

12 May 2007

**COMMENTS ON THE COMMISSION'S DRAFT GUIDELINES  
ON THE ASSESSMENT OF NON-HORIZONTAL MERGERS UNDER THE  
MERGER REGULATION  
("the Guidelines")**

**I. Introduction**

1. Hogan & Hartson appreciates this opportunity to comment on the *Draft Commission Notice - Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings* (the "Draft Notice").
2. The Draft Notice, once adopted, will address an important gap in the Commission's guidance on the substantive interpretation of Council Regulation 139/2004 (the "Merger Regulation"). It can also provide a stimulus for discussion of an international paradigm for a modern, economics and competitive effect-based antitrust approach to non-horizontal mergers, an area where regulatory guidance is scant or obsolete.<sup>1</sup>
3. Non-horizontal mergers are rightly considered even less likely to be problematic, in most circumstances, than horizontal mergers. As a consequence, however, they also tend to be debated in less depth, detail and clarity during the merger review process. Hence case-law alone may be too limited and fragmented to set clear and comprehensive standards for the antitrust analysis of non-horizontal mergers. In the absence of such standards, speculative arguments on the case-specific implications of non-horizontal issues can flourish based on untested theories, and escalate to prolonged litigation and controversy, as demonstrated by the examples of the *GE/Honeywell* and *Tetra Laval/Sidel* cases. Regulatory guidance on non-horizontal mergers should thus aim to minimize the margin for a counterproductive increase of the regulatory cost associated with the review of non-horizontal mergers. It should achieve this by defining clear and pragmatic factors for analysis. It should not legitimize or inspire questionable new theories or extended inquiries that risk wasting the Commission's and the parties' resources on non-issues in situations in which it is clear that significant adverse competitive effects are highly unlikely or impossible.

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<sup>1</sup> For instance, in the U.S., non-horizontal mergers were dealt with in the 1982 and the 1984 Merger Guidelines, but they were not included in the subsequent revisions of these Guidelines in 1992 and 1997. In its recently adopted Report and Recommendations, the U.S. Antitrust Modernization Commission included a recommendation (11d) that the U.S. antitrust agencies "should update the Merger Guidelines to include an explanation of how the agencies evaluate non-horizontal mergers."

4. In our view, the Draft Notice provides a generally clear, well-structured and comprehensive analysis of the factors to be considered in analyzing non-horizontal mergers, especially given the relatively few precedents that the Commission can draw on to set out its views in a systematic manner. We do believe, however, that many (and probably the majority) of non-horizontal mergers that fall outside the Commission's proposed safe harbors are unlikely to present significant anticompetitive effects. While the Draft Notice (para. 26) may be intended to make this point, the point is so significant that it warrants more emphasis and clarity. Therefore, our comments that follow address this and a few other points which, in our view, could be clarified or developed further in the document's final version.

## II. Clarification of "Market Power"

5. The term "market power" is referred to extensively, but is not defined, in the Draft Notice. Para. 23 of the Draft Notice provides that "non-horizontal mergers pose no threat to effective competition unless the merged entity has market power in at least one of the markets concerned." However, it is somewhat unclear how "market power" should be interpreted in this context.<sup>2</sup> While "dominance" is a standard that has been defined and extensively discussed in EU case-law, the exact meaning of "market power" remains somewhat open to interpretation.
6. Para. 10 of the Draft Notice provides that an "increase in market power" 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. Further, consistent with the use of the term "market power" in other Commission texts, we assume that "market power" means "the power to influence market prices, output, innovation, the variety or quality of goods and services, or other parameters of competition on the market for a significant period of time".<sup>3</sup> Again, in line with these texts, "market power" would likely be understood to represent a lower threshold than "dominance", which is effectively synonymous with *significant* market power, at least under the terminology used by the Commission.<sup>4</sup>
7. None of the above definitions lends itself to easy interpretation; but they all at least offer a starting point for a meaningful discussion if the question of "market power" comes up during Commission's review of a notified concentration. It would be helpful, therefore, if the Commission could at least reiterate the above definitions in the Draft Notice, for ease of reference and the avoidance of unnecessary speculation.
8. Depending on the standards set for the definition of "market power", the Commission's implied statement that market power in only one of the markets concerned is already enough to trigger potential non-horizontal issues may need to be revisited. Indeed, this statement seems questionable if, as seems to be the case, "market power" corresponds to a lower threshold than "dominance". As reflected in the Commission's decisional

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<sup>2</sup> "Market power" is also referred to extensively, but not defined, in the Commission's horizontal merger guidelines.

<sup>3</sup> See para. 24 of DG Competition's "discussion paper on the application of Article 82 of the Treaty to exclusionary abuses", December 2005.

<sup>4</sup> *Id.*, para. 23.

practice, if the parties to a concentration are not dominant in any of the markets concerned, non-horizontal issues will present a genuine problem only in extreme circumstances. The fact that the Commission's services have had to review such non-horizontal issues in a relatively (and perhaps surprisingly) high number of cases but have found them not to constitute a real problem in the vast majority of these cases should allow the Commission to apply a more measured approach in respect of potential non-horizontal issues. We would respectfully caution against any implied presumption, in the Guidelines, that market power in only one of the affected markets automatically renders non-horizontal issues a credible threat to competition or at least an issue that needs to be investigated closely by the Commission. Such a presumption should certainly not apply if "market power" means less than "dominance".

### III. "Safe Harbor"

9. As a starting point, the idea of a "safe harbor" for non-horizontal mergers seems attractive, given the generally unproblematic nature of such mergers and the need to ease the regulatory burden associated with their review and clearance. However, defining such a safe harbor for non-horizontal mergers is less easy than for horizontal mergers. In the latter, market shares and, in particular, HHI and "delta" figures can indeed provide at least a rough proxy of market power or changes thereto, and thus serve as a sensible basis for a "safe harbor". The problem with non-horizontal mergers is that any potential competition issues they raise, however rarely, are less directly linked to easily quantifiable indicators such as market shares or the HHI. Faced with this difficulty, the Commission may have been tempted to err on the side of caution, by proposing a cumulative requirement of less than a 30% market share threshold and an HHI of less than 2000 in each of the affected markets.
10. This strikes us as far too limited a threshold for non-horizontal mergers, particularly because the Commission will not consider itself legally bound by it (as clarified in para. 26 of the Draft Notice) and will be free to ignore it under "special circumstances". The list of such special circumstances mentioned in the Draft Notice is non-exhaustive, and their description is broad enough to allow for a wide margin of interpretation. Moreover, even if none of these exceptions apply and the merger falls under the safe harbor, all that the Commission commits itself is not to "extensively investigate such mergers."
11. If the last statement is to be interpreted as meaning that non-horizontal mergers that fail to meet the safe harbors will always be investigated extensively, then this does not seem to be the right approach. Whatever safe harbor thresholds the Commission decides to adopt in the end, we would urge it to emphasize that these are intentionally conservative to avoid appearing to "bless" (despite the reservation of the Commission's right to challenge them "in special circumstances") potentially problematic non-horizontal mergers. The Commission should preferably make it clear in the text of the Guidelines that many, or most, non-horizontal mergers outside the safe harbors will not warrant an extensive investigation or challenge. The opposite interpretation would only inflate unnecessarily the regulatory burden of clearing unproblematic mergers.

12. The problem with too restrictive safe harbor thresholds for non-horizontal mergers is that, in practice, and against the Commission's best intentions, they may raise the likelihood of unnecessary debate and administrative work at the merger review stage and, eventually, invite opportunistic third party challenges. Such a prospect will, in turn, increase unnecessarily the level and detail of scrutiny and that the Commission would have normally applied in such cases and thus divert its resources from more important tasks. It should be therefore made clear in the Guidelines that, if a notified non-horizontal concentration failed to meet the safe harbor conditions, the Commission's case team would not be automatically obliged to "investigate extensively" potential non-horizontal issues. The Guidelines' safe harbors should help simplify the procedure and not increase artificially the cases where non-horizontal mergers will be "extensively investigated".
13. A further way of improving the safe harbor thresholds proposed by the Commission would be to retain them as an alternative rather than as a cumulative test. They could thus apply if the new entity's market share post-merger of the new entity would be less than 40% or if the post merger HHI remained below 2000 (which, in practice would mean that the highest possible market share would still be less than 50%) in each of the affected markets.
14. Another change that could help adjust the safe harbor thresholds to less restrictive standards could be to rely on indicators in at least two of the markets affected by the non-horizontal concentration. This strikes us as meaningful, because problems, if any, in non-horizontal mergers always result from the relationship between at least two distinct relevant markets rather than the increase of market share within a single relevant market – by definition, there is no immediate increase of market share, in any market, in non-horizontal mergers. Thus, for example, the Commission could extend the safe harbor to non-horizontal mergers, even if the above safe harbor tests were not met, provided the new entity post-merger did not have a market share of at least [x %], in each of at least two markets characterized through a vertical relationship (in vertical mergers) or a sufficiently close relationship (in conglomerate mergers). In addition, and consistent with our earlier remarks, it should be made clear that concentrations outside those safe harbors will not be presumptively subject to "extensive investigation".
15. There is also a question of potential inconsistency with the 25% market share thresholds in vertical relationships mentioned in Section 6.III.(b) of the Form CO. Under the solution currently proposed by the Commission, parties in a vertical merger with market shares between 25 and 30% would be required to provide detailed information on potentially affected markets, consistent with Section 6.III.(b) of the Form CO. Completing Sections 6, 7 and 8 of the Form CO can be cumbersome and time-consuming for the notifying parties and if their merger is not supposed to be investigated extensively at least part of this information would seem redundant. Amending the Form CO on this point may not be an immediate priority, but something the Commission could consider in the future when time permits. Furthermore, at least as a practical matter, the Commission's case-teams could be instructed to show more flexibility if the information they request for a non-horizontal merger meets any of the safe-harbor thresholds included in the Guidelines' final version.

#### **IV. Efficiencies**

16. As mentioned already, the Commission accepts that “non-horizontal mergers are generally less likely to create competition concerns than horizontal mergers”. While this is a correct statement, it also sets an overcautious tone for the text that follows. Non-horizontal mergers are not just “less likely to create competition concerns”; they are generally inherently pro-competitive. The pro-competitive effects of non-horizontal mergers are acknowledged (at least as a possibility) and described in the Guidelines, but it would be more appropriate to take them as the starting point rather than as an afterthought.
17. It may be desirable, but technically difficult, to reverse the legal burden of proof concerning the essentially pro-competitive nature of non-horizontal mergers and their generation of efficiencies, given some of the positions taken by the European Courts in non-horizontal merger cases and the current text of the Form CO (which leaves it to the notifying parties to describe any efficiency gains generated by their concentration). There is, however, ample scope to extend the Guidelines’ discussion of efficiencies in non-horizontal mergers (*i.e.*, its paras. 52-56 for vertical mergers and 113-116 for conglomerate mergers) and thus the list of arguments that notifying parties will be able to rely on in their description of any transaction-specific efficiencies.

#### **V. Vertical Mergers: “Other Non-coordinated Effects” (para. 77)**

18. The Draft Notice’s reference to “other non-coordinated effects” in vertical mergers is very short. The only example of such a non-coordinated effect discussed in the Draft Notice, and this only briefly, is the exchange of commercially sensitive information regarding the upstream or downstream activities of rivals. While we agree that this can be an issue of concern in some cases, we believe it would be appropriate to provide more detailed guidance. “Competitively sensitive information” is a relative term and the extent to which access to presents a problem depends on several factors. For example, access to competitively sensitive information can conceivably also lead to efficiencies, through the increase of market transparency, a factor that should be taken into consideration when assessing such non-coordinated effects of a vertical merger.
19. The Draft Notice should not create a false impression that vertical mergers allowing access to commercially sensitive information of any kind would be automatically problematic and invite thorough regulatory investigation. Whatever risks may be inherent in such access to information should not be inferred and argued in the abstract, but should be subject to an ability/incentive/likely impact test, similar to the one discussed in the Draft Notice in connection with non-coordinated effects.
20. In this regard, the Commission can draw inspiration from the discussion and references to earlier literature included in the study prepared in September 2004 for DG Competition, Directorate B<sup>5</sup> (albeit in connection with coordinated effects). Consistent with the remarks made in that study, we would propose that the Draft Notice clarify

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<sup>5</sup> “The Impact of Vertical and Conglomerate Mergers on Competition”, Final Report, by Jeffrey Church, Church Economics Consultants Ltd. and Department of Economics, University of Calgary, pp. 250-252.

that, in order to trigger substantial investigation, the expected information exchange in non-horizontal mergers should be

- (i) “projectable”: the prices or other information obtained by the downstream subsidiary should be at least indicative of the prices that the rivals of the vertically integrated group charge to other buyers; or *vice versa*;
- (ii) unique, *i.e.*, not readily and verifiably available from other sources; and
- (iii) conducive to a significant impediment to competition.