Comments on the Draft Commission Notice – Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings

1. Introduction

Mayer, Brown, Rowe & Maw LLP welcomes the opportunity to respond to the public consultation launched by the Commission on 13 February 2007 on the Draft Commission Notice – Guidelines on the assessment of non-horizontal mergers ("NHM") under the Council Regulation on the control of concentrations between undertakings ("Draft Guidelines").

This document reflects the views of Mayer, Brown, Rowe & Maw LLP, and it does not represent the views of any of our individual clients. Our comments refer selectively to a number of issues addressed by the Commission, which, we believe, should be reviewed:

a) Introduction (sections I - II): The Commission should clearly specify that NHM are in principle pro-competitive or have at least neutral effects on competition, and that in most cases they do not give rise to competition law concerns.

b) Market share level (section III): In our view, the 30% market share level is too low. The 30% market share initial indicator of the absence of competition concerns should at least be triggered on the basis of the shares of the acquired company alone (without counting the shares of the acquiring company as the Draft Guidelines suggest). In addition, mergers involving NHM in markets characterized by technological innovation should also benefit from the safe harbor instead of being exempted from it.

c) Incentive to foreclose (sections IV, V): We consider that the Commission should provide more guidance on the Article 82 EC defense.

d) Standard of foreclosure (sections IV, V): We believe that the Commission should clarify the standard of proof for foreclosure effects.

e) Efficiencies (sections IV, V): We believe that the Draft Guidelines do not allow any real scope for parties to a NHM to claim efficiencies.

f) Burden of proof: We consider it necessary that the Commission clarifies the burden of proof and the level of evidence required for both the Commission (to prove incompatibility of the NHM with the common market) and the parties to the NHM (to prove efficiencies generated by the merger).

g) Commitments: We consider it necessary that the Commission provides clarification on whether behavioral commitments would be available to the parties to a NHM as an effective remedy.
h) Portfolio effects: The Draft Guidelines make a very brief and unclear reference to portfolio effects. We believe that the Commission should either elaborate further on this issue or delete the reference.

2. Comments

a) The approach of the Commission towards NHM seems negative

Although there is no presumption of legality for NHM, economic theory substantiated by empirical evidence indicates that vertical and, even more so, conglomerate mergers are less likely than horizontal mergers to have anti-competitive effects. Indeed, the generally advocated and supported view is that, in most cases, NHM generate efficiencies and increase consumer welfare.

In our view, the Draft Guidelines acknowledge the pro-competitive character of NHM only to a limited extent (see paragraphs 11 - 14), and they do not stress sufficiently the principle that NHM are generally pro-competitive. In contrast, the Draft Guidelines focus mainly on the potential foreclosure effects, while they do not clarify adequately that foreclosure would not be expected to occur in most of cases.

Therefore, we strongly suggest that the Commission revisits the Introduction and the Overview sections. We would prefer a clear message to business that NHM are in principle pro-competitive, or at least have neutral effects on competition, and that they may give rise to competition law concerns only in atypical circumstances.

b) The safe harbor market share level is too low

The Draft Guidelines (paragraph 25) indicate that it is unlikely that the Commission identifies concerns in NHM where the "the market share post-merger of the new entity in each of the markets concerned is below 30% and where the post-merger HHI is below 2000." The accompanying footnote states that the threshold has been set at 30% by analogy to the relevant market share threshold provided for in the Vertical Block Exemption Regulation ("BER")\(^1\).

In our view, this "safe harbor" is a welcome development. Nonetheless, we consider that the level is set too low. The application of the 30% threshold of the BER to the NHM is arbitrary and does not serve to justify its application to conglomerate mergers. In relation to vertical mergers, no explanation is offered and we are not aware of any reason why the BER market share should be relevant "by analogy". The BER merely applies to the relationship between independent undertakings that are vertically related and that decide to enter into an agreement of a limited duration.

In any case, it should be recollected that even for vertical agreements, the assumption of the 30% market share threshold was not evident. The Commission in its Green Paper\(^2\) which

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preceded the adoption of the BER, initially contemplated two different thresholds for vertical agreements, namely 20% or 40%. In the end it opted for the 30% threshold.

In our view, a threshold of 40%, as first considered by the Commission in its Green Paper for the BER would seem appropriate, particularly as the Draft Guidelines make it clear that it does not technically create a safe harbor.

Alternatively, and following the model of the US Non-Horizontal Merger Guidelines\(^3\), it may be appropriate to introduce a market share-based threshold that measures only the acquired company’s market share. Under this approach, a detailed analysis of potential anticompetitive effects arising from NHM would only be necessary when the market share of the acquired company exceeds a certain market share threshold, irrespective of the shares of the acquiring company in vertically related or neighboring markets.

The Draft Guidelines also provide (paragraph 25(a)) that when a merger "involves a company that is likely to expand significantly in the near future, e.g. because of a recent market innovation" the Commission may examine closely the anticompetitive effects arising from the proposed NHM, even if the parties' market shares are below 30%. We have two comments in connection with this statement.

First, in our view, innovation markets are dynamic, and characterized by volatile market shares and by the potential for competitors to leapfrog the parties' current or anticipated innovations. Therefore, the Draft Guidelines fail to appropriately recognize the dynamics of those industries.

Second, the Commission seems to adopt a similar approach as in horizontal mergers regarding concentrations involving companies that are likely to expand significantly in the foreseeable future. However, NHM are different and given the highly dynamic nature of the markets characterized by innovation, such a negative approach is not sufficiently justified to exclude them from the nominal benefits of the safe harbor threshold.

Based on the above, we believe that NHM involving markets characterized by technological innovation should benefit from the safe harbor.

c) **The Article 82 EC defense is vague**

The Commission follows the jurisprudence rendered by the EC Courts in terms of taking into account the potential illegality of the alleged anticompetitive conduct in question to reduce or even eliminate the merged entity's incentives to engage in such conduct. However, the Commission lays down limiting parameters in the consideration of such a disincentive including that (i) the conduct must be clearly, or highly probably unlawful under Community law; (ii) the likelihood that the conduct will be unlawful; and (iii) the penalties that could be imposed.

By definition, the first condition excludes certain types of conduct that are not clearly unlawful under Article 82 EC (e.g. raising rivals costs) and consequently narrows the scope of the Article 82 EC defense. In our view because a NHM does not *per se* lead to dominance,

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concerns arising from NHM would to a great extent not qualify as clear-cut violations of Article 82 EC, therefore, the disincentive argument will have limited application.

We consider that the Commission has set high standards in order to accept the Article 82 EC defense and it should be examined whether this is in line with the ECJ/CFI case law on *Tetra Laval* and *General Electric*. In our view the position of the Commission is far more restrictive than the one intended by the EC Courts.

Further, the interface in practice between Article 82 EC and the ECMR is not clear. Article 82 EC provides for an *ex post* assessment of illegal conduct while the ECMR is a prospective analysis of the impact that a concentration will likely have on competition. Although the Commission's approach is a result of the CFI/ECJ's case law, better guidance as to the application of Article 82 EC on merger analysis would be helpful.

Finally, it should be also noted that the judgments of the CFI and the ECJ in the above mentioned cases concerned Commission decisions that were adopted under the previous ECMR. There seemed a concurrence of objectives in the previous ECMR and in Article 82 EC, since the former prohibited the creation or strengthening of a dominant position as a result of which effective competition would be significantly impeded and the latter prohibits the abuse of dominance insofar as it affects trade between Member States. Dominance was therefore the common denominator in both instances. However, under the new ECMR the test, at least *de jure*, is somewhat different, in that it prohibits concentrations that would significantly impede effective competition without necessarily requiring the creation or strengthening of a dominant position. This effectively creates a gap between the current ECMR and the possible application of an Article 82 EC defense which in our view would deserve an explanation.

**d) The standard of foreclosure needs to be clarified**

The Draft Guidelines attribute great importance to the marginalization of competitors. The Commission does not seem to distinguish between "foreclosure" of competitors and "marginalization" of competitors, the latter of which may merely reduce the competitive constraint to the merged entity exercised by less efficient competitors.

For example, in paragraph 46 (and footnote 39), the Draft Guidelines state that in the vertical context, anticompetitive foreclosure may occur when a vertical merger allows the merging parties to increase the costs of downstream rivals in the market, thereby leading to an upward pressure on their sales prices. This sentence refers to footnote 39, which states that "*where downstream prices are not likely to increase in the short run, foreclosed rivals may still lose significant sales to the merged entity, and as a result of lower revenue streams, foreclosed rivals may be restricted in their ability to invest so as to further compete downstream, to the detriment of consumers in the future*". In our view, the way this point is presented suggests that the mere disadvantaged position of less efficient competitors may create foreclosure concerns, despite the fact that the competitors are not in reality foreclosed from the market. This creates uncertainty as to the standard that the Commission will use to establish foreclosure effects in the context of NHM.

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4 Judgment of the Court of Justice of 15 February 2005, in Case C-12/03 P, *Commission v Tetra Laval BV*.

Anticompetitive effects do not normally arise for NHM. Unlike horizontal mergers, NHM do not involve the elimination of a direct competitor. As a result, efficiencies in the context of NHM do not derive from direct cost savings, but instead from a combination of complementary or independent vertical and/or conglomerate assets. It is commonly accepted that NHM give rise to a broad range of efficiency gains in terms of pricing efficiencies, productive efficiencies, preventing profit expropriation, avoiding the hold-up problem which deter investments, and eliminating transaction costs. Some authors even conclude that there should be a rebuttable economic presumption in favor of NHM.

However, the Draft Guidelines consider the efficiencies separately from the question whether the NHM under review would lead to a significant impediment to effective competition. As in the context of horizontal mergers, efficiencies for NHM are considered as a potential justification to already identified and substantiated anticompetitive concerns. This seems counter-intuitive simply because, in most cases, the pro-competitive efficiency effects of NHM cannot be separated from the potential anticompetitive effects. Both efficiencies and foreclosure effects will have the same source. In our view, the Draft Guidelines should therefore render the efficiencies analysis an integral part of the Commission's assessment, and not assess efficiencies only as a potential justification to anticompetitive effects of the proposed concentration. It follows that the Commission should actively include in its own agreement of the anticompetitive effects its views of efficiencies arising. By analogy, this is similar to the issue that not all anticompetitive effects are caught by Article 81(1) EC.

Further, efficiencies that arise from NHM should not be subject to the same stringent conditions as efficiencies resulting from horizontal mergers. In particular, the obligation for the parties to identify and substantiate efficiencies together with the cumulative conditions required by the Commission (merger-specific, verifiable and benefiting consumers) are unduly burdensome in the NHM context. In relation to a number of efficiencies, it would be difficult for the parties to a NHM to prove that the projected efficiencies are merger specific. The Commission mentions that, particularly for vertical mergers, efficiencies may not always be merger specific (paragraph 56), and therefore would reject such efficiency claims. This seems to be too dismissive.

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7 The Efficiency-Enhancing Effects of Non Horizontal Mergers, by RBB Economics (Simon Bishop et al.), 2005, page 3. See, also the ECJ in Tetra Laval (paragraph 44) stated: "The analysis of a conglomerate-type' concentration is a prospective analysis in which, first, the consideration of a lengthy period of time in the future and, secondly, the leveraging necessary to give rise to a significant impediment to effective competition mean that the chains of cause and effect are dimly discernible, uncertain and difficult to establish. That being so, the quality of the evidence produced by the Commission in order to establish that it is necessary to adopt a decision declaring the 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 development envisaged by it would be plausible".

8 See, RBB Report cited above, page 121. The Report concludes that the two step approach to assessing efficiencies can only be appropriate if two conditions are met: (i) the anticompetitive issues raised by the NHM can be assessed separately from the likely effects of any efficiency; and (ii) a direct trade off comparison can be made, i.e., the efficiency can be readily translated into an impact on pricing incentives.
Further, the decisional practice of the Commission suggests an extremely restrictive approach towards efficiencies. In the recent Inco/Falconbridge⁹ case, the Commission explicitly dealt with efficiencies and found that there were no efficiencies because they were not-merger specific and would not be passed on to consumers because of high barriers to entry. Therefore, there is a concern as to whether the Draft Guidelines allow any real scope for the parties to successfully claim efficiencies in NHM. Again, NHM are very different to horizontal mergers. If the Commission does not expand the scope for consideration of efficiencies under NHM, then, in our view, the notifying parties to NHM are being improperly guided, which is a fault in itself and is likely to lead to unnecessary litigation before the EC Courts.

f) The burden of proof is unbalanced

Given the prospective nature of the analysis to be undertaken, especially for conglomerate mergers, the obligation for the Commission to prove to the requisite standard the likelihood of anti-competitive effects of the merged entity's conduct is high.

In Tetra Laval, the ECJ stated that in a prospective analysis of future conduct (which inherently applies to NHM and especially conglomerate mergers), the chains of cause and effect are dimly discernible, uncertain and difficult to establish¹⁰. That being so, the quality of the evidence produced by the Commission in order to establish that it is necessary to adopt a decision declaring the 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 development envisaged by it would be plausible.

The Draft Guidelines do not clearly establish the Commission's burden of proof to prove anticompetitive effects arising from NHM. Based on the Court precedents, the Commission's evidentiary burden is significant, given that it would have to demonstrate why the merged entity would have the incentives and ability to engage in certain practices in the medium term (i.e. potentially several years after the merger). The Draft Guidelines do not make any precise statement on who bears the burden of proof and the level of the evidence required. By contrast, the Draft Guidelines impose on the notifying parties a very strict evidentiary burden to prove efficiencies. In our view, the Commission should address these points.

g) The potential for commitments need to be addressed

The Draft Guidelines do not make any reference to commitments of any nature being able to counteract specific foreclosure concerns in the context of NHM. The ECJ confirmed in Tetra Laval that, in conglomerate mergers, a behavioral commitment might be the only effective remedy that is available because the structural effects of an operation will only be perceived in the future after possibly anticompetitive conduct has taken place¹¹.

We would welcome any clarification by the Commission on this point, in particular to confirm whether behavioral commitments may be put forward by the parties as an effective remedy. The relevance of this clarification is undoubted, especially since the Commission is

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⁹ Case No COMP/M.4000 of 4 June 2006, Inco/Falconbridge, paragraphs 537 et seq.
¹⁰ See Commission v Tetra Laval, cited above, paragraph 44.
¹¹ See Commission v Tetra Laval, cited above, paragraphs 88 and 89.
cautious of behavioral remedies as it is also shown in its recently published draft Notice on remedies (see paragraphs 67 and 68)\textsuperscript{12}.

h) The portfolio effects need to be clarified

Paragraph 103 of the Draft Guidelines indicates that customers may have a strong incentive to buy a range of products from a single source (one stop-shopping), \textit{e.g.} because it saves transaction costs. The Draft Guidelines identify this point in passing as "portfolio effects".

It is true that portfolio effects doctrine is intrinsically related mainly to conglomerate mergers. However, the message, in our view, is unclear and may create confusion as to the nature of portfolio effects. For portfolio effects to arise several elements need to be present (\textit{e.g.} dominance in at least one market of the complementary product range, unique range of complementary products, inability of competitors to replicate, likelihood of competitors' exit etc.\textsuperscript{13}). If the Commission considers portfolio effects to be an issue, we would recommend including a paragraph on the constitutive elements of the portfolio effects doctrine in relation to NHM.

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