INTERNATIONAL BAR ASSOCIATION
ANTITRUST COMMITTEE

SUBMISSION OF THE
IBA WORKING GROUP ON THE EUROPEAN COMMISSION’S DRAFT GUIDELINES ON
THE ASSESSMENT OF NON-HORIZONTAL MERGERS

I. INTRODUCTION AND EXECUTIVE SUMMARY

1. The Working Group of the Antitrust Committee of the International Bar Association (the "Working Group" or the "IBA")\(^1\) sets out below its submission on the European Commission’s Draft Guidelines on the Assessment of Non-Horizontal Mergers (the “Draft Guidelines”).\(^2\)

2. The IBA is the world’s leading organisation of international legal practitioners, bar associations and law societies. The IBA takes an interest in the development of international law reform and helps to shape the future of the legal profession throughout the world. Bringing together antitrust practitioners and experts among the IBA’s 30,000 individual lawyers from across the world, with a blend of jurisdictional backgrounds and professional experience spanning all continents, the IBA is in a unique position to provide analysis in this area. Further information on the IBA is available at <http://www.ibanet.org>.

3. The IBA greatly appreciates the opportunity to provide comments on the Draft Guidelines and commends the Commission for continuing its now well-established practice of submitting Notices and Guidelines for wide-ranging consultation.

4. The IBA also welcomes the Commission’s efforts in producing guidelines in this area of merger control. The Commission’s motivation in producing the guidelines for the assessment of non-horizontal mergers\(^3\) is to provide “clear and predictable guidance for businesses”.\(^4\)

5. The provision of clear and predictable guidance for businesses (and their legal advisors) is an objective that the IBA endorses wholeheartedly.

6. Given the critical role that guidelines assume in structuring and thus shaping the future assessment of merger cases, the IBA notes that it is of the utmost importance that the Commission’s final non-Horizontal Merger Guidelines do indeed provide clear and predictable guidance, strike the right balance in approaching non-horizontal mergers and send out the correct messages to the business and legal community about the generally benign (and even beneficial) nature of such mergers, the limited likelihood of anti-

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\(^1\) A full list of the Working Group Members is attached in Annex 1. The Working Group was chaired by Janet McDavid and Goetz Drauz.


\(^3\) The term "merger" is used in this context as a proxy for all types of transactions which are usually captured by the notion of a "concentration" within the meaning of the definition contained in Article 3 (1) of Regulation 139/2004 (the "Merger Regulation", or "ECMR").

competitive concerns arising from such mergers and, by consequence, the limited likelihood of regulatory intervention with regard to such mergers.

7. The Working Group believes that the main policy messages that the Commission should clearly send by promulgating any future Guidelines are that:

- Non-horizontal (vertical and conglomerate) mergers have specific characteristics that dictate an approach to their assessment that is different from that applied to horizontal mergers;

- Non-horizontal mergers are far more likely than horizontal mergers to be benign and frequently entail significant efficiencies to the benefit of consumers. Vertical mergers do not entail a direct loss of competition and do not change the level of market concentration. Indeed, they are very likely to be pro-competitive, in particular as they decrease transaction costs, increase the efficiency with which goods are produced or distributed and internalize double mark-ups. Conglomerate mergers, too, do not result in a loss of choice. If they have an impact on the competitive situation at all, they are likely to allow the parties to combine their product offering and to supply customers more efficiently.

- Economic theories for the assessment of non-horizontal mergers are not as well established as the theories applied to horizontal mergers and require a complicated assessment that is very case-specific. Models and theories predicting consumer harm in this field of merger control should therefore be used with caution.

- Collection of reliable evidence is particularly difficult in the case of non-horizontal mergers so that in the majority of cases it will be difficult to establish with sufficient certainty that consumer harm will ensue. The assessment of such mergers should be therefore, subject to high evidentiary standard. Unlike horizontal mergers, where possible anti-competitive effects are more direct and often straightforward to measure, a non-horizontal merger will only produce indirect effects on competition. Any effects on competition will depend on secondary acts of the merging parties and other market players. Potential effects and causal links to the merger may thus be only dimly discernible, uncertain and difficult to establish.

- The above factors should result in an appropriate "light touch" approach by the Commission. Regulatory scrutiny and intervention in non-horizontal mergers ought to be restrained and reserved for those rare circumstances where it is highly likely, on the basis of reliable evidence, that overall anti-competitive harm to consumers will ensue. The Commission should reserve a full scale review only for those exceptional cases.

- A general presumption of efficiency ought to apply to non-horizontal mergers. Moreover, the treatment of efficiencies should be an integral part of the analysis with the burden being on the Commission to show that the overall effects of the merger are anti-competitive because the likely harm outweighs the efficiencies. The parties should not need to verify efficiencies to the same level as in horizontal mergers.

- There should be a rebuttable presumption of compatibility with the common market. The assessment of non-horizontal mergers should start with a presumption that such transactions are pro-competitive and then the Commission should determine whether, based on the specific circumstances, the transaction presents competitive concerns that outweigh the likely benefits.

- A balancing exercise ought to be undertaken which would place more weight to the likely short-term efficiencies rather than the less likely long-term harm. Overall
anticompetitive harm ought to be quantified and shown clearly before a case merits regulatory intervention.

- Over-enforcement should be avoided as it may lead to consumer harm rather than prevent it. The Commission should avoid creating a chilling effect on mergers that will generally entail pro-competitive efficiencies.

- Ex post recourse to competition law, where necessary, (including the deterrent effect of Article 82), and private enforcement ought to be preferred to ex ante intervention other than in exceptional cases. Similarly, behavioural and other suitable remedies which could preserve the efficiency-enhancing effects of the merger ought to be preferred.

- A large number of cases ought to benefit from clear safe harbours dictating that scrutiny will not be necessary unless the merged entity enjoys "significant" market power to the level of dominance or at least a level of 40% or more in at least one of the affected markets.

8. In the view of the Working Group, the Commission has made a laudable effort to acknowledge many of the above points and in particular the generally benign nature of non-horizontal mergers and to put in place an economics-based analytical framework for the assessment of such mergers. In this respect, the members of the Working Group very much welcome the supportive attitude which the Commission displays in its Draft Guidelines with regard to such transactions (for example in paras 11-14 of the Draft Guidelines).

9. However, the Working Group believes that the Commission may have been too timid in putting this key finding at the very centre of its Guidelines. The benefits for consumers which are inherent in non-horizontal mergers, and the fact that competitive harm is difficult to predict and would be likely only in very few circumstances, should be the central element of the analysis.

10. The Working Group believes that the current drafting of the Guidelines may send the wrong message by focusing too much on the potentially negative effects that very few transactions may have in special circumstances. A small and highly case specific number of cases are used to paint a rather gloomy picture which may create the impression that non-horizontal mergers frequently give rise to problems in merger control.

11. In this context, the members of the Working Group would welcome an approach that encapsulates the above key messages more clearly and is built upon the central theme that non-horizontal mergers will be benign or even pro-competitive in the overwhelming majority of cases.

12. The Working Group therefore provides in the present Submission certain suggestions for rebalancing the message of the Guidelines.

13. The Working Group has provided comments on the following areas:

- General Comments on the Overall Approach of the Guidelines
- Safe Harbours
- The treatment of efficiencies
- Foreclosure analysis in vertical mergers
- Foreclosure analysis in conglomerate mergers

14. The Working Group has also provided a summary analysis of the approach to the assessment of non-horizontal mergers in the United States (Annex 2) which the Commission may find of assistance.
15. The Working Group submits the present comments in the hope that they will assist the Commission in producing an improved final version of the Guidelines. The Working Group remains at the Commission’s disposal for further clarifications and assistance in the drafting of the final version of the Guidelines.

II. GENERAL COMMENTS ON THE OVERALL APPROACH OF THE DRAFT GUIDELINES

Usefulness, "user-friendliness", and objectives of the Guidelines

16. The Working Group welcomes the Commission’s efforts to produce guidelines for the assessment of non-horizontal mergers.

17. The economic approach for the assessment of mergers under the Merger Regulation necessitates the promulgation of guidelines in order to give more precise and predictable guidance to businesses and their legal advisors as to how the Commission is likely to analyse a given merger transaction.

18. The Merger Regulation acknowledges the need for guidance in its Recital 28 which emphasises that “[i]n order to clarify and explain the Commission’s appraisal of concentrations under this Regulation, it is appropriate for the Commission to publish guidance which should provide a sound economic framework for the assessment of concentrations with a view to determining whether or not they may be declared compatible with the common market”. Recital 29 to the Merger Regulation also directs the Commission to promulgate guidance explaining how it will treat efficiencies in assessing the compatibility of concentrations with the common market.

19. Indeed, in issuing the Draft Guidelines for consultation, the Commission explained that its motivation in producing guidelines for the assessment of non-horizontal mergers is to provide “clear and predictable guidance for businesses”. ⁵

20. The provision of clear and predictable guidance for businesses (and their legal advisors) is an objective that the IBA applauds. The Working Group believes that the Draft Guidelines play an important role in relation to the substantive assessment as well as the procedural details of dealing with such cases. In respect of the latter, it is suggested that the Guidelines might benefit from a clarification as to the role which the Commission expects third parties to play in the context of the merger review and their relative importance to this process. With regard to the substantive assessment, the IBA notes that, given the critical role that guidelines assume in structuring and thus shaping the future assessment of merger cases, it is of the utmost importance that the Commission’s final non-Horizontal Merger Guidelines do indeed provide clear and predictable guidance and strike the right balance in approaching non-horizontal mergers.

21. In order to increase their “user-friendliness”, the Working Group is of the view that any future Guidelines should not only provide an analytical framework for the economic assessment of mergers under the Merger Regulation but also provide clear guidance to businesses as to when a transaction will be considered unproblematic and setting out the exceptional circumstances absent which further analysis will not be necessary. This can be achieved through the use of safe harbour market share/concentration thresholds (which the Commission has attempted to provide). Further examples of circumstances absent which a transaction will be unlikely to cause any concern could be provided in a more clear way by

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summarising those factors which are now scattered in the sections concerning foreclosure analysis.

22. The Working Group believes furthermore that one of the main tasks of any future Guidelines is not only to provide specific guidance but to signal the overall approach that the Commission is likely to adopt when assessing non-horizontal mergers. In this respect, a firm commitment to recognizing the beneficial effects of non-horizontal mergers and the corresponding need to exercise regulatory restraint when reviewing such transactions could provide helpful reassurances to the legal and business communities.

23. As the Working Group explains in further detail below, although the Draft Guidelines set out a detailed and well drafted analytical framework for the economic analysis of non-horizontal mergers, they do not fully take into account the central economic theme in the context of non-horizontal mergers and instead focus on a technical and detailed discussion of potential competition issues that in reality will be relevant to a limited number cases.

24. The Working Group strongly believes that striking the right balance in the overall approach of any future Guidelines to non-horizontal mergers is of crucial importance. The Guidelines should give the correct impression to the business community as to the general positive effects of non-horizontal mergers and the limited likelihood of a finding of anti-competitive effects arising from such mergers.

25. In the view of the Working Group, non-horizontal mergers have specific characteristics which necessitate a different approach to that used to assess horizontal mergers: (i) non-horizontal mergers are rarely problematic and frequently entail pro-consumer efficiencies, and (ii) economic analysis of non-horizontal mergers is inherently more difficult than the economic assessment of horizontal mergers and intervention requires evidence meeting a particularly high standard.

Greater focus is needed on the main characteristic of non-horizontal mergers: they are rarely problematic and are generally good for consumers

26. The Working Group submits that it is widely acknowledged that non-horizontal mergers are generally not problematic and in principle actually produce pro-competitive effects.6

27. Vertical mergers do not entail a direct loss of competition and do not change the level of market concentration.7 They are very likely to be pro-competitive, in particular as they decrease transaction costs, increase the efficiency with which goods are produced or distributed and internalize double mark-ups. Conglomerate mergers, too, do not result in a loss of choice. If they have an impact on competition at all, they are likely to allow the parties to combine their product offering and to supply customers more efficiently.

28. There is, indeed, a consensus among economists that in principle there are stronger efficiency arguments for non-horizontal mergers than for horizontal mergers. This observation is underscored by the fact that, unlike most horizontal mergers, non-horizontal mergers are often preceded by contractual relationships between the merging parties that “mute” the competitive change following the merger. This means that the non-horizontal merger itself may not, or not predominantly, cause any undesirable effects.8

29. In the view of the Working Group, there is therefore a strong efficiency presumption in favour of non-horizontal mergers and this acknowledgement should be a central theme of any future Guidelines.

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6 This is indeed acknowledged by the Commission in paras 11-14 of the Draft Guidelines.
7 The Commission acknowledges this in para 12 of the Guidelines.
30. The members of the Working Group believe that the starting point for any assessment of non-horizontal mergers must be the fact that these transactions will raise competition issues only in very rare situations and only where they involve parties which already enjoy a significant amount of market power (leading to foreclosure effects) or where they significantly increase the incentives to tacitly collude. It is suggested that the instances in which this is the case, are very few and far between.\(^9\)

31. Any future Guidelines should be based on the Commission’s past experience (i.e., that non-horizontal mergers give rise to serious competitive concerns in very rare occasions) and on the findings of modern economic analysis (i.e., that non-horizontal mergers as a general rule are pro-competitive and efficiency enhancing).

32. The Working Group very much welcomes the supportive attitude which the Commission displays in the introductory remarks of the Draft Guidelines with regard to such transactions.

33. However, in the view of the Working Group, the Commission’s approach is too timid. The Draft Guidelines do not contain a policy statement that offers clear guidance to the parties to potential transactions that non-horizontal mergers are generally benign and will only very rarely merit regulatory intervention.

34. In the present draft of the Guidelines, the Commission does not clearly articulate such a policy statement. Instead, it deals with the central theme of economic analysis – the beneficial effects of non-horizontal transactions – only briefly in the introductory section of the draft Guidelines (at paras 11-14). It then proceeds to deal with efficiencies which can potentially arise from vertical mergers in a total of five (short) paragraphs in the chapter on the assessment of the impact on competition of vertical mergers (paras 52-56) and in the context of conglomerate mergers in a total of four paragraphs (paras 113-116)). The fact that only a total of 11 out of 119 text paragraphs are devoted to the most important economic element associated with non-horizontal mergers portrays a certain imbalance in the Draft Guidelines.

35. The Working Group recommends to the Commission to include a specific sub-section dealing with the benign and pro-competitive nature of such mergers which would set out in more detail the absence of competition concerns that such mergers generally pose (including the theories suggesting that such mergers do not usually lead to a change in incentives leading to anticompetitive foreclosure) and the efficiencies that frequently arise from such mergers.

36. In particular with regard to efficiencies, any future Guidelines could specify more clearly the various efficiencies flowing from vertical and conglomerate mergers and conclude that such efficiencies are present in the overwhelming majority (if not totality) of non-horizontal mergers.

37. The Working Group therefore suggest that this benign, efficiency-enhancing nature of non-horizontal mergers should be the central theme of any future Guidelines.

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\(^9\) Administrative practice would seem to support this point: the Commission cites a total of 20 vertical and conglomerate cases (including GE/Honeywell and Tera Laval/Sidel, the analysis of which on non-horizontal aspects was largely criticised by the CFI), as examples for the points made in the Guidelines. Given well in excess of 4000 cases already dealt with under the ECMR, the small number of cases – including both vertical and conglomerate mergers – shows the relative insignificance of this type of transaction for the merger control process.
Need for specific acknowledgement that analysis of non-horizontal mergers is particularly complicated and requires evidence of a particularly high standard

38. A second feature that differentiates non-horizontal mergers is that economic analysis with regard to such mergers remains a complicated exercise and, as a result, in most situations any anti-competitive effects and causal links of the merger will be difficult to establish with the requisite certainty.

Acknowledgment that economic theories for the assessment of non-horizontal mergers are not entirely reliable and should be treated with caution

39. First, economic theories with regard to non-horizontal mergers are much less established than theories and models applicable to horizontal mergers.

40. The Draft Guidelines are based to a large extent on post-Chicago school theories which suggest that, in certain limited circumstances, non-horizontal mergers can lead to foreclosure or can facilitate collusion. It is widely acknowledged that these theories and the economic models that accompany them are highly stylised, and based on a large number of assumptions. A change in one of the fundamental assumptions underlying those theories and models can lead to very different outcomes. The theories and models are also in some occasions contradictory and are not tested sufficiently with empirical research. In the Working Group’s view they must be used with caution when analysing non-horizontal mergers.

41. The Working Group recommends to the Commission to include a broader survey of the various economic theories and a specific acknowledgement of the difficulties that economic analysis of non-horizontal mergers entails.

42. As currently drafted the Guidelines give the impression that the analysis is straightforward, established and uncontroversial. A more direct acknowledgement of the existence of various theories including theories showing that the overwhelming majority of non-horizontal mergers are benign or pro-competitive would be welcome. Any future Guidelines should also refer to the various problems associated with empirical testing and should acknowledge more clearly that evidence of a high standard will be required before any conclusions can be reached on the basis of those theories and models. In the view of the Working Group these clarifications would not only be very welcome but are actually necessary.

Acknowledgment of the high evidentiary standard required and the likelihood that this will only be met in very few cases

43. Secondly, and similarly, the Working Group recommends that the Commission should specifically acknowledge the evidentiary difficulties associated with an analysis on the basis of non-horizontal theories of harm and, therefore, the particular importance of high evidentiary standards in the assessment of non-horizontal mergers.

44. Since non-horizontal mergers are generally benign and frequently entail pro-competitive efficiencies, any finding of competitive concerns requires evidence of a sufficiently high quality to support a specific prognosis of facts that – due to their remoteness – are by definition likely to be "dimly discernible, uncertain and difficult to establish".10

45. The Community Courts have pointed out (in General Electric11 and Tetra Laval12) how difficult it is to properly capture the factual elements required to fully assess a non-

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10 Case C - 12/03P, Tetra Laval v Commission (hereinafter "Tetra Laval (ECJ)").
11 Case T - 210/01, General Electric v Commission ("General Electric" or "GE").
12 Case T - 5/02, Tetra Laval BV v Commission (hereinafter "Tetra Laval").
horizontal merger. The reason for this lies in the fact that the potential anti-competitive effects of the merger (in particular the ultimate effects on consumers) are not a direct and immediate consequence of the transaction.

46. In a horizontal merger, the transaction produces at least some immediately discernible effects: where two undertakings competed as suppliers or customers against each other pre-merger, only one undertaking remains post merger. This direct loss of competition is the starting point for the competitive analysis. It does not require further action by the undertakings concerned (other than the closing of the notified transaction).

47. In a non-horizontal merger, generally the transaction itself does not directly and immediately lead to any potentially anti-competitive effects to consumers. In some (but by no means all) cases, it may merely create the opportunity to take action that might lead to anti-competitive effects (e.g. deciding not to supply competitors with an important input material or to offer certain products as a bundle). Whether or not such actions are taken depends on future decisions of the merging parties and the behaviour of other market participants. Whether any effects will further be felt by consumers depends on various other scenarios in particular the likelihood and level of foreclosure that may result. Such effects may occur only, if at all, many years after the merger takes place.

48. In other words, uncertainty with regards to the effects on competition is the rule in the assessment of non-horizontal mergers.

49. This has an effect on the evidentiary requirements that may justify regulatory intervention. As the Court held in Tetra Laval, the evidence relied on must be "factually accurate, reliable and consistent" and it must contain "all the information which must be taken into account in order to assess a complex situation" and must be "capable of substantiating the conclusions drawn from it". In the view of the Court, such a detailed review is "all the more necessary in the case of a prospective analysis required when examining a planned merger with conglomerate effect." Indeed, relying on the Court's judgment in Tetra Laval, the CFL in General Electric, clearly highlighted the problems associated with meeting the requisite evidentiary standard in non-horizontal merger cases.

"Conglomerate-type concentrations give rise to certain specific problems, in particular inasmuch as, first, the assessment of such a transaction may involve a prospective analysis covering a period of time stretching well into the future and, second, the specific conduct of the merged entity may determine to a great extent what effects the concentration has. Thus, the chains of cause and effect following a merger may be dimly discernible, uncertain and difficult to establish. That being so, the quality of the evidence produced by the Commission in order to form a sound basis for a decision declaring a concentration incompatible with the common market is particularly important, since that evidence must support the Commission's conclusion that, if such a decision were not adopted, the economic changes envisaged by it would be plausible."  

50. In non-horizontal mergers, the level of uncertainty therefore places particular evidentiary requirements on the Commission. The Court made this abundantly clear when it required the authority to produce clear evidence on which to base its prognosis. Overall, a number of factors raise the evidentiary bar for the Commission to intervene in non-horizontal mergers. These include but are not limited to (i) the nature of potential concerns, in particular their dependency on a set of future actions by the merged entity that are distinct from the merger itself, (ii) the fact that any problematic actions and effects will occur well

13 See Tetra Laval, ECI, paras 39 and 44.
14 General Electric, para 66.
into the future, (iii) the fact that they are interdependent on (re)actions of other market participants and (iv) that they may be substantially influenced by competition law induced restraints on certain types of behaviour.

51. In relation to the last item, non-horizontal mergers impose an additional evidentiary requirement which is that the likelihood of the conduct alleged actually occurring must be analysed by taking into account not only the incentives but also the disincentives that may exist for adopting such conduct. Apart from purely economic considerations, disincentives, importantly, include the deterrent effect of the ex-post application of Article 82 as required by the CFI’s jurisprudence in Tetra Laval and GE.

52. As the CFI explained in General Electric:

"[W]here the Commission, without undertaking a specific and detailed investigation into the matter, can identify the unlawful nature of the conduct in question, in the light of Article 82 EC or of other provisions of Community law which it is competent to enforce, it is its responsibility to make a finding to that effect and take account of it in its assessment of the likelihood that the merged entity will engage in such conduct."  

53. In this respect, the Working Group recommends that the Commission should specifically refer, at paragraph 44 of the Draft Guidelines, that it will take account of the deterrent effect of ex-post application of Article 82 EC within the framework of its ex ante assessment of non-horizontal mergers involving foreclosure through strategic conduct.

54. In this respect, the Working Group notes that the final version of the Guidelines will need to ensure an integrated approach with the final outcome of the Commission’s current review under Article 82 EC. It is essential that the Commission follows a consistent approach in ex ante assessment of non-horizontal issues under merger control laws and ex post control in cases of similar nature, i.e., where competitive harm results from strategic conduct.

55. Finally, the Working Group would welcome an acknowledgement that before regulatory intervention is warranted the Commission would need to prove, at the high standard outlined above, that the merger would indeed lead to specific and significant harm at the level required under the Merger Regulation to justify regulatory intervention.

56. The Working Group believes that the level of harm required to justify regulatory intervention under the new substantive test of the Merger Regulation ("significant impediment to effective competition" or "SIEC") should be sufficiently high and equivalent to the level of harm that would ensue from the creation or strengthening of a dominant position. 16 The Working Group believes that the Commission should take the opportunity of the promulgation of the Guidelines to reassure the business and legal community that the introduction of the Commission’s more economic approach under the new test will result in less not more regulatory intervention with regard to non-horizontal mergers.

The generally benign nature of non-horizontal mergers and the difficulties in predicting anti-competitive effects should lead to a "light touch" regulatory approach in the Guidelines

57. The two main characteristics of non-horizontal mergers as outlined above can be summarised as follows:

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15 General Electric, para 74.
16 In this respect the Working Group notes that Recital 26 to the Merger Regulation explains that the introduction of the new test should maintain "consistency with the standards of competitive harm which have been applied by the Commission and the Community courts regarding the compatibility of a concentration with the common market".
• Non-horizontal mergers generally do not create competition concerns and are frequently pro-competitive as they do not entail any direct loss of competition and bring about substantial efficiencies to the benefit of consumers.

• Economic analysis of non-horizontal mergers is complex and uncertain and requires evidence meeting a particularly high standard. In the majority of situations, the analysis is not likely to lead to robust predictions of the anti-competitive effects of a merger.

58. These two fundamental features of non-horizontal mergers (their benign and frequently pro-competitive nature and the fact that prediction of any anti-competitive effects is uncertain) lead to an important conclusion which permeates the approach of regulatory authorities in many countries including notably in the United States: regulatory intervention on non-horizontal mergers should be restrained and reserved for the rare and exceptional occasions where clear anti-competitive effects can be identified on the basis of a high standard of evidence.

59. If the Commission’s aim is to clearly define a general policy in a very public way, the most pertinent point is that there will hardly ever be any issues at all.

60. The generally pro-competitive nature of non-horizontal mergers should result in a "light touch" from the regulator – both in terms of substance and procedure. Any future Guidelines should acknowledge and reflect this general approach.

An appropriate "light-touch" regulatory approach should include a general presumption that non-horizontal mergers are benign and pro-competitive and a more lenient treatment of efficiencies

61. The members of the Working Group suggest that, given the generally benign or even beneficial nature of vertical and conglomerate mergers, the order of assessment should be reversed and indeed the substance of the analysis rebalanced.

62. Indeed, we believe that the assessment of non-horizontal transactions should start with the presumption that such transactions are generally pro-competitive and efficiency enhancing. It should then be for the Commission to assess whether, because of the very specific circumstances of a particular case, the transaction raises competitive concerns and whether these concerns outweigh the beneficial effects associated with the merger.

63. Using a (rebuttable) presumption of compatibility with the common market and a reversed order of assessment would reflect the lack of competitive issues that economic theory generally accords to non-horizontal mergers. The presumption could be based on the general findings of economic theory as well as the experience of the Commission gained in its administrative practice, which provide the necessary basis for a general finding that non-horizontal mergers are as a rule pro-competitive and in the absence of indications to the contrary more likely than not to increase consumer welfare.

64. While such a presumption may not have the legally binding force of a presumption based on a legislative act, it would carry the weight of established economic theory as well as the Commission’s own experience from a large number of previous cases. It would also benefit from the fact that the CFI itself has acknowledged that as a general rule, such concentrations do not produce anti-competitive effects.\(^\text{17}\)

65. To be clear: this would not preclude the Commission from taking a decision in each particular case.\(^\text{18}\) It would rather allow the Commission to base its decision on the factual

\(^\text{17}\) Tetra Laval, at para 142, and General Electric, at para 65.

\(^\text{18}\) As required by the CFI for example in Tetra Laval, at para. 120.
experience as well as theoretic foundation provided by previous administrative practice and economic theory. These elements would provide prima facie evidence of the compatibility of a transaction with the common market, which – although they can be disproved – would form a sound basis for the purposes of reaching a decision on the merits of the case. Such an approach would have the benefit of clearly spelling out the Commission’s policy in relation to non-horizontal mergers in line with established economic theories.  

66. More generally, an appropriate light-touch approach should accord a more lenient treatment of efficiencies with regard to non-horizontal mergers than that accorded to horizontal mergers. In this respect, the Working Group has provided specific comments relating to the treatment of efficiencies in section IV below.

An appropriate "light-touch" regulatory approach should reserve a full scale analysis only for exceptional circumstances

67. In the light of the fact that non-horizontal mergers are generally benign and that their economic assessment is complex and uncertain, the Working Group suggests that the Commission should not spend significant resources in assessing non-horizontal mergers in detail.

68. First, an appropriate "light-touch" regulatory approach should allow for a generous safe harbour thus excluding the majority of non-horizontal mergers from regulatory scrutiny. The Working Group believes that the thresholds suggested in the Draft Guidelines are far too conservative and suggests a higher threshold requiring significant market power to the level of dominance below which regulatory scrutiny will be unnecessary (please see section III on Safe Harbour below for detailed comments in this respect).

69. A light-touch regulatory approach based on a general presumption in favour of non-horizontal mergers would, as outlined above, allow the Commission to focus its limited resources on dealing with the cases that really do raise issues and to investigate the factual circumstances of such cases thoroughly as required by the Community Courts.

70. The Working Group believes that, as the Commission itself will no doubt be aware, such a full analysis is a complicated task that imposes burdens on both the parties and the Commission. In the view of the Working Group therefore such a full-scale analysis should only be reserved for exceptional situations rather than applied in every non-horizontal scenario above the safe harbour thresholds. We suggest that this framework should be reversed.

71. The Working Group suggests that the Commission should therefore acknowledge that there are cases – and in non-horizontal mergers, these will be the vast majority of the cases – where the overall economic analysis is straightforward and can rely on what would be considered prima facie evidence of the pro-competitive nature of a transaction. In straightforward matters, it would be neither necessary nor appropriate to spend the resources required for a full-scale analysis.

72. The Working Group submits that that where a case does not display any special elements that might indicate the potential existence of competitive concerns (and which the Commission would have to investigate thoroughly), a decision could make full use of the weight of the general economic analysis available on the topic of non-horizontal mergers to

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19 This approach would complement any safe harbours that the Commission establishes (as it has attempted to do in at paras 25-26 of the Draft Guidelines).

20 A rebuttable presumption of the efficiency-enhancing, pro-competitive nature of non-horizontal mergers would also alleviate the need to put an excessive burden on the merging parties, namely the burden of providing full proof of any efficiencies which the transaction may give rise to (see section IV below on more detailed comments with regard to the treatment of efficiencies).
conclude that the transaction is not likely to pose any competitive concerns. Any future Guidelines should therefore contain more elements supporting the view that such mergers will pose concerns in very rare and exceptional situations.

73. The Working Group recommends that the Commission should give further guidance on the circumstances which need to be present before the Commission embark on a full-scale analysis using the analytical framework of the Guidelines. The Working Group would also welcome a clear acknowledgement that a full-scale analysis would only be necessary in rare circumstances and that, in most situations, non-horizontal mergers could benefit from the safe harbour or the absence of specific circumstances that would lead to more intense scrutiny.

An appropriate "light-touch" regulation should avoid over-enforcement and should reserve ex-ante intervention for exceptional cases and should make greater use of the prospect of ex post intervention

74. The members of the Working Group believe that an appropriate light-touch regulatory approach which reflects the generally accepted theories on non-horizontal mergers should result in restrained ex-ante enforcement.

75. It is important to acknowledge clearly that a necessary balancing between the likely short-term efficiencies and any less likely anti-competitive effects will tilt the balance towards a conclusion that the merger overall is not expected to lead to anti-competitive effects with sufficient certainty to trigger ex-ante regulatory intervention. In such situations, where there is a possible fear of long-term anti-competitive effects, ex-post intervention may be a more appropriate solution. The longer into the future the anti-competitive effects are expected to occur (such as in particular in situations of customer-foreclosure and conglomerate mergers), the more the balance should tilt towards the efficiency enhancing nature of such mergers and hence to lighter ex-ante regulatory intervention and in favour of ex-post intervention where necessary.

76. Indeed, given the generally benign nature of non-horizontal mergers, a light-touch regulatory approach would consist of placing greater weight on the likelihood that such mergers will not result in consumer ailt, if and when it arises, under the ex post instruments of competition law. Under Eham and that any possible anti-competitive action by the merged entity could be a European competition law, conduct that constitutes an abuse of a dominant position is prohibited and may be subject to a fine. The application of merger control rules should take the corrective effect of Articles 81 and 82 EC into account when deciding upon the intensity of interference in the context of preventive measures under the Merger Regulation. Especially given the difficulty of accurately predicting whether a transaction will have anti-competitive effects, a light touch should govern regulatory endeavours in this field.

77. In this context, the developing private enforcement which is high on the Commission's agenda might benefit from a more prominent treatment in any future Guidelines. In fact, the issues raised by the Commission in the Draft Guidelines - in particular in relation to foreclosure, bundling and tying issues - would seem to be ideally suited for private enforcement. The members of the Working Group believe that more weight should be given to this element when assessing whether to take regulatory action at the stage of merger control.

78. In any event, the Working Group also suggests that it would be important that, in relation to conduct legal under Article 82 EC or "grey zone" practices for which it is unclear whether these amount to unlawful abuses, the Commission spell out that behavioural commitments are, in principle, acceptable, in line with the Court's ruling in Tetra Laval.
III. SAFE HARBOUR

79. The Working Group welcomes the Commission’s efforts to provide a safe harbour threshold for non-horizontal mergers. However, we believe that the usefulness of any future Guidelines will be greatly enhanced if the Commission provides clear indicative thresholds at appropriate levels providing safe harbours for certain categories of non-horizontal mergers.

80. The Working Group strongly believes that the safe harbour suggested by the Commission in the Draft Guidelines is unnecessarily narrow.

81. The particular market share and concentration thresholds established by the Guidelines as unlikely to create concern for the Commission are:
   - a post-merger market share less than 30%; and
   - a post-merger Herfindahl-Hirschman Index (the HHI) less than 2000.

82. These specific thresholds are based on the general premise 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” (para 23 of the Draft Guidelines). The Draft Guidelines also specify that market power in at least one of the markets concerned is a necessary condition for competitive harm (but not a sufficient condition) (para 26 of the Draft Guidelines).

83. In the view of the Working Group, the Commission should clearly set out that unless the merged entity enjoys “significant” market power, a non-horizontal merger will not pose any competition concerns and the Commission will be unlikely to investigate it. In addition, the Commission could specify that usually “significant” market power at the level of monopoly power or dominance will be required for a non-horizontal merger to pose competitive concerns. Indeed, most of the economic models that can be applied to assess the effects of non-horizontal mergers require the existence of significant levels of market power or even monopoly power.

84. The Commission has chosen the 30% to a great extent in order to align its policy with the approach it has adopted in the Article 81 Vertical Guidelines.\(^{21}\) However, given the efficiency-enhancing nature of non-horizontal mergers and the general presumption of efficiency in favour of mergers rather than agreements between undertakings that remain independent, alignment with the approach in the Article 81 Vertical Guidelines seems unnecessarily strict.

85. The 30% threshold also appears unreasonably low when seen in the context of the thresholds applied by the Commission with regard to horizontal mergers, the thresholds applied in the Merger Regulation itself, and the thresholds specified in the Form CO for affected markets. Thus, the 30% threshold is only 5% higher than the threshold specified in Recital 32 to the Merger Regulation itself as a (legal) presumption for absence of competition concerns in all kinds of mergers. The 30% threshold is also only 5% higher than the threshold specified in Form CO as indicating an absence of affected vertical or conglomerate markets and leading, if all the other conditions are met, to the application of a simplified procedure. It is interesting to note that as regards horizontal mergers, the relevant threshold in the Form CO is 15% to indicate an absence of affected markets and this threshold rises by 10 percentage points to 25% in the Horizontal Guidelines (and the Merger Regulation itself) as a safe harbour threshold. By contrast, the difference between

\(^{21}\) See footnote 18 of the Draft Guidelines.
the Form CO “no affected markets” threshold for non-horizontal mergers and the safe harbour threshold in the Draft Guidelines is only 5 percentage points.

86. As noted earlier, it is generally accepted that vertical and conglomerate mergers are less likely to raise competition concerns than horizontal mergers. Efficiencies are very likely to result from non-horizontal mergers and enforcement agencies need to exercise caution to avoid preventing efficiency enhancing mergers that pose little risk to competition in the markets concerned.

87. Given the generally benign and pro-competitive nature of non-horizontal mergers, the Working Group would recommend a much more lenient approach and thus a correspondingly larger safe harbour threshold for non-horizontal mergers. The Working Group is indeed of the view that competition concerns in non-horizontal mergers are only likely to arise at market share levels far greater than those that may give rise to concerns in respect of horizontal mergers and generally at levels of significant market power and more likely at the level of dominance.

88. In these circumstances the safe harbour thresholds should not be set conservatively low. In this light, the Commission’s choice of a 30% threshold seems unnecessarily low. Therefore, the Working Group recommends that the Commission should, as a minimum, create a clear safe harbour of 40% below which there is a presumption that a non-horizontal merger will not raise concerns. This would be more in line with the general requirement of significant market power outlined above. It would also send the right signals to the business community that the Commission regards non-horizontal mergers as posing concern only in rare situations.

89. The Working Group also recommends that, if the Commission is concerned that a higher threshold would not be suitable in situations of possible coordinated effects, then it should de-couple the safe harbour thresholds applicable in foreclosure situations (where a higher threshold should be necessary) and coordinated effects situations. In addition, the Working Group would welcome clarification as to the markets where the safe harbour would apply (i.e., the upstream or downstream market, the tying or tied market, etc.). In this respect, the Working Group believes that significant levels of market share are needed in both markets affected.22

Special circumstance exceptions

90. The special circumstances exception in the Draft Guidelines appears designed to highlight situations that could result in competition concerns that may not be obvious from an initial screen of market share and concentration statistics. The Working Group agrees that these factors could give rise to competition concerns in certain circumstances but is of the view that those circumstances are unlikely to occur where the merger is occurring in an unconcentrated or only moderately concentrated market and the market share thresholds are not breached.

91. The overall purpose of safe harbour provisions is to assist in providing clear legal guidelines for businesses and practitioners as to the circumstances in which a merger is unlikely to raise competition concerns. In light of this, the Working Group thinks that the special circumstances exception outlined in part III of the Draft Guidelines should qualify

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22 It is indeed hard to see what type of negative vertical effects there could be for example in a customer foreclosure type situation if the upstream market share were above the suggested threshold (e.g. 35%) but the downstream market share is significantly below the suggested threshold (e.g. 5%). Foreclosure in a situation should generally not be possible since the new entity must continue selling the upstream product also to the downstream competitors, the upstream competitors do not lose a significant source of demand, and the more beneficial terms given to the new entity’s downstream operator will be forwarded to customers because of the small market power on that market.
the safe harbours only to the extent absolutely necessary because the exception may negate the usefulness of the safe harbour provisions.

IV. THE TREATMENT OF EFFICIENCIES

The Guidelines could focus more on the significant efficiencies flowing from non-horizontal mergers

92. As noted earlier, by way of general comments on the overall approach adopted in the Draft Guidelines, a central feature of non-horizontal mergers is that not only do they not lead to any direct loss of competition but frequently enhance consumer benefits by producing significant efficiencies. Indeed, a large number (if not the majority) of non-horizontal mergers are in reality pro-competitive.

93. This premise is particularly important for the assessment of the pro-competitive, efficiency-enhancing effects of non-horizontal mergers.

94. The Working Group greatly welcomes the Commission’s statements that vertical and conglomerate mergers provide substantial scope for efficiencies. However, the Working Groups suggests that a more fulsome discussion of the types of efficiencies that the Commission will recognize in the context of vertical and conglomerate mergers, as well as the extent to which evidence bearing on efficiencies will be quantified and substantiated would provide greater clarity to firms (and also to other competition authorities that are likely to rely on guidelines in their enforcement activities).

95. For instance, in a recent note to delegates to a 21-23 February 2007 Roundtable of the OECD Competition Committee on Vertical Mergers, Frederic Jenny, stated that “Vertical mergers can give rise to numerous types of efficiencies. Some arise, for example, because of enhanced coordination and production efficiencies; internalization of non-price externalities and alignment of incentives; or transaction cost savings. Another potential efficiency benefit from a vertical merger is the elimination of double marginalization. If there is market power upstream and downstream, as well as linear pricing, then the downstream firm will sell at a price above its marginal cost. Its marginal cost, however, reflects a mark up paid on the input supplied by the upstream firm. Consequently, when either raises their price they do not realize that this reduces the volume and hence profits of the other. If the two firms were integrated however, they would recognize this effect and hence set a lower price for consumers.”

96. Types of efficiencies that may be generated by a vertical or conglomerate merger are also discussed in the Church Report, and in the RBB Report prepared for DG Enterprise.23

97. We suggest that paragraphs 21 and 27 of the Draft Guidelines should be revised to state more clearly that vertical mergers will be addressed from the presumption that they will generate efficiencies (which seems to be the intent of paragraph 50). Moreover, the Commission should recognize that efficiencies can overcome adverse effects and lead to an overall pro-competitive and pro-consumer outcome. In other words, the analysis of efficiencies should be part of the analysis of whether anticompetitive effects will result from a vertical merger. This approach will minimize the risk of impeding an efficient allocation of resources. The U.S. has also recently argued that “vertical mergers merit a stronger presumption of being efficient than do horizontal mergers, and should be allowed

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to proceed except in those few cases where convincing, fact-based evidence relating to the specific circumstances of the vertical merger indicates likely competitive harm."^{24}

More relaxed treatment in assessing efficiencies in non-horizontal mergers

98. We also recommend that the Commission consider requiring less stringent proof when assessing efficiencies in the context of non-horizontal mergers than required for horizontal mergers.

99. Specifically, paragraph 51 of the Draft Guidelines provides that for the Commission to take into account efficiency claims, they must benefit consumers, be merger specific and be verifiable. However, some of the efficiencies generated by a vertical merger may not be easily verifiable (e.g., quality assurance, reduced transaction costs, mitigating a hold-up problem or dynamic efficiencies). For the reasons discussed above, namely the potential pro-competitive benefits of a non-horizontal merger, a more relaxed approach should be taken to the verification burden and this should be reflected in the text also as a matter of principle, i.e., with an express reference of a more lenient sliding scale analysis.

100. In the light of this, the Working Group suggests that the Commission might wish to further clarify how it will weigh efficiencies against competitive effects, including which efficiencies will be recognized, what criteria will be applied for determining the plausibility of the estimated efficiencies or their claimed magnitude, as well as how the Commission will assess the magnitude of the projected anticompetitive effects from input foreclosure. Para 50 of the Draft Guidelines could benefit from an example illustrating how a vertical merger with the potential for anticompetitive effects can be offset by the inherent efficiency of mitigating double marginalization. For example, a scenario where a vertical merger generates costs savings for the integrated firm in relation to the sale of inputs to the downstream division and improves the firm’s productivity, thus enabling it to reduce prices to consumers. While third parties would not benefit from this reduced price and arguably there could be a foreclosure concern, the downstream price to third parties is the same with or without the merger. Accordingly, given the efficiencies to the integrated firm, absent other concerns such as high barriers to entry, such a case should not raise competition issues.

The Guidelines should clearly articulate that the Commission does not apply an efficiency offence

101. The final version of the Guidelines should clearly and definitively indicate that, when dealing with non-horizontal mergers, the Commission will not apply a so-called “efficiency offence”, i.e., using efficiencies to argue that the merger will give the parties an opportunity to indulge in anticompetitive practices.\footnote{Note submitted by the delegation of the United States to the OECD Competition Committee. DAF/COMP/WD(2007)38.}

102. In particular, the final version of the Guidelines should clearly state that efficiencies, such as the elimination of double marginalization or Cournot effects, will \textit{not} be viewed as being the cause of competitive harm, unless a number of stringent conditions are fulfilled. If the Commission wishes to allege such competitive harm, it ought to be able to demonstrate that harm will actually ensue to consumers because rivals are not only forced, as a result of the merged entity’s efficiencies, to exit the market, but are also unable to implement strategies

\footnote{In this respect, we suggest that the Draft Guidelines should confirm the position of former Commissioner of Competition Mario Monti regarding this issue who stated "I would like to refute the assertion that the European Commission, when dealing with conglomerate mergers, is in fact applying what he has dubbed an 'efficiency offence' (see Antitrust in US and Europe, General Counsel Roundtable, American Bar Association, 14 November 2001).}
to achieve similar efficiencies, and are unable to re-enter the market if some of them have been forced to exit the market.

103. In addition, a balancing should be made between the efficiencies that are likely to materialise in the short term and the potential anticompetitive effects that are uncertain and could, if at all, only materialise in the long term. It is only in very exceptional circumstances that this balancing exercise would indicate the existence of overall anticompetitive effects. The final version of the Guidelines could greatly benefit from such a clear acknowledgement.\textsuperscript{26}

104. In the absence of such statements, there is a significant risk that companies might be deterred from pursuing non-horizontal mergers that generate efficiencies, and consumers will be at risk of being denied the benefits of such pro-competitive mergers. For instance, if it were sufficient to show that efficiencies would ‘marginalize’ or ‘disadvantage’ rivals (as opposed to forcing rivals to exit the market place) to justify a finding of competitive harm, merger control would deny final consumers the immediate beneficial effects of reduced prices that are often inherent to non-horizontal mergers (efficiencies put greater pressure on rivals to reduce their prices), only to prevent the occurrence of effects that are difficult to establish and quantify on an objective basis, namely the fact that rivals of the merged entity would be ‘disadvantaged’ or ‘marginalized’.

**Efficiencies and coordinated effects**

105. The Working Group also suggests that the Commission could clarify the relevance of efficiencies in an analysis of possible coordinated effects. From the current version of the Draft Guidelines it appears that efficiencies may be taken into account only in relation to the possible non-coordinated effects of vertical or conglomerate mergers, whilst no reference to efficiency considerations is made in relation to coordinated aspects. The Working Group would recommend that this be revised to bring it into line with the Commission’s Horizontal Merger Guidelines.\textsuperscript{27}

**Efficiencies and remedies**

106. If the analytical conclusion is that a vertical or conglomerate merger would significantly impede effective competition, it is important that the Commission be willing to accept a remedy which preserves, to the greatest extent possible, the anticipated merger efficiencies. The Working Group believes that one possible option in lieu of a divestiture remedy is to accept commitments that would, if the merger should give rise to anticompetitive effects, seek a remedy under the abuse of dominance provisions.

**Efficiencies and the allocation of the burden of proof in the context of non-horizontal mergers**

107. The Working Group has already outlined above in its general observations that there is a strong efficiency presumption underlying non-horizontal mergers. By contrast to horizontal mergers, non-horizontal mergers do not eliminate the competitive constraint imposed by other players in the market. Instead, in the case of conglomerate mergers, they involve the combination of complementary or independent products and are generally presumed to enhance efficiency (or at the very least to be neutral).

\textsuperscript{26} Similarly, we suggest that the Draft Guidelines should acknowledge the fact that efficiencies can either enhance the ability and incentive of the merged entity to act pro-competitively. Given that foreclosure issues arise only if the merged entity would have both the ability and the incentive to foreclose, it should be sufficient, in order to remove competition concerns, to demonstrate that efficiencies will remove either one of these conditions (i.e., to show that the efficiencies enhance either the ability or the incentive to compete).

\textsuperscript{27} See para 82 of the Horizontal Merger Guidelines.
The Commission’s Draft Guidelines acknowledge the possibility that non-horizontal mergers may entail efficiencies and benefit consumers in the short and long term. However, as noted in the general observations above, the Draft Guidelines are characterised by a certain imbalance in that they concentrate primarily on the negative effects that such mergers may exceptionally bring about. This is not remarkable in itself, as one of the objectives of the Draft Guidelines is to indicate those circumstances where further analysis of the merger is warranted.  

Notwithstanding the presumption, supported by the economic literature, that most non-horizontal mergers are efficiency enhancing, in the view of the Working Group, the Draft Guidelines impose unduly stringent requirements on the merging parties to establish and substantiate efficiencies.

The language used in para 21 of the Draft Guidelines enshrines this overly stringent approach: “... the Commission will consider both the possible anti-competitive effects arising from the merger and the pro-competitive effects stemming from the efficiencies identified and substantiated by the parties” (emphasis added). It is reinforced by the statement in para 51 that: “... for the Commission to take account of efficiency claims in its assessment of the merger, the efficiencies have to benefit consumers, be merger-specific and be verifiable. These conditions are cumulative.”

In our view, these requirements are at odds with accepted economic theory and with the general remarks made by the Commission in the introductory paragraphs of the text. Moreover, they go well beyond what in many cases might be sufficient for the parties themselves embarking on the merger in the first place.

The Working Group therefore submits that the obligation on the parties to identify and substantiate efficiencies in the case of a non-horizontal merger should not be the same as that for a horizontal merger (and should in any event be triggered only in exceptional cases). This is particularly important in non-horizontal mergers as in most circumstances the efficiencies will be more certain to occur and benefit consumers in a relatively short period whereas the anti-competitive effects of the merger, if any, will be uncertain to occur and may do so only in the long term.

There is a second, and arguably more important, reason why the treatment of efficiencies in non-horizontal mergers should be fundamentally different from that in horizontal mergers. It is that potentially anti-competitive effects of a non-horizontal merger will frequently have the same source as the pro-competitive benefits of the merger. More specifically, the elimination of cost inefficiencies may, while lowering the marginal costs of the merging parties, create the very mechanism of anticompetitive foreclosure.

The sequential analysis - whereby the Commission identifies possible anti-competitive effects (at what appears to be a relatively low standard of proof) and the parties then have to identify and substantiate efficiencies (at what appear to be a higher standard) - advocated by the Commission in the draft Guidelines should, it is submitted, be abandoned.

As the authors of the RBB report (2005) remark, a two step approach to assessing efficiencies may be appropriate where the anti-competitive effects of a merger can be assessed separately from its positive effects (as in a horizontal merger), but a unitary analysis is more appropriate where a merger’s anti-competitive effects have the same source as its pro-competitive benefits. Thus, when examining a merger involving

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28 See also the Church Report, above, at p.iii.
29 See also the Church Report, above, at p. 304-305.
30 RBB Report, see above footnote 23.
31 See also EAGCP report, recommendation 7 and RBB report, page 121.
complementary products and significant market power, in circumstances where the ability of competitors and customers to counter the effects of the merger or to engage in a counter strategy are limited, it will be incumbent on the Commission to construct its theory of competitive harm in the light of the consumer benefits brought about by the merger. Accordingly, the Working Group would advocate the adoption of a unitary approach to the substantive assessment of non-horizontal mergers, as it is the only approach that is consistent with the economic consensus.

116. Finally, in the view of the Working Group, although there are arguments that militate in favour of a simple rule that requires the Commission to demonstrate that the merger decreases consumer welfare over time before it may prohibit that merger, we acknowledge that (to the extent that it exists) the evidence required to evaluate the overall effects of the merger will be in the possession of the parties. Accordingly, the Working Group believes that it would be entirely reasonable to expect the notifying parties to submit data supporting their decision to embark on the merger at the time of notification. Evidence of the type described at para 88 of Horizontal Merger Guidelines would be relevant and should be sufficient at this initial stage.32

V. THE THEORY OF FORECLOSURE IN VERTICAL MERGERS

General observations

117. The Working Group greatly welcomes the promulgation of an analytical framework for the assessment of foreclosure theory in vertical mergers.

118. The analytical framework directs the Commission to assess (i) the ability and (ii) the incentive to foreclose rivals and (iii) the overall impact on effective competition. The Working Group commends the Commission for producing a well-drafted analytical framework that will provide a useful conceptual basis for the analysis of non-horizontal mergers.

119. Nonetheless, the Working Group has certain reservations as to the presentation of this framework in the Draft Guidelines which appear to focus on the anti-competitive effects of foreclosure theories without placing equal emphasis on the pro-competitive effects of non-horizontal mergers which, in many instances, can flow from the same “foreclosure” conduct. General comments on the approach of the Draft Guidelines have been provided above. In this section the Working Group presents a number of observations on specific points raised in the Draft Guidelines section on foreclosure theories.

Necessary Conditions

120. The Draft Guidelines correctly point out that a number of conditions must be fulfilled to be able to conclude that there to be a risk of harm to competition from input foreclosure or from customer foreclosure. Before input foreclosure can be of concern, the input product must be an important product for the downstream market (see para 33) and the firm must have market power in the upstream (input) market (see para 34).33 However, a further necessary condition generally is that the merged firm will also need to have a strong position in the downstream market. Analogously, for a vertical merger to create competitive concerns in the form of consumer foreclosure, the new entity generally should not only have market power in the downstream market, but should enjoy a strong position

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32 As a final remark, the Working Group draws the Commission's attention to the fact that the cross-reference in footnote 66 of the Draft Guidelines should refer to IV.A.1 and not V.A.1.

33 Similarly, for customer foreclosure, first, the customer must be an important customer (see paragraph 60), and second, there must be significant economies of scale or scope in the input market (see paragraph 61).
in the upstream market as well. The Working Group believes that by including such a condition to its Draft Guidelines, the Commission would add a useful screen that would allow users to better identify those cases that may satisfy the test of ‘ability’, ‘incentive’ and ‘overall impact’.

121. For input foreclosure, in the absence of significant shares in the downstream market, it generally will be too difficult, risky and unlikely for the merged entity to try to create market power in the downstream market by reducing sales, or not selling to downstream rivals. If the entity has a modest downstream position, the merged entity generally will not have the necessary ability or incentive to attempt to raise its rivals’ costs, since it will not likely be able to recoup its lost profits or sales revenues via increasing prices or expanding sales in the downstream market. For customer foreclosure, in the absence of significant shares in the upstream market, it will be very unlikely that the merged entity will have to ability or incentive to sell all of its capacity to the customer operating downstream, since the important downstream customer is unlikely to be willing to depend on a single and small source of supply (even assuming the relatively small supplier would be able to satisfy the downstream demand).

The degree of market power required for anti-competitive foreclosure

122. The Working Group suggests (following accepted economic theory) that the Guidelines explicitly state that, in order for a foreclosure strategy by the merged entity to be detrimental to competition, a significant degree of market power should be required.

123. Furthermore, it seems that the Draft Guidelines do not properly distinguish between mergers in which both parties hold market power, and mergers in which only one of them – either the upstream or the downstream player – holds market power. The Working Group suggests that the analysis in the Guidelines explicitly refer to each such case, as the analysis of ability, incentives and overall impact on the market may be different under the different situations.

The notion of foreclosure

124. Para 10, 16 and 18 of the Draft Guidelines provide the basis for the Commission’s approach regarding vertical mergers. According to Para 10 and 16 the Commission would prevent only mergers that “significantly increase the market power of firms,” which could harm consumers. The Draft Guidelines appropriately make it clear that if a merger adversely affects competitors “it is not in and of itself a problem.” In other words, the Guidelines are appropriately meant to protect competition rather than competitors. Therefore, it appears that the Commission agrees that the mergers that should be blocked are those that would lead to consumer harm. If a merger is not expected to affect consumers negatively, then the Commission should not oppose it.

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34 Para 42 of the Draft Guidelines notes that (in case of input foreclosure), the greater the market share of the merged entity downstream, the greater the base of sales on which to enjoy increased margins, and para 69 notes that the incentive to engage in customer foreclosure depends on the extent to which the upstream division of the merged entity can benefit from possibly higher price levels in the upstream market [...]. However, both paragraphs critically omit to note that input foreclosure is unlikely to be profitable unless the entity has significant shares on the downstream market and that customer foreclosure is unlikely to be profitable unless the entity has significant shares in the upstream market.

35 The same reasoning is valid for conglomerate mergers as well. If the merged entity has only a small or modest position in a market (for instance the ‘tied’ market), it will be very difficult to cause rivals to exit and create substantial market power in that tied market, by tying or bundling, in order later to raise prices. If it will be very difficult to do so, it is unlikely that the merged entity will have a proper incentive to attempt to do so, and it will be unlikely that the merger will be producing harm to competition in that market.
Para 18 of the Draft Guidelines then defines the term foreclosure as “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.” However, from combining Paras 16 and 18 of the Draft Guidelines, it is clear that foreclosure that merely affects competitors but not competition (and hence consumers) should not be a factor working against the approval of the vertical merger under review. This point should be stressed explicitly in any future Guidelines.

The Working Group acknowledges that, according to accepted economic theory, there could be some cases in which vertical mergers can be used to achieve anticompetitive goals, which may result in consumer harm. However, the Working Group recommends that the Commission clarify in any future Guidelines that it is only in rare circumstances that vertical mergers may achieve such outcome. If the Commission does wish to identify such rare situations in which vertical mergers could be harmful to competition in the Draft Guidelines, the Working Group recommends that these be addressed more specifically than is the case in the current draft.

VI. THE THEORY OF FORECLOSURE IN THE ASSESSMENT OF CONGLOMERATE MERGERS

General Observations

The Working Group welcomes the general recognition that in the "majority of circumstances" conglomerate mergers will not lead to any competition problems. It also welcomes the recognition, consistent with the Draft Discussion Paper on Article 82 EC, that tying and bundling are common commercial practices which generally have no anticompetitive consequences and are cost-effective for consumers (para 92).

Nevertheless, the Working Group notes that the structure of the Draft Guidelines gives an overall negative impression towards non-horizontal mergers, including conglomerate mergers, which in the view of the Working Group is not justified.

The Commission's analysis starts with the premise that conglomerate mergers may cause foreclosure and provides an analytical framework for applying relevant foreclosure theories. While an analytical framework is welcome, the Working Group believes that the Draft Guidelines should clearly state that conglomerate mergers are extremely unlikely to pose any competitive concerns and will in most situations be benign if not pro-competitive.

In the view of the Working Group, the Draft Guidelines therefore fail to recognise that efficiencies are intimately linked to the economic rationale of non-horizontal mergers. The Commission should rather stress that in most cases, conglomerate mergers do not harm competition but instead generate substantial efficiencies for consumers.

By contrast, the Working Group notes that the U.S. competition authorities recognise that conglomerate mergers are mostly pro-competitive and do not give the merged entity the ability and the incentive to raise prices and restrict output. Intervention in conglomerate merger cases remains extremely rare around the world. The Working Group is aware of only two transactions that have been challenged and ultimately blocked by major jurisdictions (not counting the EC) around the world in recent years. We are not aware of any successful challenges to conglomerate mergers in the U.S. for 30 years.

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36 See Federal Cartel Office, decision of 19 January 2006, B6 – 103/05, Axel Springer/ProSiebenSat1 Media, http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion06/B6-103-05.pdf; and
Definitions

132. Conglomerate mergers involve essentially two categories: the products produced by the merging firms are complements or independent. Products are complementary if an increase in price of one product leads to a reduction in the demand of another product. Economically speaking, the cross-price elasticity of complements is negative. Products are independent, if a given change in price of one product has no effects on the demand of another product; hence the cross-price elasticity is zero.

133. The Draft Guidelines focus on companies that are active on "closely related markets" and exemplify such a situation with "complementary products or products that belong to the same product range" (para 5, 90). For the definition of "closely related markets", the Draft Guidelines also refers to Form CO, Section IV 6.3. (c), that is, "mergers involving suppliers of complementary products or of products which belong to the same range of products that is generally purchased by the same set of customers for the same end use".

134. The Working Group recommends that the Commission should adopt a clearer and economically based explanation of the nature of conglomerate mergers. The Working Group would greatly welcome a clearer definition of the particular elements of conglomerate mergers, the specific concerns arising in the situation that the products are complementary or independent, the types of exclusionary conduct that may exist (i.e., commercial, technical, and mixed bundling) and an explanation of other notions found in the Draft Guidelines, such as “product range” or “portfolio effects”.

Economics of Foreclosure - Focus on Bundling and Tying

135. The theory of harm of conglomerate mergers is foreclosure. The Draft Guidelines identify the deterrence effect on new entry and the reinforcement of market power through leveraging (by means of bundling and tying). In this respect, the Draft Guidelines seem to be based entirely on post-Chicago theories, and they appear to be also in line with the concerns reflected in the Discussion Paper on Article 82 EC in relation to tying and bundling.

136. It seems that foreclosure as discussed in the Draft Guidelines would be limited to harm in the secondary market by means of bundling/tying of a monopoly good to a complementary product. This is reflected in para 94 which describes the relevant conduct as "conditioning sales in a way that links the products in the separate markets together [...] either by bundling or tying", and footnote 76 where the leveraging conduct is described as increasing sales of a product in one market (tied or bundled market, i.e., secondary market) by virtue of the strong market position of the product to which it is tied or bundled (tying market or leveraging market, i.e., primary market).

137. In this respect, the Working Group notes that the Draft Guidelines do not elaborate on other potential foreclosure practices such as share shifting, which, for example, was discussed in the GE case. In this case, share shifting concerned the alleged ability of a merged entity to enhance its market power by making use of its financial strength and position in a given market as leverage to promote the sale of other products. The Working Group would welcome further explanation of the Commission's view on such conduct and would expect the Commission to reject such theories.

the South African decision in *Telkom SA Ltda and Business Connexion Group Ltd*, (51/LM/Jun06) regarding a ban on the acquisition of an IT technology services company called Business Connexion by a fixed-line telecom provider called Telkom.
Approach of Draft Guidelines consistent with precedents

138. The Draft Guidelines follow the main elements as developed in the GE and Tetra Laval cases: (i) ability to engage in bundling practices; (ii) likelihood (i.e., incentive) to engage in those practices on the basis of convincing evidence; and (iii) competitive effects, that is, meeting the substantive test (in the cases of GE and Tetra Laval the creation or strengthening of a dominant position).

139. However, the Draft Guidelines seems to apply the test rather mechanically. In particular, given the prospective nature of the assessment, the Draft Guidelines do not properly acknowledge that the causality between the behaviour in question and its effects may be not be easy to evaluate with sufficient certainty. The Draft Guidelines disregard to a large extent the need for such a causality factor.

140. The Working Group sets out below a number of specific comments in relation to the different steps of the analysis.

Ability to foreclose

141. The Working Group welcomes the effort made to establish a framework to determine the ability of a merged entity to foreclose in a particular industry and product market. However, it notes that most of the specific guidelines refer only to complementary products, and not to independent products.

142. The Draft Guidelines correctly identify the degree of market power as an inherent criterion of the ability to foreclose. However, the Working group is concerned about the low level of market power the Commission would find sufficient for the merged entity to be able to foreclose. As the market share safe harbour ceiling for initial competitive concerns is already set at 30%, and given the analytical framework suggested (that is, a two step approach as set up in the Horizontal Mergers Guidelines), merging firms may all too easily find themselves in a defensive situation, subject to an onerous full Phase II review and forced to prove efficiencies to a high standard.

143. The circumstances set out in paras 98 et seq. of the Draft Guidelines become therefore important filters in concluding that no anti-competitive effects can arise due to an absence of the ability to foreclose. This is welcome but the Working Group believes that the Commission should stress the importance of those factors in a clearer way in the final version of the Guidelines.

144. For instance, the ability to commit to the bundle strategy is an essential element of the ability analysis (para 101). Therefore, the Working Group considers it important that the Commission elaborates more on its understanding of commitment. The Draft Guidelines seem to limit commitment to technical tying and cases where bundling is costly to reverse. The economic literature, however, develops concepts implying a commitment, to continue with a strategy having evaluated the possible reactions of rivals, and also "moral hazard issues".

145. In line with the GE case, the Draft Guidelines state that a broad range of products does not raise competition concerns as such (para 103). However, the same paragraph introduces the notions of "one-stop shopping" and "portfolio effects". The Working Group recommends that the Commission should clarify the rationale of these notions, and clearly state that just having a product range does not give a merged entity the ability to foreclose. Such statement would thus be in alignment with the US approach of rejecting such "range effects" theories.

146. The Working Group welcomes the recognition that ability is dependant on the existence of a large common pool of customers demanding both products. This statement is not only
relevant as regards the effects on individual products and suppliers, but also in connection to the incentive (commercial rationale) for the merged entity to engage in such practices.

Incentive to foreclose

147. The Draft Guidelines focus on the profitability of the bundling strategies, and do not stress the fact that leveraging conduct may not be commercially viable. This counterbalancing analysis should not only reflect rivals’ counter-strategies but also the likely reaction of customers. The Working Group would welcome a clearer emphasis on customer reaction and how it can make any foreclosure strategy unprofitable and commercially unviable. This was an important aspect the Commission did not take into consideration in the GE case, and the Working Group would recommend its inclusion in any future Guidelines.

Level of anti-competitive effect

148. While it is recognized that any guidance document necessarily has to be abstract to a large extent, the Working Group would consider it helpful if the Commission clarifies the level of foreclosure that is deemed sufficient to meet the SIEC test.

149. The examples given in the Draft Guidelines (reduction in sales by competitors must be significant enough, para 109; large fraction of the output must be affected, para 111; foreclosure is a concern if a large common pool of customers are concerned, para 99; products are being considered important by many customers, para 98) are too vague. By contrast, in relation to potential competition (para 110) it is mentioned that entry can be deterred by reducing sales "below the minimum viable scale".

150. In addition, the Draft Guidelines do not sufficiently underline the efficiencies which conglomerate mergers could generate. The ability to increase competition and lower prices for consumers should be given a more prominent place in any future Guidelines. In particular, the statement included in para 112 appears insufficient. Indeed, the Commission appears to stress which benefits would not be considered sufficient to counterbalance any restriction of competition. The only sufficient benefit expressly mentioned is the Cournot effect or the internalization of the double mark up in para 115. The Working Group believes that this also merits a more prominent position in any future guidelines. Moreover, the Commission should also more positively acknowledge the inherent benefits that could ensue for consumers in the form of lower prices that could flow immediately from the merger.

Long term v. short term effects

151. The Working Group recommends that the Commission should clarify the time period of the foreclosure analysis, as this is not sufficiently elaborated in the Draft Guidelines. This is an important point. As noted earlier in the general remarks on the overall approach of the Draft Guidelines, the Working Group would welcome a clear acknowledgement that timing and uncertainty considerations will tip the balance in favour of non-horizontal mergers in situations where the efficiencies are certain to arise in the short term whereas any anti-competitive effects are uncertain and would, if at all, only arise in the long term.

152. In the context of conglomerate mergers, it is worth noting that tying and bundling have generally positive effects in the short term. According to the Draft Discussion Paper on Article 82 EC, the Commission analyzes long term effects of the potential leveraging conduct.

153. However, given that the merger analysis is prospective and it is not established that the conduct will take place, the Working Group believes that the short-term pro-competitive effects should trump the long-term anti-competitive effects in all but the most exceptional of circumstances.
Counter-strategies

154. The Working Group welcomes the inclusion in the Draft Guidelines (para 102) of rivals' counter-strategies in the context of analyzing the ability of a merged entity to foreclose. The Working Group, however, notes that the concepts of "effectiveness" and "timeliness" of such strategies as expressed in the Draft Guidelines are vague, and invites the Commission to further clarify these notions.

155. The Working Group recommends that any future Guidelines should set out further examples of effective rivals' counter-strategies which are commonly found in the market place (including but not limited to mergers). The Commission seems to offer only one economically rational example, which is teaming-up by single product companies. The second example (re-selling the unbundled product) rarely exists. The third example (aggressive pricing of rivals) raises the question how the Commission intends to verify the effectiveness of such pricing strategy (how many rivals need to counter-act, how to measure the likelihood and degree of aggressive pricing strategies?).

156. The Working Group notes that no explanation is given as to what timely means. Given that particularly long-term foreclosure effects raise concerns, the Working Group recommends a clarification by the Commission that the rivals' "reaction time" may be equally long.

157. The Working Group believes that counter-strategies by other market players are inherently difficult to predict or to assess. Any future Guidelines should acknowledge this difficulty in assessing/predicting the response of the competitors in a particular given case.\textsuperscript{37} Therefore, such difficulty should in general work in favour of a restrictive approach to regulatory intervention, rather than against the merger by establishing a presumption that, in general, rivals should be able to find suitable counter-strategies. This suggests that preference for ex-post review under Article 82, where necessary, would be especially appropriate in such cases.

158. Finally, the Working Group recommends that any future Guidelines should include an acknowledgement of the increased incentive for entry by new competitors (or expansion of production by existing rivals) in the case of foreclosure, especially when large proportion of the market is foreclosed.

\textsuperscript{37} As an example, in the Boeing - McDonnell Douglas case, was it possible to foresee the improvement in the financial position of Airbus, which occurred 2 years after the Commission's decision was given.
ANNEX I

THE IBA WORKING GROUP

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ANNEX 2

NON-HORIZONTAL MERGERS: THE VIEW FROM THE UNITED STATES

1. US foreclosure analysis in the vertical merger context is primarily an examination of whether post-transaction the merged company will have the ability to eliminate or severely curtail its competitors’ capacity to compete by foreclosing their access to an essential input, either through raising the price of the input or restricting access to the input in some other fashion, or by restricting competitors’ output opportunities and, if so, whether such conduct would result in anticompetitive harm. The first step in this analysis is gauging the merging parties’ incentive and ability to undertake such conduct, which is done through an inquiry into the combined entity’s post-merger market power in the relevant markets and determining whether alternative sources of supply are available to rivals. The assessment of market share plays an important element in this analysis, however, it is only one element. Under US law there is no specific threshold market share that automatically focuses the attention of enforcement authorities on a vertical transaction, although a market share below 35-40% is unlikely to be sufficient to do so. See e.g. Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2 (1984). Also important in assessing the parties’ market power (and their ability to exercise it) are the level of market concentration, barriers to entry, and the identity and capabilities of other existing competitors and buyers. Indeed, the 1984 US Department of Justice Merger Guidelines (the “Guidelines”), state that anticompetitive harm resulting from vertical mergers is unlikely unless the primary market is highly concentrated, there are high barriers to entry to the secondary market, and there is insufficient un-integrated capacity in the secondary market. See Guidelines 4.211 – 4.213.

2. Assessment of market power does not end the inquiry in vertical mergers. Once the merged entity’s ability to foreclose competition is established, the analysis moves on to whether this ability likely will translate into anticompetitive harm. Specifically, will the parties have the incentive to foreclose competition and, if so, will that foreclosure injure competition? This involves careful consideration of the parties’ past conduct, the merged entity’s economic incentives going forward, and the efficiencies generated by the merger. This last step is particularly critical because the same vertical restraints that have the purpose and effect of restraining competition also have the potential to generate substantial pro-competitive efficiencies. These efficiencies, if real and demonstrable, ultimately can lead to improved consumer welfare as opposed to anticompetitive harm. Consequently, “[i]n the merger context . . . the US enforcement authorities take efficiencies into account and will not challenge a merger if the verified efficiencies are of a magnitude and character such that the merger is unlikely to be anticompetitive in any relevant market.” Vertical Restraints and Vertical Aspects of Mergers – a US Perspective, Prepared Remarks of Robert Pitofsky, Chairman, Federal Trade Commission, at the Fordham Corporate Law Institute 24th Annual Conference on International Antitrust Law and Policy (Oct. 16-17, 1997).

3. In sum, US antitrust authorities are generally sceptical regarding the potential of most vertical mergers to result in anticompetitive harm. This position has evolved over a number of years. Initially, the enforcement authorities were willing to seek, and courts were willing to grant, injunctions halting vertical combinations involving relatively small foreclosure. See Brown Shoe Co., v. United States, 370 U.S. 294, 334 (1962) (halting combination of fourth largest shoe manufacturer with a substantial retailer of shoes, noting, “We reach this conclusion because the trend toward vertical integration in the shoe industry, when combined with Brown’s avowed policy of forcing its own shoes upon its retail subsidiaries, may foreclose competition from a substantial share of the markets for men’s,
women’s and children’s shoes, without producing any countervailing competitive, economic, or social advantages.”) Over time, however, increasingly sophisticated economic analysis has made it clear that foreclosure does not inevitably result in anticompetitive harm, a finding which has resulted in fewer vertical enforcement actions. Today, while US antitrust authorities accept the view that foreclosure generated by a vertical merger can result in anticompetitive harm, they require a showing of substantial likelihood of anticompetitive harm to justify a merger challenge. See Vertical Merger Enforcement Challenges at the FTC, Address by FTC Commissioner Christine Varney at the PLI 36th Annual Antitrust Institute, San Francisco, California (July 17, 1995) (“Remember that the cornerstone of antitrust law is ‘the protection of competition, not competitors.’ Thus, even in a raising rival’s cost theory, some showing of consumer injury should be required before a vertical merger is challenged. . . “).

4. US antitrust authorities are even more sceptical regarding the possibility of anticompetitive effects resulting from a conglomerate merger. Early cases found that conglomerate mergers could violate the antitrust laws through increasing the dominance of a competitor or by creating the possibility for reciprocal dealing. See ABA Section of Antitrust Law, Antitrust Law Developments (Sixth) (2007) at pp. 386-87 (internal citations omitted). The agencies have moved away from these theories and instead now believe conglomerate mergers generate more pro-competitive benefits than anticompetitive harm. To quote a former Deputy Assistant Attorney General of the Department of Justice (“DOJ” or the “Department”), “After fifteen years of painful experience with these now long abandoned theories [of competitive harm], the US antitrust agencies concluded that antitrust should rarely, if ever, interfere with any conglomerate merger. We simply could not identify any conditions under which a conglomerate merger, unlike a horizontal or vertical merger, would likely give the merged firm the ability and incentive to raise price and restrict output.” Conglomerate Mergers and Range Effects: It’s a Long Way From Chicago to Brussels, Address by William J. Kolasky, Deputy Assistant Attorney General, Antitrust Division, US Department of Justice, Before the George Mason University Symposium, Washington, DC (Nov. 9, 2001). Potential benefits of conglomerate transactions include infusions of capital, improving management efficiency, transfer of technical and marketing know-how and best practices, and the meshing of research and distribution. Id. (internal citations omitted). Neither DOJ nor FTC has challenged a conglomerate transaction in almost 30 years.

5. Although the US antitrust agencies’ analysis of vertical and conglomerate mergers has evolved over the past two decades, this evolution has not been reflected in official merger guidelines. The 1984 Department of Justice Merger Guidelines are the most recent guidelines to include provisions relating to vertical mergers. The 1992 Guidelines, which were updated in 1997, focus solely on horizontal mergers. One of the recommendations of the Antitrust Modernization Commission (“AMC”), a bipartisan commission established by the US Congress three years ago to examine whether to modernize the US antitrust laws, is that this situation be remedied. In its report issued last month, the AMC urged US antitrust authorities to “update the Merger Guidelines to include an explanation of how the agencies evaluate non-horizontal mergers.” Antitrust Modernization Commission, Report and Recommendations (Apr. 2007) at 11. In the words of the AMC, “[t]he existing Merger Guidelines have brought significant transparency to the business community and antitrust bar as to how the agencies evaluate horizontal mergers. Businesses and antitrust practitioners would benefit greatly from a similar statement of how the agencies assess the competitive effects of vertical mergers. Id. (internal citations omitted). Challenges to conglomerate mergers are so unlikely that the AMC Report only referenced them in passing, and then by noting that it was unlikely conglomerate mergers would raise any
antitrust issues. *Id.* (‘‘Conglomerate’ mergers, which are neither horizontal nor vertical, generally do not raise antitrust issues.’’) It is not clear whether the agencies will take up the AMC’s suggestion.

6. Set forth below are summaries of several vertical cases which hopefully illustrate the process and views set out above.

**GE-Honeywell (May 2, 2001)**

7. It is well known that DOJ and the European Commission (the “Commission”) came to opposite conclusions regarding the legality of the GE’s proposed acquisition of Honeywell. At the time the deal was announced, GE was a leading producer of jet engines for large commercial aircraft and large regional jets. Honeywell was a leading producer of jet engines for smaller regional and corporate jets and of avionics and non-avionics systems, such as landing gear and auxiliary power units. GE also was heavily involved in aircraft financing. While DOJ cleared the deal, subject to divestiture, the Commission found, among other things, that the merger would enable the combined company to engage in mixed bundling by offering a package of GE engines and Honeywell avionics and non-avionics systems at discounted prices (the so-called “range effects” theory). The Commission predicted that long term this bundling would render GE’s competitors unable to cover their costs and force them from the market. The Commission also raised concerns about the combination of aircraft financing and sales. DOJ disagreed.

8. As an initial matter, the Commission and DOJ differed as to GE’s share of the large jet engine market — with the Commission finding a share of 65% and the US finding GE’s share to be 44%. However, even accepting for the sake of argument that GE had a dominant market position, DOJ disputed the conclusion that the merger would result in anticompetitive harm. In public comment, then Deputy Assistant Attorney General Deborah Majoras noted that the US had rejected the “range effects” theory of competitive harm in non-horizontal mergers in the early 1980’s. “We did so because we recognized that efficiency and aggressive competition benefit consumers, even if rivals that fail to offer an equally “good deal” suffer loss of sales or market share. Mergers are one means by which firms can improve their ability to compete. It would be illogical, we concluded, to prohibit mergers because they facilitate efficiency or innovation.” *GE-Honeywell: The US Decision, Remarks of Deborah Platt Majoras, Deputy Assistant Attorney General, Antitrust Division, US Department of Justice, before the Antitrust Law Section, State Bar of Georgia (Nov. 29, 2001).* While the Commission raised concerns that post-merger price cuts by the merged entity would ultimately harm consumers by forcing competitors from the field, DOJ believed these price cuts, provided they were not below cost, would benefit consumers. “[O]ur view is that such price cuts benefit consumers both directly — by reducing price and increasing output — and indirectly — by stimulating rivals to become more efficient so they can match those lower prices.” *U.S. and EU Competition Policy: Cartels, Mergers, and Beyond,* Address by William J. Kolasky, Deputy Assistant Attorney General, Antitrust Division, US Department of Justice, Before the Council for the United States and Italy Bi-Annual Conference, New York, New York (Jan. 25, 2002).

9. DOJ also rejected the Commission’s theories of harm based on the vertical integration of manufacturing and financing: (1) that the merged company’s access to the financing offered by GE Capital would enable Honeywell to create a dominant position in the small jet engine, avionics and non-avionics market and (2) the merged company’s access to GE’s aircraft leasing subsidiary GECAS would enable GE to gain further dominance in engines. In regard to the first theory, DOJ instead expressed confidence that capital markets would work appropriately and that competitors of both Honeywell and GE would have necessary access to capital. Further, it found blocking a merger due to increased efficiencies
to cheaper capital) and lower prices that would cause “ruinous competition” contrary to the goal of antitrust enforcement. In regard to the second theory, DOJ disputed the facts, arguing that the GECAS’ share of aircraft purchases was less than 10%, it was not a significant launch customer and that claims GECAS could seed airlines with GE engines were seriously overrated. “To the extent seedling was even a possibility, we could see no reason why rival engine manufacturers could not do the same simply by offering discounts off their engines.” See Kolasky, Conglomerate Mergers and Range Effects: It’s a Long Way From Chicago to Brussels.

10. Ultimately, the Court of First Instance (“CFI”) disagreed and in essence overturned the Commission’s analysis of conglomerate, and to a certain extent, vertical effects with regard to this transaction. Specifically, the CFI held that the Commission had failed to put forth sufficient evidence to suggest that either the merged entity would engage in mixed bundling, or that such conduct would result in competitive harm. Application for the annulment of Commission Decision 2004/134/EC of 3 July 2001 declaring a concentration to be incompatible with the common market and the EEA Agreement, Case No. COMP/M.2220 – General Electric/Honeywell, Court of First Instance of the European Communities (Dec. 14, 2005) at ¶¶ 470 - 473. It also found that although GE’s subsidiaries contributed to its commercial strength in large commercial jet engines, insufficient economic evidence had been presented to assess the likelihood that the merged entity would extend its practices to the markets for avionics and non-avionics or, if so, the extension of such practices would have created a dominant position in those markets. Id at 364.

Synopsys Inc./Avant! Corporation (July 26, 2002)

11. The Federal Trade Commission’s (“FTC’s”) acquisition of Avant! Corporation (“Avant!”) focused on the effect of the transaction in the electronic design automation (“EDA”) industry, a crucial part of the development of integrated circuits. The two companies had largely complementary products – Synopsys had a dominant market share in logic synthesis or “front-end” tools and Avant! held approximately 50% of the market for “back-end” place and route tools – and the transaction promised substantial efficiencies, i.e., tighter integration between Synopsys’ front-end and Avant! back-end tools, which would enable chip designers to more efficiently complete designs for increasingly complex, tiny and densely-packed integrated circuits. However, the concern that the combined company would use its leading position in logic synthesis tools to enhance its position in complementary place and route tools, and to heighten barriers to entry in both tools by making the interface between these software tool proprietary, led the FTC to conduct a substantial and thorough investigation.

12. Ultimately, the FTC found that Synopsys had neither the incentive nor the intention to adopt a strategy of total or partial disclosure. See Statement of Commission Thomas B. Leary, Synopsys Inc./Avant! Corporation (File No. 021-0049). Synopsys had for years made its tools interoperable with a wide variety of other EDA tools, including those sold by Avant!’s competitors. While in theory post-acquisition Synopsys would not have the same incentives to maintain interoperability, or, if it didn’t completely foreclose Avant!’s back-end competitors, could subtly alter its logic synthesis tool so as to render it more difficult for customers to use place and route tools offered by Avant!’s competitors, the FTC found, “[A]t this time, there are too many ‘might’ and ‘maybes’ to satisfy the reason-to-believe standard. To conclude otherwise would require excessive speculation by the Commission...” Statement of Commissioner Sheila F. Anthony, Synopsys Inc./Avant!

38 The CFI, however, confirmed the Commission’s prohibition decision on the basis of the Commission’s finding concerning horizontal merger aspects of the case.
Corporation (File No. 021-0049); see also Statement of Commissioner Mozelle W. Thompson, Synopsys Inc./Avant! Corporation (File No. 021-0049) ("I do not believe that the current evidence before the Commission is sufficient to demonstrate that such foreclosure would likely occur and result in anticompetitive effects. . . ") (emphasis in original).

*Time Warner Cable/Adelphia Communications (Jan. 31, 2006)*

13. The FTC has not moved away from the standard that a vertical merger must result in substantial likelihood of anticompetitive harm in the intervening years since it decided the Synopsys/Avant! deal. Indeed, last year the FTC closed an investigation of the merger and asset-swap of certain cable systems despite concerns that the significant share of the post-transaction entity in certain geographic markets would harm competition, particularly when combined with their ownership of certain “must-carry” Regional Sports Networks (“RSNs”). Specifically, the FTC explored whether as a result of increased shares in certain markets and control over a RSN, Time Warner or Comcast would be able to hinder rival’s access to RSNs, which was vital to the ability of the rivals to compete. The FTC determined that any anticompetitive harm was too speculative to outweigh the potential efficiencies of the transaction. *See* Statement of Chairman Majoras, Commissioner Kovacic, and Commissioner Rosch Concerning the Closing of the Investigation Into Transactions Involving Comcast, Time Warner Cable, and Adelphia Communications (FTC File No. 051-0151) (2006) (“The evidence obtained by the Bureaus . . . indicates, for each relevant geographic market, that the proposed transactions are unlikely to make the hypothesized foreclosure or cost-raising strategies profitable for either Comcast or TWC. Further, even if the Bureaus had concluded that foreclosure or cost-raising strategies were likely, that would not end the analysis. For the transactions to violate the antitrust laws, such foreclosure would need to create a likely risk of substantial harm to competition, on balance making consumers worse off. We do not have the facts that indicate such a loss of competition is likely"). Notably, however, two FTC Commissioners expressed concerns about the potential competitive issues.

14. There are cases in which the US antitrust enforcement authorities have found the potential anticompetitive harm generated from a vertical merger sufficient to justify blocking the transaction, or to condition approval on adoption of remedial measures.

*Lockheed Martin/Northrop Grumman (Mar. 23, 1998)*

15. DOJ challenged, and ultimately halted, Lockheed Martin Corp.’s ("Lockheed’s") acquisition of Northrop Grumman Corp.("Northrop") in part due to vertical concerns. Both Lockheed and Northrop were among the very few prime contractors used by the US Department of Defense to manage major defense platforms. For example, Lockheed and Northrop were two of only three prime contractors for high performance fixed-wing military aircraft platforms – post-merger there would be only two competitors. Lockheed was the only systems integrator for combat systems on surface combat vessels and submarines, and the prime contractor on certain key space programs. Further, both companies were key suppliers of a number of critical systems and subsystems for many of these programs. Ultimately, DOJ found this vertical integration, in programs that would be left with two or three competitors and industry segments in which the time and cost to entry is significant, to be contrary to the antitrust laws.

16. The increase in vertical integration which would result from Lockheed’s acquisition of Northrop may substantially lessen competition in many critical military systems and subsystems and in the aircraft and space platforms and integrated electronics systems requiring these systems and subsystems. The acquisition will likely result in less innovation by Lockheed and other system, subsystem and prime contract competitors,
possible exit by competitors, fewer opportunities for and increased barriers to competitive
entry, and lower quality subsystem and platform products at higher costs and higher prices.
transaction was abandoned following DOJ’s challenge.

CADENCE DESIGN SYSTEMS/COOPER & CHYAN TECHNOLOGY, INC. (“CCT”) (MAY 8,
1997)

(“CCT”) took place in the same industry as the Synopsys/Avanti transaction set out above –
the design and sale of integrated circuits. At the time of the acquisition, Cadence was the
dominant seller of integrated circuit layout environments and CCT was the only firm with a
commercially viable constraint-driven, shape-based integrated circuit routing tool, although
at least one other company was developing a similar tool. CCT’s routing tool was the only
technology that could accommodate the unique issues associated with deep submicron
integrated routing, a critical process in the move to make integrated circuit design smaller
and smaller. Moreover, barriers to entry in the market for this tool were high, with de novo
entry taking two to three years for a company that already possessed the underlying
technology, and even longer for a company without this technology.

18. According to the FTC, these combined factors meant that post-merger, “Cadence will
become less likely to permit potential suppliers of competing constraint-driven, shape-
based integrated circuit routing tools to obtain access to Cadence integrated circuit layout
environments,” which would hinder the necessary compatibility between Cadence’s
integrated circuit layout environment and developers of integrated circuit layout tools.
Analysis of Proposed Consent Order and Aid to Public Comment, Cadence Design Systems,
Inc. /Cooper & Chyan Technology, Inc., FTC No. C-3761 (Sept. 1997). Further, the FTC’s
investigation revealed evidence that Cadence had disadvantaged competitors in the past.
See Statement of Chairman Robert Pitofsky and Commissioner Janet D. Steiger, Cadence
Design Systems, Inc. /Cooper & Chyan Technology, Inc., FTC No. C-3761 (“There is some
reason to believe that Cadence in the past has thwarted attempts by firms offering
potentially competitive technology to develop interfaces to its layout environment”). This
circumstance supporting a finding that not only was foreclosure possible based on market
conditions, it was probable given the parties’ past conduct. The remedy imposed was a
consent decree requiring that Cadence permit developers of commercial integrated circuit
routing tools to participate in a pre-existing Cadence program enabling independent
software developers to develop and sell interfaces to Cadence integrated circuit layout tools.