

STUDIO LEGALE

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## **COMMENTS OF GRIMALDI E ASSOCIATI**

**ON THE**

### **DRAFT COMMISSION GUIDELINES ON THE ASSESSMENT OF NON- HORIZONTAL MERGERS**

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## I. Introduction

This paper provides some observations on the Draft Commission Guidelines on the assessment of non-horizontal mergers (hereinafter the “Draft Guidelines”) under Council Regulation (EC) n. 139/2004 on the control of concentrations between undertakings (hereinafter the “ECMR”)<sup>1</sup>.

Grimaldi e Associati welcomes the efforts of Director General for Competition (hereinafter “DG Competition”) in preparing the Draft Guidelines on non-horizontal mergers as this represents a delicate and difficult issue to approach. The draft gives a good example of the economic approach to be followed and it will as such provide active companies a good instrument for defining their future policy concerning expansion in other markets. It will be easier for them to predict the position of the Commission and to provide sufficient arguments to have their merger cleared without long, difficult and sometimes unpredictable procedures.

In what follows, Grimaldi e Associati submits some observations on the Draft Guidelines and particularly on elements which might be improved in order to offer undertakings and the legal community a clearer framework in the field of merger control.

## II. Importance of a systematic approach to non-horizontal mergers

Chapter “II. Overview” of the Draft Guidelines offers indications of the effects on competition of non-horizontal mergers. In particular, paragraph 11 states that such mergers, as a general rule, do not pose a threat to effective competition unless the merged entity has market power in at least one of the markets concerned.

It is important that the Draft Guidelines on non-horizontal mergers state that, as a general rule, non-horizontal mergers do not produce anti-competitive effects unless they significantly impede effective competition. Non-horizontal mergers might harm competition, in case of market power of the merged entity, because of either a unilateral or a coordinated effect. As stated in the study commissioned by DG Competition in 2004: *“in particular, unilateral effects occur if, after the merger, products of other producers are no longer as attractive substitutes from the consumers’ point of view as they were before the merger had taken place.*

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<sup>1</sup> Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), Official Journal L 24, pages 1-22.

*Consequently, this situation creates or increases the market power for the merging firm. Coordinated effects occur if, after the merger takes place, it gets easier for the remaining firms on a market to coordinate their competitive behaviours and to jointly exercise market power”<sup>2</sup>.*

The above principle is then explained in the following Chapters of the Draft Guidelines, which offer a definitive substantial test for the assessment of such kind of concentrations, which will be applicable to all future cases also on the basis of the rulings of the European Court of Justice (hereinafter “ ECJ”) and the Court of First Instance (hereinafter “CFI”)<sup>3</sup>. Uniformity in the assessment of non-horizontal mergers is most welcome following the recent developments in the field of non-horizontal mergers. These developments appeared to suggest that the approach of the EC Courts and the Commission in the *Tetra Laval/Sidel*<sup>4</sup> and *GE/Amersham* mergers<sup>5</sup> could be replaced by a case-by-case approach. This seemed to happen in the *Procter & Gamble/Gillette* merger<sup>6</sup>. In that case, the Commission authorised the merger on the basis that there would not be any anticompetitive harm due to the considerable buying power of the retailers - including small retailers in a very competitive market - and to the efficiencies of portfolio effects. Apparently, these two elements of assessment differ and are opposite to the reasoning used by the Commission to forbid the *Tetra Laval/Sidel* merger.

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- 2 The Impact of Vertical and Conglomerate Mergers on Competition, Jeffrey Church - Church Economic Consultants Ltd. and Department of Economics University of Calgary for Directorate General for Competition Directorate B Merger Task Force European Commission, September 2004, Final Report.
  - 3 Judgment of the Court of First Instance of 25 October 2002, *Tetra Laval BV v Commission of the European Communities*, case T-5/02, ECR 2002 page II-4381; Judgment of the Court of Justice of 15 February 2005, *Commission of the European Communities v Tetra Laval BV*, case C-13/03 P, ECR 2005 page I-1113; Judgment of the Court of First Instance of 14 December 2005, *General Electric Company v Commission of the European Communities*, case T-210/01, ECR 2005 page II-5575; Judgment of the Court of First Instance of 21 September 2005, *EDP - Energias de Portugal, SA v Commission of the European Communities*, case T-87/05, ECR 2005 page II-3745.
  - 4 Commission Decision No 2004/124/EC of 30 October 2001, case No COMP/M. 2416 – *Tetra Laval/Sidel*, OJ L 43 of 13 February 2004 pages 13 – 87.
  - 5 Decision of the Commission of 21 January 2004, case No COMP/M.3304 – *GE/Amersham*. This merger was notified to the Commission after CFI’s judgement in *Tetra Laval/Sidel*. It represents the first case in which the Commission applied the legal framework set out by the CFI regarding the *Tetra Laval* case.
  - 6 Decision of the Commission of 15 July 2005, case No COMP/M.3732 – *Procter & Gamble/Gillette*.

The substantive test presented in the Draft Guidelines is more structured and severe than that required in the US, where, according to the 1982 Department of Justice (hereinafter “DOJ”) Merger Guidelines, as confirmed in 1984, non-horizontal mergers raise concerns only if they are liable to eliminate specific potential entrants: “*in some circumstances, the non-horizontal merger of a firm already in a market (the acquired firm) with a potential entrant to that market (the acquiring firm) may adversely affect competition in the market*”. In the US there is not such detailed checklist as to competitive harm of conglomerate mergers.

As for vertical mergers, in the DOJ Merger Guidelines, barriers to entry might rise if three conditions are met: i) the degree of vertical integration between the two markets must be so extensive that entrants to one market (the "primary market") also would have to enter the other market (the "secondary market") simultaneously; ii) the requirement of entry at the secondary level must make entry at the primary level significantly more difficult and less likely to occur; iii) the structure and other characteristics of the primary market must be otherwise so conducive to non competitive performance that the increased difficulty of entry is likely to affect its performance.

Also in the case of vertical mergers, competitive harm is considered as deriving from the elevation of barriers to entry as direct consequence of the merger or in collusive behaviours.

### **III. Non-horizontal mergers and Article 82 EC Treaty**

The Draft Guidelines do not explicitly mention the interface between ECMR and Article 82 EC Treaty. The debate over the application of the assessment of a conduct in light of Article 82 EC Treaty raises questions as to the evidence needed and the rigorousness of the analysis of a conglomerate merger.

In this regard, in a first moment, the CFI, in the *Tetra Laval/Sidel* judgement, concluded that the Commission, in carrying out an assessment as to future conduct of the merging parties which might lead to the creation or the strengthening of a dominant position, should have taken into account the extent to which the economic incentives of the merging parties to engage in anticompetitive practices would have been reduced, or even eliminated, i) by the illegality of the conduct in question, ii) the likelihood of its detection, iii) action taken by antitrust authorities and iv) the financial penalties which

could ensue from such conduct. The Commission should not have merely referred to the economic incentives of the merged entity to engage in anticompetitive practices<sup>7</sup>.

The ECJ, in the *Tetra Laval/Sidel* ruling, stated that it was outside the scope of ECMR to require the Commission to examine, “*for each proposed merger, the extent to which the incentives to adopt anti-competitive conduct would be reduced, or even eliminated, as a result of the unlawfulness of the conduct in question, the likelihood of its detection, the action taken by the competent authorities, both at Community and national level, and the financial penalties which could ensue*”.

However, as later on confirmed by the CFI in the *GE/Honeywell* merger, it was concluded that it is duty of the Commission to take into account the potentially unlawful and thus sanctionable nature of certain conduct as a factor which might reduce, or even eliminate, incentives for an undertaking to engage in particular conduct. The Commission should identify the likelihood that the merged entity would engage in conducts which might reveal unlawful under Article 82 EC Treaty but not investigate on the actual application of this provision.

The Draft Guidelines do not seem to address specifically the problem of how to treat the standard of “*balance of probabilities*” in relation to the kind of assessment required by Article 82 EC Treaty.

#### **IV. Time framework for the assessment of the potentially unlawful nature of certain conducts**

The Draft Guidelines do not give indication as to the limits of the investigation of the Commission in terms of prospective analysis of the future conducts of the merged entity. Indeed, this is an important element of assessment of non-horizontal mergers which contributes to determine whether the chains of cause and effect following the conclusion of a merger may be dimly discernible, uncertain and difficult to establish. A clear time framework to assess the future conduct of the merged entity guarantees that the conclusions reached by the Commission are formed on a sound basis and not on economic speculation.

According to the rulings on *Tetra Laval/Sidel* and *GE/Honeywell*, prospective analysis in merger control must be carried out with great care since it does not entail the

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<sup>7</sup> Standard of proof in merger cases: reflections in the light of recent case law of the Community Courts, Bo Vesterdorf, European Competition Journal, March 2005.

examination of past events - for which often many items of evidence are available which make it possible to understand the causes - or of current events, but rather a prediction of events which are more or less likely to occur in future if a decision prohibiting the planned concentration or laying down the conditions for the merger to take place is adopted.

Moreover, because often non-horizontal mergers are pro-competitive and do not involve the removal of a direct competitive constraint, to establish competitive harm it is necessary to show a temporal link between i) the alleged illegal practice foreseen, ii) its impact on rivals profitability in the short term and iii) their ability to compete in the future.

## V. Market shares

Paragraph 25 of the Draft Guidelines introduces a safe harbour of 30% market share for a non-horizontal merger not to raise competition concerns. The introduction of this provision has been made in analogy with the Vertical Block Exemption, which fixes at 30% of the market share of the supplier the presumption of legality for a vertical agreement.

The choice of introducing a safe harbour is to be welcomed as it gives certainty to companies as to the attitude of the Commission in investigating a merger. Moreover this is in line with the 25% safe harbour settled by the Commission in the Horizontal Merger Guidelines.

As to the level of the threshold, it is reasonable to fix a market share similar to that included in the Vertical Exemption Regulation, as the competition problems raised in terms of market foreclosure by the non-horizontal mergers and especially the vertical mergers are similar to vertical restraints.

However, less clear is the list of specific circumstances which might lead the Commission to investigate a merger even if the position of the merging parties is below 30% of market shares in any of the markets concerned. In particular, points c) and d) of paragraph 25 extend the duty of a serious investigation to mergers below the safe harbour in the hypothesis where there is the possibility for one of the merging firms of disrupting coordinated conducts and there are indications of present or past coordinated practices.

In this regard, the substantive test for merger control (Article 2 EECMR) states that a concentration, to be forbidden, should “*significantly impede effective competition, in*

*the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market*". In general, as reported in the Draft Guidelines, it is unlikely that if the market share post-merger of the new entity is below 30% the merger might meet the requirement settled by the substantive test of the ECMR, unless there are structural links with other market participants or unless the market share is foreseen to increase in the very short term (hypothesis a) and b) of paragraph 25).

Therefore, it does not seem to be any justification to investigate a merger which is not liable to conduct to any "*significant impediment of competition*" since it is below the safe harbour. Moreover, there are other means of investigating markets which might present competition concerns in terms of possible coordination of commercial behaviours of market participants through the instruments offered by Regulation 1/2003. In this regard, also the rulings of the CFI and ECJ impose a pre-requisite to investigate behaviours of the merging firms provided that the new entity has a dominant position in one of the markets where it will operate.

US Guidelines also contains certain exceptions to the general threshold chosen to investigate non-horizontal mergers. However, these exceptions are addressed in a more cautious manner and under stricter conditions.

## **VI. Use of evidence**

Paragraph 43 of the Draft Guidelines makes reference to the possible sources of considerations that the Commission might use in the course of its investigation in order to assess the possible incentives of the merged firm to adopt illegal conducts.

The paragraph addresses the remarks of the EC Courts in the *GE/Honeywell* and *Tetra Laval/Sidel* mergers, on the fact that the Commission cannot rely solely on economic theories to support its case; it has to be based on specific and proven facts. An anticompetitive conduct following a given merger is considered to be proven when the economic commercial and factual context of the case shows that the anti-competitive conduct foreseen by the Commission and its effects on rivals is compelling or persuasive and/or there is direct evidence of the merging parties' anticompetitive intentions.

The Commission has to establish that the merged entity has an ability to engage in practices which might lead to market foreclosure. The evidence can be gathered from i) the conduct of the merging firms prior to the merger, ii) internal documents describing such practices or iii) the merging parties stated intentions to engage in such practices

post merger. The quality of evidence is however important in order to support the Commission's conclusions that "*the economic development envisaged by it would be plausible*".

Preference should be given, in conformity with CFI *GE/Honeywell* ruling, to the merging parties' stated intention instead of economic theories of harm. Such direct evidence might be difficult to obtain since the parties might be careful when creating internal documents<sup>8</sup>. The Commission must carefully analyse any inherent practical difficulties associated with the alleged illegal practice.

In this regard, a useful and more complete example of documentation relevant for the assessment of future conducts of the merged entity is paragraph 88 of the Horizontal Merger Guidelines, according to which evidence relevant to the assessment of efficiency claims includes, in particular, internal documents that were used by the management to decide on the merger, statements from the management to the owners and financial markets about the expected efficiencies, historical examples of efficiencies and consumer benefit, and pre-merger external experts' studies on the type and size of efficiency gains, and on the extent to which consumers are likely to benefit.

## **VII. Efficiencies**

The Draft Guidelines, in sections concerning vertical mergers (paragraphs 51-56) and conglomerate mergers (paragraphs 113-116), introduce the concept of efficiencies which have to be taken into account when assessing a non-horizontal merger.

In this regard, the Commission has made a further step in the process of strengthening the checks and balances necessary to appraise the effects of mergers on competition. Non-horizontal mergers provide substantial scope for efficiencies and in this regard they are in general more beneficial than horizontal merger. Efficiencies are present in different forms than in horizontal mergers (for example, internalisation of double mark-up in vertical mergers and benefits for consumer deriving by buying complementary products from the same source in case of conglomerate mergers).

This circumstance, stressed in the Note by the EAGCP Merger Sub-Group and in the Draft Guidelines at paragraph 10-22, is not adequately examined in the specific

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<sup>8</sup> Large use of the internal documents of the parties has been done in occasion of the assessment of the case COMP/M.3440 – EDP/ENI/GDP decided with decision C(2004) 4715 of 9 December 2004, OJ 302, 19 November 2005, pages 69 – 78.

sections of the draft Notice dedicated to efficiencies in vertical and conglomerate mergers.

In these sections, reference to the Horizontal Merger Guidelines seems inappropriate due to different role of efficiencies in the assessment of horizontal mergers.

The Draft Guidelines do not offer sufficient explanation of the role of efficiencies in the assessment of non-horizontal mergers. In particular, they do not focus on whether efficiencies have to be balanced with the elements of the merger which might cause harm to competition or if they constitute an analytical tool to refine its judgement as to the harm to competition likely to result from the operation. Furthermore, a serious enquiry into the efficiencies likely to result from a transaction provides the competition authority with the means to realistically assess the rationale behind the operation and thus the incentives of the merging firms.

### **VIII. Coordinated effects**

Paragraphs 78-89 and 117-199 address the issue of coordinating effects of non-horizontal mergers.

In general the ruling of the ECJ on *Tetra Laval/Sidel* and the one of the CFI on *GE/Honeywell* require that the Commission, when appraising a non-horizontal merger, takes into account the deterrent effect of Articles 81 and 82 when considering the merged entity's incentive to engage in anti-competitive behaviours.

In the decision on *E.ON/MOL* merger<sup>9</sup>, the Commission investigated the likelihood that the illegal conduct of the merging parties could be detected by National Regulators.

It is advisable that, also in the Sections of the Draft Guidelines devoted to the assessment of conducts of the merged entity relevant for the application of Article 81 EC Treaty, the Commission takes account of the possibility for the competent Competition Authority or for the National Regulator to obtain adequate information on the commercial behaviour of the company and to intervene in good time and efficiently where, because of the merger, firms that previously were not coordinating their behaviour, are now significantly more likely to coordinate and raise prices or otherwise

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<sup>9</sup> Commission Decision No 2006/622/EC of 21 December 2005, case COMP/M.3696 — *E.ON/MOL*, OJ L 253, 16 September 2006 pages 20 – 28.

harm effective competition. Only in the event that there are no instruments providing disincentives for the adoption of the alleged coordinated behaviour, the Commission can consider it as an element of harm.

Paragraph 44 of the Draft Guidelines applies this principle where non-coordinated effects of vertical mergers might lead to input foreclosure. It seems appropriate to extend this requirement also to the hypothesis of co-ordinated effects arising from vertical mergers.

### **IX. Effects of conglomerate mergers**

Paragraphs on conglomerate mergers assess the exclusionary practices - bundling and tying - that the merged entity can adopt. In addition, they establish the condition to be met for these practices to lead to competition problems. However, this section does not sufficiently specify that part of the assessment of tying and bundling is strongly dependant on market characteristics.

In this regard, paragraphs 99 and 100 describe the main characteristics of a market in which foreclosure effects of bundling and tying are likely to be more pronounced. However, according to the *Tetra Laval/Sidel* and *GE/Honeywell* rulings, the Commission should assess the alleged illegal practices of the merged firm taking into account a whole range of elements, such as, i) the exact definition of the market concerned, ii) the specific rules governing the meeting of demand and supply, iii) the degree of future market expansion, iv) the characteristics of the consumers, v) the financial weakness of the buyers which could induce them to accept short-term cost savings.

Equally, particular attention should be given to the characteristics of the products, the degree of innovation which could induce buyers not to buy the goods which the merged entity offers through bundling. Moreover, given that preferences for a product are often relative, account should also have been taken, in the course of such analysis, of any harmful commercial effects which pure bundling might have. Indeed, such approach could deter a potential purchaser of one of the merged entity's products, notwithstanding its preference - which might only be slight - for those products.

### **X. Conclusions**

In conclusion, Grimaldi e Associati welcomes the efforts of the Commission aimed at clarifying some important concepts of rules on the control of non-horizontal merger.

However, some clarification is needed as to some issues such as i) the relation between the appraisal of non-horizontal merger and Article 82 EC Treaty; ii) the time framework for the assessment of the potentially unlawful nature of certain future conducts; iii) the exceptions to the application of the safe harbour; iv) the use of evidence; v) the treatment of efficiencies; vi) the analysis of coordinated effects and vii) the assessment of the effects of conglomerate mergers.

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**11<sup>th</sup> May 2007**

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