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# Control of Non-Horizontal Mergers in the EU

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(*) Disclaimer (EN): the views expressed are those of the author and cannot be regarded as stating an official position of the European Commission

## Overview

- Background
- EU Non-Horizontal Merger Guidelines
  - Adopted on 28.11.2007
- Recent cases

## Background

- Evolution of Commission treatment of mergers: more focus on effects of mergers on customers (and less emphasis on market structure as such)
  - Introduction of a new test in the EC Merger Regulation (Reg. 139/2004)
    - SIEC = Significant Impediment to Effective Competition
  - CFI/ECJ Jurisprudence:
    - Tetra (C-12/03 P; 2004)
    - GE/Honeywell (T-210/01; 2005)
  - Commission's recent decision making practice

## Non-Horiz. Merger Guidelines

- Outline:
  - Section I: Introduction
  - Section II: Overview
  - Section III: Market share and concentration levels
  - Section IV: Vertical mergers
  - Section V: Conglomerate mergers

## Section II - Overview

- Broad principles:
  - Non-horizontal mergers raise different concerns than horizontal mergers
    - no loss of direct competition between the merging parties
    - possible complementarity of merging parties
      - Scope for efficiencies, incl. pricing efficiencies
  - However, there are circumstances in which non-horizontal mergers may significantly impede effective competition
    - “merger may change the ability and incentive to compete on the part of the merging companies and their competitors in ways that cause harm to consumers” (NHMG para 15)

## Overview (cont’d)

- In the application of Art. 2 ECMR, “... the Commission examines the various chains of cause and effect with a view to ascertaining which of them is the most likely” (NHMG para 21)
  - A “balance of probabilities” standard (cf. Tetra, para. 44)
  - No presumption of legality non-horizontal mergers (cf. GE/Honeywell, para. 61)

## Overview (cont'd)

Distinction between

- Non-coordinated effects (mainly foreclosure)
- Coordinated effects

## Section III - Market share and concentration levels

- No threat to effective competition unless the merged entity has a significant degree of market power in at least one of the markets concerned (par 23).
- Safe harbours:

  Commission unlikely to identify competition concerns when in each of the markets concerned:

  - **Market share merged entity < 30%**

    and

  - **HHI < 2000**

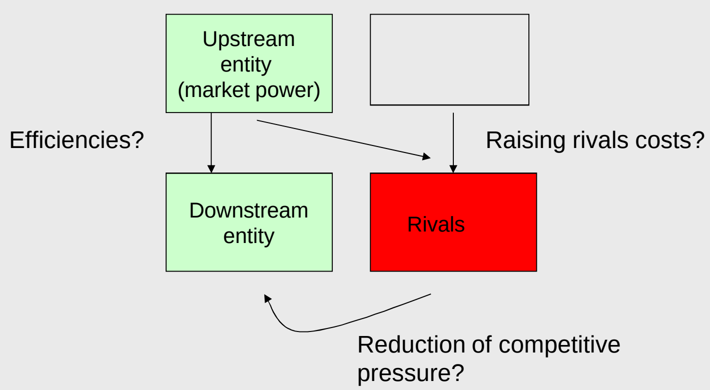
  (Except where certain special circumstances are present which make market shares / HHI less informative)

# Section IV - Vertical mergers

Theories of harm

- Non-coordinated effects
  - Main concern: foreclosure, if it leads to consumer harm
    - foreclosure = “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” (par 18)
  - Two forms
    - Input foreclosure
    - Customer foreclosure
  - Other non-coordinated effects
- Co-ordinated effects

# Example: Input foreclosure




è Net effect on consumers ?

## Analytical framework

- Commission will examine:
  - Ability to foreclose
  - Incentive to foreclose
  - Likely impact on effective competition

## (i) Ability to foreclose

- Necessary conditions for the merged entity to have the ability to foreclose
  - the input must be important (e.g. in cost or technology terms)
  - merged entity must have a “significant degree of market power” upstream (pars 23;35)
    - Not necessarily dominance
    - E.g. other upstream rivals are less efficient, offer less preferred alternatives, cannot expand easily
    - Input foreclosure may also expose downstream rivals to independent upstream suppliers with increased market power
- Check possible counter-strategies of downstream rivals

## (ii) Incentive to foreclose

- Incentive depends on the degree of profitability of the foreclosing practice
- Merged entity faces possible trade-off between
  - profit loss due to no longer supplying to downstream rivals and
  - profit gain due to expanding sales downstream and/or being able to raise price in that market
- Incentive to foreclose may be higher in case
  - Profits upstream are low (compared with downstream)
  - Possibility to expand downstream high
  - Merged entity has high market share downstream

## Incentive to foreclose (cont'd)

- Obligation to examine whether unlawfulness of conduct can act as a disincentive:
  - *Tetra; para 75-78*
- Elements that the Commission will take into account, on the basis of a summary analysis (NHMG para 46)
  - (i) likelihood that the conduct would be clearly, or highly probably, unlawful,
  - (ii) likelihood that the conduct could be detected, and
  - (iii) the penalties which could be imposed

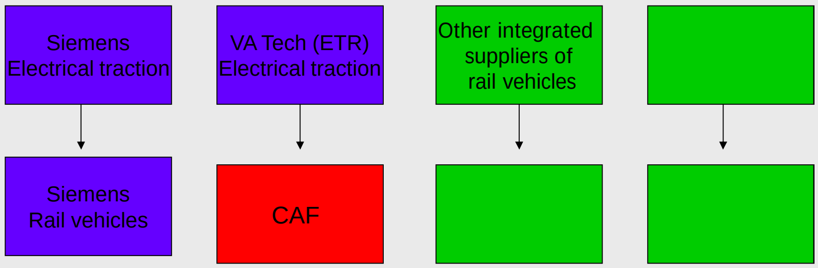
# (iii) Effect

- Effect: impede effective competition in the downstream market
  - Merger may raise rivals' costs (e.g. increase input prices) thereby causing an upward pressure on rivals' prices. This may in turn allow the merged entity to raise price
    - Effect more likely to be significant when proportion of foreclosed rivals is high or foreclosed rivals are close competitors
  - Merger may allow merger entity to raise entry barriers
    - In particular, if foreclosure establishes need for "two-level entry".

# Effect (2): where?

- Competition policy protects competition, not competitors. Consumer welfare standard is well established.
- Problem: in vertical mergers some firms are both customers and competitors to the merged entity
- Principle: Commission will focus on the effect on customers immediately below the merged entity (NHMG para 16)

• Example: Siemens/ VA Tech (M.3653)

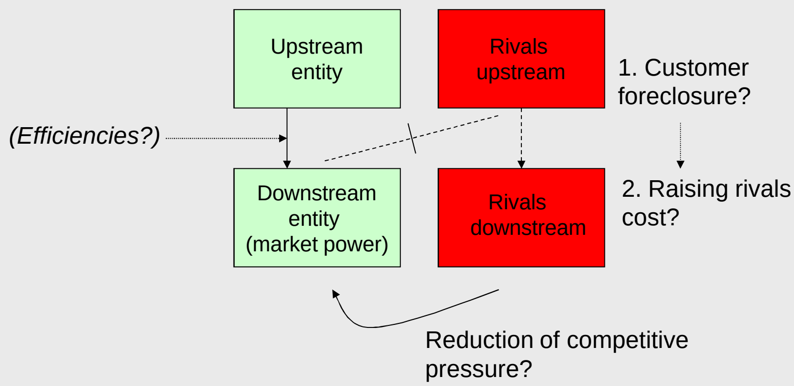



”Even if the non-integrated suppliers of rail vehicles, including the main non-integrated supplier CAF, were eliminated from the market for electrical rail vehicles, there would continue to be in the individual Member States a sufficiently large number of actual and potential competitors in the overall train market.”

# Effect (3): efficiencies

- Efficiencies can counteract adverse effects on competition
- General principles apply
  - to be identified by the merging parties;
  - be verifiable / be merger-specific/ benefit consumers
- Specific efficiencies to vertical mergers:
  - Internalisation of double mark-ups
  - Reduction of inventories costs (e.g. co-ordination of production and distribution)
  - Alignment of incentives (e.g. increased investment in distribution)

# 2. Customer foreclosure




è Net effect on consumers ?

# Customer foreclosure (cont'd)

- The decision no longer to procure from upstream rivals may raise their costs and/or reduce their revenue streams. To the extent that this reduces their ability and incentive to compete, downstream rivals of the merged entity may be faced with higher input costs (input foreclosure)

- Commission will examine
  1. Ability to foreclose
  2. Incentive to foreclose
  3. Likely impact on effective competition

## 3. Other non-coordinated effects

- The merged entity may, by vertically integrating, gain access to commercially sensitive information regarding rivals' upstream or downstream activities
  - For instance, by becoming the supplier of a downstream competitor, a company may obtain critical information, which allows it to price less aggressively in the downstream market to the detriment of consumers.

## Coordinated effects

- General principle: Co-ordination more likely to emerge in markets where it is fairly easy to establish the terms of co-ordination and where co-ordination is sustainable
  - Sustainability requires that
    - the companies involved can monitor each other's market behaviour (market transparency)
    - there is a credible 'deterrence mechanism' (disciplining mechanism) to ensure adherence
    - outsiders and customers cannot undermine the co-ordination
- A vertical merger may have an effect on each of these conditions

## Section V – Conglomerate mergers

- Theories of harm:
  - Focus on anti-competitive foreclosure, through tying and bundling
    - common practices, that often have no anticompetitive consequences
    - in some circumstances they may deter entry or harm consumers by reducing the rival's ability or incentives to compete
- Three-step analytical framework:
  - ability / incentives / effects
  - including assessment of efficiencies (e.g. Cournot effect; economies of scope)

## Recent cases

- NHMG in line with analytical approach Commission in recent cases
- Vertical mergers:
  - EDP/ENI/GDP (2004)
  - EON/MOL (2005)
  - Philips/Intermagnetics (2006)
  - J&J/Pfizer Consumer Healthcare (2006)
  - Evraz/Highveld (2007)
  - Thales/Finmeccanica/ AAS Telespazio (2007)

## Recent cases (2)

- Conglomerate mergers:
  - GE/Amersham (2004)
  - P&G/Gilette (2005)
  - GE/Smiths Aerospace (2007)

## Discussion