	Para. 5.1(a)
12. We question whether harm resulting from access to commercially sensitive information (in and of itself) should be sufficient (absent a consumer detriment) for a finding of competitive harm (paragraph 77).	Para. 5.1(b)