Conglomerate and vertical mergers in the light of the Tetra Judgement

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Conglomerate and vertical mergers call for particular attention today because of the recent developments with the judgement given by the Court of Justice in the Tetra Laval case. This judgement was rendered following an appeal by the Commission against the decision of the Court of First Instance three years ago. It was considered at the time that there were some important questions of law that had to be clarified by the Highest Court. Most importantly, clarifications were sought as regards the applicable standard of proof in merger control, in particular with respect to conglomerate effects. Clarifications were also sought as to the implications of the CFI’s judgement on the relationship of the ECMR with article 82 and the approach to be taken towards behavioural commitments.

In the first part of this presentation I will develop some reflections on the analytical framework for non-horizontal mergers in view of some of the statements contained in the Court’s judgement. The second part will be dedicated to specific considerations relevant to leveraging theories, i.e. the link with article 82 and the Commission’s assessment of behavioural remedies.

I. Some Considerations relevant to the analytical framework for non-horizontal mergers

A) Standard of proof in merger control

Returning to the recent Tetra judgement, one of the main questions raised by the Commission in its appeal concerned the standard of proof in EU merger control. Essentially, the Commission considered that, as in other EU jurisdictions, the standard of proof for prohibiting but also for allowing mergers should be one of ‘balance of probabilities’. In other words, for reaching a final decision (whether positive or negative), it should be required from the Commission to assess, on the basis of the various elements at its disposal, which effects are the most likely.

This reasoning relies, first, on the fact that the test contained in Article 2 is a symmetric test in which the Commission must adopt reasoned decisions to approve as well as to prohibit mergers. The high standard of proof required from the Commission therefore works in both ways as illustrated, for instance, by the judgement of the CFI in the Seb/Moulinex case, in which the Court had essentially considered that there were indications of a dominant position in some markets where the Commission had reached a different conclusion. Interestingly, one of the most important factors mentioned by the CFI at the time was the ‘product-range effect’ resulting from the operation, that is, one well-known type of conglomerate effect.

Second, the Commission’s position also relied on the consideration that merger control is about conducting a prospective analysis and that it would be unworkable to require an excessively high standard. Merger control (and accordingly consumer protection) would indeed be ineffective if negative decisions were to be taken only if anticompetitive effects are shown ‘beyond any reasonable doubt’.

The recent Tetra judgement positively confirms, in our view, that our standard should indeed be one of ‘balance of probabilities’.

In particular, the Court of Justice explicitly stated that, in a prospective analysis such as the one conducted in merger control, ‘it is necessary to envisage various chains of cause and effect with a view to ascertaining which of them is the most likely’ (1). In other instances, the Court also used similar terminology (2). Let me say that I welcome this development.

B) Standard of proof in conglomerate (and other non-horizontal) mergers

That being said, the question then arises whether, when applied to conglomerate effects — or even more generally to non-horizontal mergers —, the standard of ‘balance of probabilities’ remains in fact much higher than when applied to horizon-

(1) C-12/03 P, judgement of 15 February 2005, Paragraph 43, emphasis added.

(2) Judgement, paragraph 42 ‘the prospective analysis does not entail the examination of past events…but rather a prediction of events which are more or less likely...’
tal mergers. The Court’s judgement entails two important and undisputable consequences for merger control:

1) The Court clearly confirms the Commission’s competence to address conglomerate effects resulting from mergers;

2) More generally, the Court also confirms that the Commission should not only examine ‘direct and immediate’ effects resulting from concentrations but also indirect effects occurring in the foreseeable future (provided that there is — of course — sufficient evidence).

In summary, the Court’s message is that the Commission should not be ‘short-sighted’ in its assessments.

In its judgement, the Court also found that, with respect to ‘conglomerate-type mergers’ in which harm to competition may occur after a ‘lengthy period of time’ and through ‘leveraging’, ‘the chains of cause and effect are dimly discernible, uncertain and difficult to establish’ (1). The quality of evidence is therefore particularly important in order to support the Commission’s conclusion that ‘the economic development envisaged by it would be plausible’ (2). The Court also distinguished the situation in Tetra with the situation examined in the Gencor case — i.e a horizontal merger case in which collective dominance was the concern — by stating that, in the former, the ‘structure of the market would not have been immediately and directly affected by the notified operation’ (3).

Some commentators have considered that, as a result of these statements, it would therefore become very difficult for the Commission to challenge ‘conglomerate-type’ mergers and, more generally, non-horizontal mergers. These comments also suggest a systematic opposition between the analytical frameworks of horizontal and non-horizontal mergers.

Such statements appear to be excessive: they go well beyond the specificities of the Tetra case and ignore that various types of anticompetitive effects can result from conglomerate and vertical mergers.

There are several elements which suggest that a systemic opposition that is sometimes made between horizontal mergers and conglomerate (and more generally non-horizontal) mergers is somewhat ‘over emphatic’. The purpose here is not to deny the specifics of non-horizontal effects, whether they are vertical or conglomerate, but on the contrary to insist on the need to have a practical approach, which takes account of the specificities of each case (whether it is horizontal or not), and to keep in mind the basic principles of merger control.

- **Unilateral / Coordinated effects**

The first element that should be recalled is that the purpose of merger control, in economic terms, is always to assess whether a merger will result in the creation or the enhancement of market power, irrespective of whether it is a horizontal or a non-horizontal merger. Just as in a horizontal merger, a non-horizontal merger can result in an increase in market power either because of a unilateral effect or because of a coordinated effect.

For example, a unilateral effect can occur in a non-horizontal merger when products of rivals would no longer be considered as attractive as they were pre-merger, or when competitors would be prevented from entry, thereby enhancing or creating market power for the benefit of the merged entity. As you know, when assessing horizontal mergers, the Commission’s analysis also aims at identifying the existence of such effects.

Besides, as for non-horizontal mergers, the Commission’s practice and the recent Horizontal Merger Guidelines also show that our assessments of horizontal mergers are more and more refined and based on dynamic and complex assessments, rather than on a mere ‘static approach’ relying on overlaps.

Thus, in that perspective, there is not so much difference in the type of exercise that the Commission pursues as an agency. Whatever the type of merger, the Commission is looking at whether the merger would change the ability and the incentives of the merged entity in a sense that it would end up with significant market power, which would be detrimental to competition i.e. to consumers.

- **In practice, most problematic non-horizontal mergers are ‘multidimensional’**

The second important element to keep in mind is that in practice, the distinction between horizontal and non-horizontal mergers is somewhat artificial because many problematic mergers can have horizontal effects, as well as vertical and conglomerate effects, and each of these effects may have an influence on the other. Therefore, the fact that a merger is mainly perceived as being of a conglomerate nature does not necessarily provide useful information as to the type of anticompetitive effects that it would cause. Such mergers can entail a variety of complex effects and each of them has to be addressed.

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(1) See judgement, paragraph 44.
(2) See judgement, paragraph 44.
(3) See judgement, paragraph 83.
• *Structural / behavioural effects*

Finally, the Tetra judgement has to be read in the very specific context of the operation that was put under the Court's scrutiny. It would be wrong to assume, on the basis of the Tetra judgement, that the distinction between horizontal and non-horizontal mergers is essentially one between structural and behavioural effects. In other words, it is wrong to assume that non-horizontal mergers only produce anticompetitive effects if the merged entity adopts a certain conduct — which may be more difficult to predict —, and that horizontal effects tend to be more 'structural', that is, more immediate and direct.

Such distinction is not verified in practice and the Tetra judgement, when referring to the indirect 'chain of cause and effect', was focusing on the specificities of the case and on the wording of the decision itself, which refers to the conduct that the merged entity would adopt.

For example, in a vertical merger, the Commission may have serious concerns when the operation allows a company to acquire the whole quantities available of its main input, thereby restricting access to this essential source of supply for its potential competitors. In such a case, there is very direct causal link between the operation and its anticompetitive effects.

In the same vein, a recent example of a vertical merger involving energy players shows that the Commission can have equally strong concerns when, thanks to the merger, a dominant supplier upstream would have full access to proprietary information on the costs of its competitors downstream. That is also one example of a concern that may occur in some cases, and it is hard for me to consider that such an anticompetitive effect arises from a specific conduct. This is clearly an immediate and direct effect arising from a non-horizontal merger.

Similarly, there are various types of conglomerate effects that may arise from mergers, and it is clear that some of them may directly affect the market structure.

For example, the Seb/Moulinex case in which the Court of First Instance insisted upon the competitive advantages arising from the capacity to propose a range of products. Such 'portfolio effects' obviously do not fit in the specific type of scenario that was considered in Tetra, involving products that are in fact imperfect substitutes.

There is also take the example of conglomerate mergers involving (as in GE/Honeywell) the sale of complementary goods to a single group of customers, which are clearly different from the type of mergers considered in Tetra.

All these elements show that the Tetra judgement does not lay down the principle that the standard of proof should systematically be higher for conglomerate effects or that non-horizontal effects are systematically 'behavioural' rather than 'structural'. The Tetra judgement rather shows that each case should be examined on its own merits and that the assessment of the consequences of a merger should be made on the basis of solid and cogent evidence.

II. Leveraging and its relationship with Art. 82 and behavioural commitments

A) *The role of Art. 82 in the assessment of leveraging practices*

What is the role of Art. 82, when assessing non-horizontal mergers? If the theory of harm in such a case is based on leveraging a dominant position on one market into another related market, the potentially leveraging undertaking is subject to control under Art. 82 and the relevant practices may qualify as unlawful under this provision. This applies typically to the practices addressed in the Tetra case, namely tying and predatory pricing. At this point it seems important to mention that there are also leveraging practices that may not necessarily be considered as abusive. Mixed bundling is an example here, which by the way was one of the concerns considered by the Commission in the GE/Honeywell case.

As regards practices caught by Art. 82, the CFI in the Tetra judgement took the view that when assessing the incentives to leverage is an important element in the analysis. However, it had a major problem with this far reaching obligation that the CFI was about to impose on the Commission, and this is the reason why it was one of the core elements in its appeal to the ECJ.

As regards practices caught by Art. 82, the CFI in the Tetra judgement took the view that when assessing the incentives to engage in the leveraging practice, 'the Commission must also consider the extent to which those incentives would be reduced or even eliminated owing to the illegality of the conduct, the likelihood of its detection, action taken by the competent authorities both at Community and national level, and the final penalties which could ensue.' (1)

The Commission fully agrees that an assessment of the incentives to leverage is an important element in the analysis. However, it had a major problem with this far reaching obligation that the CFI was about to impose on the Commission, and this is the reason why it was one of the core elements in its appeal to the ECJ.

These concerns were twofold: The first is a systematic one. In our view the very reason for the merger regulation was that an ex-post control under Art. 82 was not considered sufficient for the prevention of such abuses. On the basis of this concept it seems inconsistent to disregard potential leveraging practices merely because of their conflict with Art. 82. And this reasoning applies to abuses resulting from dominance established by the merger, as well as to abuses to gain dominance in a neighbouring market as long as this leveraging is possible and profitable as a result of the merger.

The second concern was a practical one. How can it be reasonably possible for the Commission to assess the likelihood of detection and the potential reaction by probably several competition authorities, and all that in the tight timeframe of a merger investigation? Any such assessment would have been inevitably purely speculative, and thus in conflict with the high standard of proof and evidence set by the CFI itself.

Due to these concerns, we noted with satisfaction that the ECJ shared these concerns and followed the Commission’s arguments in that respect. Some commentators feel that the ECJ judgement remained somewhat unclear in that point. We do not share this view. According to the Court, “it would run counter to the regulation’s purpose of prevention to require the Commission, as was held in […] the judgement under appeal, 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.” (1) In our view this clearly means that an Art. 82 assessment does not have to be integrated into a merger assessment.

To avoid a misunderstanding here: This does not mean that the Commission considers Art. 82 to be a weak or obsolete instrument — on the contrary. Some very recent headline cases reflect its importance, and the reform projects launched recently with regard to Art. 82 show that the Commission considers it as one of its core enforcement instruments.

The view has been expressed that the whole issue about Art. 82 in practice may be of limited relevance, as the parties to the merger could introduce the assurance to respect Art. 82, i.e. not to engage in abusive leveraging, in the form of a commitment that the Commission would have to take into account. This brings us to the next aspect, the role of behavioural remedies in leveraging cases.

B) Behavioural remedies in leveraging cases

The issue of behavioural remedies is not exclusively relevant in non-horizontal cases, it can come up in all types of merger cases. But in scenarios where the theory of harm is based on leveraging behaviour, the question seems obvious to what extent a behavioural remedy is acceptable to eliminate the competition concern. As a starting point, the distinction between structural and behavioural remedies is useful for general presentation purposes, but one has to be careful not to get caught by a too simplistic categorisation. Practitioners know from case experience that the term ‘behavioural remedy’ covers a wide range, and that some commitments in that category can have structural features. Examples include granting access to an essential facility, not using an IPR, or making production capacity in a plant available to third parties. However, these are not the type of remedies that were at stake in the Tetra case. The point at issue there was about a promise not to abuse a dominant position, not to engage in practices forbidden by Art. 82.

- Tetra judgement: No rejection of behavioural remedies without assessment

In its decision, the Commission had rejected such commitments in a rather categorical way. And that’s where the ECJ followed the CFI’s reasoning, and concluded that the Commission could not on mere grounds of principle reject a behavioural remedy of that kind, based on the mere reasoning that a behavioural commitment cannot remedy a structural change brought about by a merger.

But it is also important to stress at this point that there is nothing in the judgment that establishes a presumption to the contrary. The judgement does not suggest that the Commission has to be in principle satisfied with such promises in leveraging scenarios to eliminate competition concerns. Such an approach would be contrary to the Court’s conclusions on Art. 82 mentioned earlier. If the Court concludes that illegality and fines under Art. 82 are not sufficient to reliably stop undertakings from engaging in leveraging practices, why should a mere promise to respect Art. 82 make such a substantial difference? The additional risk of a revocation of the merger clearance decision does not appear to add much.

What the ECJ requires the Commission to do is to undertake a thorough assessment of any remedy proposal, be it structural or behavioural, and to reflect this analysis in the decision. This is in line with the general standard of proof set by the Community Courts, and the Commission will reinforce its efforts to meet this standard also in the remedies field.

(1) Judgement, para. 75.
• **Criteria to assess behavioural remedies**

What does this mean in operational terms? The Commission will submit every remedy proposal regardless of its nature to an assessment of efficiency and effectiveness to eliminate the competition concern. And it may have to market test the remedy proposal, because the market normally knows fairly well what remedy will work in practice, and what not. In the assessment of behavioural remedies, as for any remedy, the Commission will, *inter alia*, take the following considerations into account:

First, assuming the remedy works properly, does it fully address the competition problem in its entirety? It must be sufficiently complete in scope and not leave room for doubt or ‘exceptions’. Second, can non-compliance be detected easily and is the remedy ‘self-policing’ without the need for continued monitoring by the Commission? This is a crucial element with regard to behavioural remedies, which typically translate into many individual commercial interactions on the market that cannot — and indeed should not — be followed by the Commission in detail. And third, assuming non-compliance is detected, would Commission intervention still be timely? If a violation of the commitment can only be detected when it has taken place, this speaks against the suitability of the remedy.

It seems unlikely that mere promises not to abuse a dominant position will, in the future, play an important role as a suitable remedy in leveraging cases. Not because this is a behavioural remedy. But because from the practice one can see that the criteria set out above are difficult to meet by such a commitment proposal. As usual, there must be a case-by-case assessment where all merits of a case are taken into account.

A final remark in this context: without entering into discussions about the comparability of the Tetra case and the scenario assessed in the Gencor/Lonrho case. It seems justified, based on the emphasis put on the distinction between the two cases by the ECJ, to consider that in horizontal scenarios where a dominant position is formed directly by the merger, the principal rejection of a remedy that promises not to abuse as formulated by the Court in Gencor still stands.

### III. Conclusion

The category of ‘non-horizontal mergers’ comprises a wide variety of scenarios, and it raises a variety of interesting and relevant questions that have to be taken into account in their assessment. Does the Commission intend to develop guidance on these scenarios as it did for horizontal mergers? On some of the questions we already have guidance and clarification from the Community Courts, but the Tetra case only addressed one scenario from this wide variety. On some questions such clarification by the Courts is still to come. At that stage the Commission will then have to draw its conclusions as to its future policy in this area and in what way further guidance could be provided for the legal and business communities.