Comments of Pavia e Ansaldo on the Proposed Guidelines on Non-Horizontal Mergers

Dear Sirs,

Please find hereinbelow the comments of the Antitrust Department of Pavia e Ansaldo on the above captioned Guidelines (reference is made to the order and headings used in the text of the said document):

II. Overview / III. Market share and concentration levels

1. Para. 10 lays down the test against which non-horizontal mergers are to be assessed, adapting to non-horizontal settings the key concepts used in implementing the SIEC standard of merger review. Contrary to the analysis made in respect of horizontal concentrations, when faced with non-horizontal

1 This document reflects the views of Pavia e Ansaldo and it does not represent the views of any of our individual clients.
transactions the Commission is essentially called to examine if and to what extent, post-consummation, the merger would change the behaviour of the merging parties. This concept seems to be expressed in para. 10, where it is made clear that “significantly increasing the market power of firms” (the other side of the SIEC-test coin) has a special meaning in relation to non-horizontal mergers. Yet, para. 10, when describing what amounts to an increase of market power in non-horizontal mergers, refers only to the ability to increase prices or other parameters of competition. While it is conceded that such a paragraph is merely descriptive of the analysis developed in the remaining sections of the Guidelines, we point out to the following:

- it is in our opinion important to stress from the very outset, and thus also in para. 10, that the increase of market power (which needs to be significant) shall require not only the ability but also the incentive to change the merging parties’ behaviour. In connection herewith, para. 10 simply cites the “ability” and not the “incentive”. Also, it should be clear that harm of competition is a necessary element of the assessment (as, indeed, explained in the Guidelines);

- para. 10 rightly considers price, output, quality, innovation, etc., as parameters of competition. Elsewhere in the Guidelines, emphasis seems to be placed on price only (probably it is a problem of better expressing this concept in footnote 8);

- on the same tone, we suggest that para. 10 makes clear that the ability to profitably increase price shall be “significant” and non-transitory, so as to rule out merely contingent or immaterial changes of behaviour.

2. According to the Guidelines, non-horizontal mergers pose no threat to competition unless the merged entity “has market power in at least one of the markets concerned” (para. 23). On this issue, we respectfully think that it is worthy clarifying when does a firm has “market power” for the purposes of the assessment of non-horizontal mergers. Two aspects come into consideration:

(a) whether or not market power is required and, if so, whether it needs to be “significant” in order to trigger close antitrust scrutiny;
(b) what is the appropriate level for measuring such a significance.
3. As regards (a) the first issue, the Guidelines are somewhat contradictory. On the need for market power as such, while, as cited, para. 23 states that “no threat to effective competition [exists] unless the merged entity has market power in at least one of the markets concerned”, para. 98 seems instead to suggest that foreclosure is unlikely to give rise to concern “if the new entity ... has no market power in any of the markets concerned”. In other words, para. 98 could be interpreted as meaning that, pursuant to the Guidelines, non-horizontal mergers pose no threat to competition only if the merged entity has no market power at all in any of the markets concerned. This interpretation is overly broad.

Furthermore, in relation to the nature of this market power, it would be preferable that the Guidelines clarify that the same needs to be “significant”. Even if paras. 23-26 address the issue of calculation of market power, it is striking to note that the expression “market power” is unqualified and never associated with the notion of “significance” (save, probably, for para. 92 where reference is made to the notion of “strong market position”). As non-horizontal mergers (at least in principle) do not lead to the creation of market power (since the merging firms are not competitors in any given market), competitive problems should arise only if one of the parties already holds a significant market power prior to the merger. We believe this fundamental concept could be better emphasised, eventually adding that, in order to avoid doubts and so as to provide more legal certainty, unless prior to the merger any of the parties holds a significant market power in at least one of the markets concerned, non-horizontal mergers are presumed not to pose threat to competition (save for exceptional circumstances).

4. On the (b) second issue, para. 25 uses market shares and HHI index as useful first indications of market power, underlying that “the Commission is unlikely to find concern in non-horizontal mergers where the market share post-merger of the new entity in each of the markets concerned is below [30%]”. This is said to be “[i]n analogy to the indications given in Commission Regulation (EC) No 2790/1999”. We note that:

- para. 25 states that the market share needs to be “below” 30%, whereas the threshold set forth in the EC Regulation 2790/99 refers to a share which “does not exceed 30%”;
- the “discussion paper on the application of Article 82 of the Treaty” makes reference to a different safe-harbour, providing that
“undertakings with market shares of no more than 25% are not likely to enjoy a (single) dominant position on the market concerned”. While we appreciate that the Commission has now seemingly raised the bar of relevance to 30%, this should probably imply a future upward adjustment of the “Discussion Paper” threshold;

- the Form Co relating to the notification of a concentration pursuant to Regulation (EC) 139/2004, when dealing with the notion of affected markets, defines as relevant product markets those markets where “one or more of the parties to the concentration are engaged in business activities ..., which is upstream or downstream of a product market in which any other party to the concentration is engaged, and any of their individual or combined market shares at either level is 25% or more”.

The Commission seems to have fixed at 25% the minimum market share threshold above which non-horizontal mergers may arise concerns. We welcome the idea that such a percentage is increased, considered the pro-competitive more than anti-competitive effects of this type of the mergers, as acknowledged by the Commission too. However, this could imply modifying Regulation 802/2004 and its attached Form Co.

5. At para. 16, the Guidelines introduce the concept of “consumers”, pointing out that the Commission assessment will focus “on the effect of the merger on the customers to which the merged entity and those competitors are selling” and specifying that “the fact that a merger affects competitors is not in and of itself a problem”.

We welcome this added emphasis, implying that a merger needs to be prohibited if it is dangerous for consumers. We in fact appreciate that the Commission introduces such a theory also in this paper, showing a continuity with both the “Discussion Paper” (“exclusionary abuses are meant behaviours by dominant firms which are likely to have a foreclosure effect on the market, i.e. which are likely to completely or partially deny profitable expansion in or access to a market to actual or potential competitors and which ultimately harm consumers”, and, more in general, European most recent case law (e.g. the CFI decision in Glaxo I).

Nevertheless, we find that this general principal is not fully explored in some sections of the Guidelines, where great attention is devoted to competitors foreclosure rather than to consumers’ harm.

IV. VERTICAL MERGERS
6. Pursuant to para. 28 of the Guidelines, foreclosure may be found “even if foreclosed rivals are not forced to exit the market: it is sufficient that the rivals are disadvantaged”. For the reasons already explained, it would seem preferable to qualify such disadvantage, specifying that the latter be significant. If, as stated in para. 16, the focus of the Commission is consumer welfare and not protection of competitors, a mere and unqualified disadvantage of a competitor should not be deemed sufficient to warrant a material foreclosure.

7. Para. 38 provides that in its assessment of the new entity’s ability to foreclose access to inputs, the Commission may consider “whether there are effective and timely counter-strategies that the rival firms would be likely to deploy”. The Commission refers to the “likelihood” that such counter-strategies be implemented by competitors, whereas we believe that the correct criterion to be used here should be that of the possibility, for competitors of a comparable size, to deploy such counter-strategies. If a competitor is empowered to put in place the same strategies as the merging firms but elects not to do it (e.g. because it wishes not to make the relative investments and/or to ripe the related efficiencies) we see no reason for its ‘inertia’ to be rewarded and for the merger to be blocked. In other words, we fear that the test of “likelihood” may offer competitors not willing to invest some sort of ‘free-riding’ on the merging parties. If vertical integration is efficient, as the Commission itself acknowledges, to block a merger because competitors – while capable of doing so - are not likely to adopt the same business model, risks going to the detriment of an efficient allocation of resources.

Non only so. From reading the Guidelines one gets the impression that the Commission does not consider the possibility of parallel vertical integration by competitors as an element capable of counterbalancing the ability to foreclose. E.g. in paras. 47 and 74, the Commission seems even to suggest that parallel vertical integration is considered negatively, as either a barrier to entry or an instrument for rising rivals’ costs.

8. In paras. 39 to 42, the Commission, in order to assess the incentive to foreclose access to inputs, employs an objective evaluation criteria: whether or not it would be economically rational for the merging parties, post-merger, to raise prices. It is evident why the Commission fears the express adoption of a subjective criterion, i.e. linked to the willingness of the merging parties to
adopt certain foreclosing conduct post-merger. Yet, the latter could be indirectly addressed if the parties were to offer behavioural remedies so as to obtain a conditional clearance of the merger. In this connection, it is suggested that the preference for ‘structural’ remedies may cede its way to behavioural remedies in relation to non-horizontal remedies (para. 17 of the Commission draft Notice on remedies seems still to stipulate that behavioural remedies are best also for non-horizontal remedies).

9. In relation to para. 44, we understand that the Commission has followed therein the ECJ/CFI’s reasoning in *Tetra Laval* and *GE/Honeywell*. That being said, it has nonetheless to be noticed that, on the basis of the present wording of para. 44, it is difficult to imagine cases where the deterrent represented by the likelihood of the unlawfulness of a conduct under Community or national antitrust law (and in particular under Article 82 of the EC Treaty) may be regarded as sufficient to counterbalance the incentive to adopt a foreclosure conduct.

10. Pursuant to para. 46, significant harm to effective competition normally requires that the foreclosed firms “play a sufficiently important role in the competitive process on the downstream market”. The expression “sufficiently important” is rather ambiguous and could give rise to legal uncertainty. Also, in light of the above mentioned remarks, the expression could render foreclosure potentially relevant in an extremely wide number of cases. This would run contrary to the assumption that, instead, non-horizontal mergers are generally innocuous. It would be therefore preferable to require that, for the purposes of para. 46, the foreclosed firms need play “a significant competitive role”, as (incidentally) the same paragraph 46 does in its last sentence, where it states that, despite its relatively small market share, a specific firm may play “a significant competitive role compared to other players”.

11. As mentioned, para. 47 provides that effective competition on the downstream market may be significantly impeded by raising barriers to entry, in particular if input foreclosure would entail for potential competitors the need “to enter at both the downstream and the upstream level in order to compete effectively on either market”. As already mentioned, the provision at stake seems to consider negatively vertical integration (thereby casting a negative light also on the related provision of para. 38 above). If vertical integration is more efficient, there is no need to indirectly reward competitors.
who wish not to pursue it by blocking the merging parties’ integration plan. Here too, as explained in our comment on para. 38, the suggested test would be (at least) that of the “possibility” of replicating the integration, rather than of the “likelihood” thereof.

12. Paras. 61 and 62 re-propose an argument already exposed in the foregoing sections. Where vertical integration gives rise to efficiencies, and if such an integration is possible for equally efficient competitors, integration is pro-competitive. Paras. 61 and 62, instead, seem to suggest that scale or scope efficiencies stemming from vertical integration at the downstream level can be treated as either rising rivals’ costs (in relation to competitors not willing to replicate the integration model) or barriers to entry (as regards those upstream potential entrants who refrain from entering the market because, absent integration downstream, presence in the upstream market only is not economically viable). This is also inferred from para. 74. Following this rationale, efficiencies arising from a vertical merger may be paradoxically used against the merging parties, even where, e.g., integration would be replicable for actual or potential competitors.

13. Para. 76 emphasises once again – with a language that leaves little room for different interpretation - the risk that non-horizontal merger efficiencies be examined just as they would be addressed in an horizontal transaction. As said, we respectfully dissent that a similar approach be warranted, given the admittedly different nature and scope of the two types of mergers.

14. It is conceded that the concerns outlined at para. 77 may indeed exist. Yet, a combined reading of para. 77 with the previous paragraphs of section A could often lead to a blocking of the non-horizontal transaction: if the merged entity, after the merger, has the ability and incentive to cut off its distributors, this may be viewed as a valid ground for preventing consummation of the merger, because it is presumed that downstream rivals shall be cut off after the integration takes place. If, however, the merged entity continues to deal with such downstream rivals, it still risks being exposed to an accusation that the coordinated effects referred to in para. 77 may arise, once again conducing the Commission to block the transaction.
V. CONGLOMERATE MERGERS

15. Pursuant to para. 93 of the Guidelines, the Commission, in assessing the likelihood that non-horizontal mergers may give rise to foreclosure effects (i.e. bundling or tying), shall examine whether the merged firm would have (i) the ability to foreclose its rivals; (ii) the economic incentive to do so; and whether (iii) a foreclosure strategy would have a significant detrimental effect on competition, thus causing harm to consumers.

However, the Guidelines do not specify how strict should be the standard of proof that the Commission would have to bear in order to satisfy the said three-prong test, i.e. which evidence it should provide as to why the merged firm would have the ability and the incentive to engage in bundling practices, and as to the likelihood of the occurrence of such detrimental effects on competition.

As non-horizontal mergers usually do not lead to any competition problem (as the Commission itself acknowledges also in para. 91), it seems that the standard of proof that the Commission would have to satisfy should be particularly high in context thereof, so as to prevent the risk of ‘false positives’ (blocking transactions which should be cleared).

16. As mentioned, para. 98 raises the concern that a safe-harbour may exist only if no market power whatsoever is held.

17. In relation to this section, we note that para. 116 of the Guidelines, while properly underlying the efficiencies usually stemming from bundling, open the door for an assessment by the Commission of the “necessity” of bundling so as to achieve these efficiencies.

We fear that this statement may, de facto, represent an undue enlargement of the 3-prong efficiency test laid down in that respect (See, para. 51 of the Guidelines and para. 79-88 of the Notice on Horizontal Mergers).

If efficiencies are indeed proven to be beneficial to consumers, merger-specific and verifiable, there should be no room for further second-guessing (by the Commission or by third parties) whether or not they may be achieved through means other than bundling.

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We remain at the disposal of this Hon. Commission for any additional comment and/or explanation that is requested.

Best Regards

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