

The European Commission's Draft Guidelines on the assessment of non-horizontal mergers

Comments

The Commission's most recent set of draft merger guidelines confirms a welcome turn of the tide. Over many years, the analytical framework used to analyse mergers between non-competitors – so-called "vertical" or "conglomerate" transactions – under the EC Merger Regulation was geared towards identifying "competitive advantages" which allegedly gave rise to competitive harm. The analysis in cases such as *Guinness/Grand Metropolitan* (1997)¹ involved speculation about allegedly anti-competitive conduct the merged firm might have employed if the merger was permitted to proceed, rather than an assessment of the likelihood of such conduct and its effects on competition. This approach to non-horizontal mergers attracted heavy criticism from antitrust experts worldwide and the Community Courts forcefully rejected superficial analyses as part of judicial review of Commission decisions of cases such as *Schneider v Commission* (2002),² *Tetra Laval v Commission* (2002 and 2005)³ and *General Electric v Commission* (2005).⁴

In the meantime, the Commission's decisional practice has matured and grown more sophisticated and rigorous. The Commission's *Draft Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings* (the "Draft Guidelines")⁵ present an opportunity for the Commission to shift out some of the hypotheses underlying older cases and to reinforce an analytical framework aligned with modern economic thinking in merger enforcement. The Commission appears to be willing to seize this opportunity, and the current Draft Guidelines is a constructive first step towards an appropriate framework of analysis. However, we highlight in this paper three respects in which the framework set out in the Draft Guidelines can still be improved.

1 Improve the benchmark for competitive harm/foreclosure

In the Overview (paragraph 10 *et seq*) the Draft Guidelines confirm the shift to an effects-based analysis: although non-horizontal mergers "are generally less likely to create competition concerns than horizontal mergers" (paragraph 10) the Draft Guidelines state there are circumstances in which such mergers "may significantly impede effective competition" (paragraph 15) and that "the fact that a merger affects competitors is not in and of itself a problem. It is the impact on effective competition that matters". (paragraph 16) These are important principles. However, in order to ensure that these principles are carried through into decisional practice, the Final Guidelines should in our view go further and establish a clearer benchmark for competitive harm.

¹ *Guinness/Grand Metropolitan*, OJ [1997] L 288/24.

² Case T-310/10 *Schneider Electric SA v. Commission* [2002] ECR II-4071; and *Schneider/Legrand* (COMP/M.2283; 10 October 2001).

³ Case C-12/03 P *Commission v. Tetra Laval BV* [2005] ECR I-987; Case T-05/02 *Tetra Laval BV v. Commission* [2002] E.C.R. II-4381; *Tetra Laval/Sidel*, OJ [2004] L 43/13.

⁴ Case T-210/01 *General Electric Company v. Commission* [2005] ECR II-5575; *General Electric/Honeywell*, OJ [2004] L 48/1.

⁵ *Draft Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings* (March 2007), available at http://ec.europa.eu/comm/competition/mergers/legislation/draft_nonhorizontal_mergers.pdf

- **Alignment with the consumer welfare standard.** The Draft Guidelines contain a “manual” for the analysis of different theories of competitive harm through foreclosure of rivals. In an effects-based approach, the standard of foreclosure needs to be crafted with exceptional care, or the risk for enforcement errors becomes too large. The Draft Guidelines define the standard of foreclosure at paragraph 18:

“Non-coordinated effects may principally arise when non-horizontal mergers give rise to foreclosure. In this document, the term “foreclosure” will be used to describe any instance where *actual or potential rivals’ access to supplies or markets is hampered or eliminated* as a result of the merger, thereby reducing these companies’ ability and/or incentive to compete. 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. These instances will be referred to as ‘anticompetitive foreclosure’.” [emphasis added]

There is a risk that this definition reintroduces speculation as a guiding principle in non-horizontal merger analysis: it establishes that any merger which “hampers” competitors’ ability and incentive to compete creates foreclosure (and therefore a problematic non-coordinated effect). By identifying non-coordinated effects with foreclosure (rather than the later defined term of “anticompetitive foreclosure”) the Draft Guidelines may imply that even absent an anti-competitive effect, this level of foreclosure would constitute a basis for intervention. However, as discussed below, that would be inconsistent with an effects-based analysis incorporating a consumer welfare standard.

Moreover, even in identifying cases of “anticompetitive foreclosure” the Draft Guidelines suggest that it is sufficient to establish whether merging firms *may* be able to profitably increase price once rivals’ ability or incentive to compete have been “hampered”. The case-law of the European Court of Justice holds that to determine that a transaction will significantly impede effective competition the Commission must ascertain that competitive harm is “likely” to arise.⁶ In this analysis

“it is not enough for the Commission to put forward a series of logical but hypothetical developments which, were they to materialise, it fears would have harmful effects for competition ... the onus is on [the Commission] to carry out a specific analysis ... and to produce convincing evidence”.⁷

The evidentiary standard required by the Courts cannot be obtained by investigating whether “hampering” competitors “may” afford merging firms the ability to raise price. As explicitly recognised elsewhere in the Draft Guidelines (paragraph 16), absent higher prices (or lower quality) for consumers, the ability of rivals to compete *per se* should not be a concern for competition policy. This important principle should also be more clearly reflected in the definition of (anticompetitive) foreclosure, making clear that customer detriment is at the heart of the analysis and cannot be identified with difficulty faced by individual rivals in competing.

⁶ Case C-12/03 P; [2005] ECR I-987, at paragraph 43.

⁷ Case T-210/01; [2005] ECR II-5575, at paragraph 429.

- **Alignment with recent thinking on Article 82 of the EC Treaty.** It is notable that the standard of foreclosure is elaborated upon less in the Draft Guidelines than in the Commission's *Discussion paper on Article 82 of the EC Treaty*.⁸ In particular, it would be useful if the final Guidelines were to make it clear that the Commission typically will not intervene in respect of foreclosure of rivals that are "less efficient" than the merged firm. The Article 82 discussion paper make it clear that

"[f]oreclosure is said to be market distorting if it likely hinders the maintenance of the degree of competition still existing in the market or the growth of that competition and thus have as a *likely effect* that prices will increase or remain at a supra-competitive level ... for assessing alleged price based exclusionary conduct are based on the premise that *in general only conduct which would exclude a hypothetical "as efficient" competitor is abusive*. The "as efficient" competitor is a hypothetical competitor having the same costs as the dominant company. Foreclosure of an as efficient competitor *can in general only result if the dominant company prices below its own costs*."⁹ [emphasis added]

There is in our view no compelling reason to apply fundamentally different concepts of foreclosure under in the analysis of conduct that might be applied in the context of non-horizontal mergers and the same conduct analysed as a possible abuse of a dominant position. By strengthening the definition of anticompetitive foreclosure as suggested above, the standards for intervention would be increasingly aligned.

Moreover, the Commission has already in some cases applied, in the context of non-horizontal merger analysis, a framework of analysis based on an "as efficient competitor" standard. For instance, the Commission's decision in *GE/Amersham* (2004)¹⁰ made it clear that:

"[f]or commercial bundling to result in foreclosure of competition it is necessary that the merged entity is able to leverage its pre-merger dominance in one product to another complementary product. In addition, for such strategy to be profitable, there must be a reasonable expectation that rivals will not be able to propose a competitive response, and that their resulting marginalisation will force them to exit the market. Finally, once rivals have exited the market, the merged firm must be able to implement unilateral price increases and such increases need to be sustainable in the long term without being challenged by the likelihood of new rivals entering the market or previously marginalised once re-entering the market."¹¹

To conclude, in our view it would be appropriate to make it clear that the standard of foreclosure applied under the final Guidelines is directed at foreclosure of actual or potential competitors as efficient as the merged firm and that such foreclosure should be a likely outcome of the merger, resulting in consumers facing higher prices or diminished quality.

⁸ *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses* (December 2005), available at <http://ec.europa.eu/comm/competition/antitrust/art82/index.html>

⁹ *Ibidem*, at paras 58 and 63.

¹⁰ *GE/Amersham* (Case No COMP/M.3304; 21 January 2004).

¹¹ *Ibidem*, at paragraph 37.

2 A coherent approach to efficiencies

The Draft Guidelines helpfully acknowledge that non-horizontal mergers are less likely than horizontal mergers to generate competition concerns (paragraph 11) and indeed will often be pro-competitive (paragraphs 13-14). However, the more specific comments on the assessment of efficiencies give rise to several issues. As a general point, the analysis of efficiencies could be more closely integrated into the analysis of competitive effects. Further, the Draft Guidelines appear to suggest that the pro-competitive effects of a merger should be subject to more exacting evidentiary standards than theories of competitive harm. Finally, the discussion of “merger specificity” needs to be revisited. These issues should be addressed in the final version of the Guidelines, which should also acknowledge more clearly (e.g. at paragraphs 91, 92 and 103) that the opportunities for bundling, tying and one-stop-shopping arising in conglomerate mergers will often be *pro*-competitive and benefit customers (not only that they do not necessarily have any *anti*-competitive effects).

- **Burden and standard of proof.** At paragraph 30 the Guidelines accept that in principle efficiencies could counteract any incentives arising from the merger to increase price, “so that the overall likely impact on consumers is neutral or positive” – but little guidance is given on how the various pro- and anti-competitive drivers should be incorporated into a unified assessment of merger effects. Moreover, paragraphs 21 and 27 state that “possible” anti-competitive effects can be balanced against pro-competitive effects “identified and substantiated by the parties, suggesting that a more exacting standard of proof may be required for pro-competitive effects, if these are to offset the competitive harm.

The general issue of burden and standard of proof carries through to the assessment of efficiencies. On the one hand, it is of course for the Commission to establish to the requisite legal standard whether a notified transaction would significantly impede effective competition – taking full account of all merger effects (pro- as well as anti-competitive).¹² On the other hand, the parties are likely to be in the best position to furnish evidence on efficiencies arising from a transaction.

However in terms of standard of proof, we believe that a consequence of the economic presumption in favour of efficiencies in non-horizontal mergers (which the Draft Guidelines recognise at paragraphs 11, 13 and 14) should be that that evidence adduced in support of efficiencies should given more weight than in a horizontal merger. For the same reasons, we also hope that the final Guidelines, unlike the draft, will not imply that the standard of evidence for pro-competitive effects should be higher than for anti-competitive effects.

- **Merger-specificity of efficiencies.** In referring to the Horizontal Guidelines at paragraph 51, and also in the discussion of efficiencies at paragraphs 56 and 116, the Draft Guidelines suggest that the efficiencies of vertical or conglomerate integration may not be merger-specific, because they could be achieved by other (presumably contractual) means. This is troubling in two respects.

First, it cannot be assumed that contractual integration necessarily would be a more competitively “benign” means of achieving such efficiencies than would integration through ownership. Second, even if such efficiencies could *theoretically* be achieved by other means, the theoretical alternative will typically not form an

¹² See Section 3.

appropriate basis for comparison, especially if the alternative *would not have* been achieved absent the merger: this is one instance where economic reality is more informative than an economic model. If the analysis of merger effects shows that the merger – efficiencies taken into account – is likely to be pro-competitive, then it would be better to allow the merger to proceed than to lose those benefits in favour of a hypothetical “superior” counterfactual scenario that is unlikely ever to materialise.

3 The nature and scope of the analysis

On the whole, the Draft Guidelines take on board the framework for burden and standard of proof established by the Community courts. However, in some important respects, the Draft Guidelines could do more to facilitate the balanced analysis mandated by case-law:

- **Comprehensive analysis.** The case-law of the Community Courts mandates an analysis based upon “factually accurate, reliable and consistent” evidence containing “all the information which must be taken into account”.¹³ In other words, all relevant circumstances must be taken into account in order to support the conclusions drawn in a decision. This should be stated more clearly in the Guidelines. There are several instances where the Draft Guidelines state that the Commission “may” take circumstances into account but where the circumstances are necessary to factor in to the analysis.

For instance, at paragraph 66 of the Draft Guidelines, in the context of the assessment of whether a merged firm might have the ability to engage in input foreclosing strategies, the Draft Guidelines state that the Commission “may consider, on the basis of the information, whether there are effective and timely counter-strategies, sustainable over time, that the rival firms would be likely to deploy.” Clearly, these are circumstances the Commission is liable to investigate, since such counter-strategies are capable of rendering ineffective a foreclosure attempt (and therefore remove any incentive that might otherwise exist to engage in such strategies). Moreover, if the greater efficiency of the merged firm induces rivals to also increase their efficiency, this should be actively welcomed as a merger benefit.

- **Pro- et contra analysis.** The case-law of the Community Courts makes it clear that the analysis of non-horizontal mergers must comprise “various chains of cause and effect with a view to ascertaining which of them are the most likely”.¹⁴ Taken as a whole, the Draft Guidelines give indications of factors that the Commission may rely upon in order to establish that a transaction would significantly impede effective competition, but they identify fewer circumstances which support the opposite conclusion.

This is particularly clear in respect of the analysis of incentives to adopt foreclosing conduct. At paragraph 39, the Draft Guidelines set out as a basic tenet that incentives to foreclose depend on the degree to which such conduct would be profitable. While this may be correct in economic theory, it is important in practice to carry the analysis beyond pure “textbook” measures of profitability. In commercial reality there are a number of factors which influence firms’ strategies. It is fair to

¹³ Case C-12/03 P; [2005] ECR I-987, at paragraph 39.

¹⁴ *Ibidem*, at paragraph 43.

assume that the short-term/narrow profitability of certain conduct is a necessary condition, but it is not sufficient evidence of a firm's intentions; this should in our view be reflected in the final version.

There is only one paragraph, paragraph 44, in the Draft Guidelines which addresses factors liable to reduce, or eliminate, incentives to adopt foreclosing conduct. This paragraph only deals with only one such factor, i.e., the possibility that the conduct in question is unlawful.

Moreover, as noted above, the discussion of efficiencies (paragraphs 21 and 27), takes as point of departure that the perspective that anti-competitive effects need merely be "possible", but that pro-competitive effects must be "identified and substantiated by the parties". There is no basis in law for this asymmetric approach.

4 Reduce and clarify the sections on coordinated effects

The Draft Guidelines deal with coordinated effects both in the context of vertical and conglomerate mergers. The amount of attention given to the hypothesis that coordinated effects might arise in non-horizontal mergers is surprising.

Coordinated effects can, in theory, arise also in vertical and conglomerate merger situations, and a few possible examples are given in the Draft Guidelines. The Commission may implicitly be subsuming under this category theories where coordination arises from "multi-market contact" in conglomerate mergers. However, we believe strongly that while it is *conceivable* that coordination could be facilitated through (for instance) greater symmetry being created *across markets* as a result of a conglomerate merger, these theories apply only in very specific circumstances: The conditions under which significant competitive harm could arise are extremely limited. More generally, we would rarely expect to see a case where the evidentiary burden established by the Community courts will be discharged in a theory of harm based on coordinated effects arising from a purely vertical or conglomerate merger. Indeed, a vertical or conglomerate merger may well destabilise, rather than reinforce, any tendency towards coordination among competitors in the market.

We note that the Commission and the Community Courts have considered coordinated effects in the context of several transactions,¹⁵ but, as far as we are aware, not a single one of these has involved a non-horizontal merger situation. Given that there is no enforcement experience in this area, a discussion on coordinated effects would by necessity be confined to instances of possible intervention (or non-intervention) based on hypothetical scenarios. If the Commission intended to include in these Guidelines newer, less established economic theories of harm, then this intention should be clearly stated, and the nature of the concerns be elaborated upon as well as the evidence relevant to these concerns. In either case, we question the value of including the discussion on coordinated effects as it stands in the final *enforcement* Guidelines. It seems to us that the discussion merits significantly less prominence in the Final Guidelines, or, if included, it ought to be more specific, as well as recognise the potentially *destabilising* effect of mergers on competing firms' ability to coordinate.

¹⁵ Most notably, Joined cases C-68/94 and C-30/95 *French Republic and Société commerciale des potasses et de l'azote (SCPA) and Entreprise minière et chimique (EMC) v Commission* [1998] ECR I-1375; Case T-102/96 *Gencor v Commission* [1999] ECR II-753; and Case T-342/99 *Airtours plc v Commission* [2002] ECR II-2585.

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