
EU Commission Adopts Non-Horizontal Merger Guidelines

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On November 28th, the EU Commission adopted its Non-Horizontal Merger Guidelines (Guidelines).^[i] The Guidelines fill a gap in the Commission's series of notices on the application of the EC Merger Regulation and provide important guidance to the business community on the Commission's assessment of "vertical" and "conglomerate" mergers in EC merger control proceedings. Vertical mergers involve firms at different levels of the distribution chain, such as the acquisition of an office product retailer by a manufacturer of office products. Conglomerate mergers involve firms that are neither direct competitors nor have a supplier-customer relationship, such as a merger between a manufacturer of printers and a manufacturer of print cartridges. The new Guidelines complement the Commission's existing guidance on horizontal mergers, which addresses mergers of direct competitors.^[ii]

Starting Point: Non-Horizontal Mergers Are Often Pro-Competitive

Non-horizontal mergers are less likely to harm competition than horizontal mergers among competitors, and indeed are often pro-competitive because the integration of complementary activities (e.g., manufacturing and distribution) can produce significant efficiencies. The Guidelines explicitly recognize this fundamental distinction between horizontal and non-horizontal mergers (paras. 11-14).

The Guidelines also accept at the outset that non-horizontal mergers pose no threat to competition if the merged entity lacks a "significant degree of market power" in any of the markets concerned (para. 23). Under the Guidelines, market shares below 30% and post-merger HHI levels below 2000 are quasi-"safe harbours," which normally will signal the absence of anticompetitive effects (para. 25). The Guidelines note, however, that special circumstances, such as cross-shareholdings among the market participants or indications of past coordination, can change the analysis (para. 26).

Anticompetitive Effects: Foreclosure

The Guidelines identify several potential anticompetitive effects from non-horizontal mergers and discuss the Commission's analytical approach to them. The most prominent theme, and a likely focus of the Commission's future review of non-horizontal mergers, is "foreclosure." Indeed, on the

same day it published the final Guidelines, the Commission announced that it would open a second-phase investigation into the proposed acquisition by TomTom, a manufacturer of portable navigation devices (PNDs), of Tele Atlas, one of two suppliers of navigable digital maps for the whole of Europe. This transaction raises no horizontal issues. The Commission stated that its investigation will focus, inter alia, on whether the transaction might harm consumers by increasing the costs for other PND manufacturers or limiting their access to these maps.

The Guidelines discuss several possible foreclosure scenarios. In practice, the evaluation of each such scenario will require detailed economic analysis, and parties to a non-horizontal merger raising possible foreclosure concerns are well-advised to retain an economist to help them mount an effective defense:

- Vertical mergers: input foreclosure. In a vertical merger, the Commission will closely analyze any indications that competitors of the downstream firm (e.g., the rivals of a retailer that is being acquired by a manufacturer) might lose access to an important supplier (i.e., the acquiring manufacturer) or could incur higher prices for their inputs. The Guidelines state that anticompetitive effects may result if this type of foreclosure forces downstream rivals to exit the market or increase prices to reflect increased costs, which in turn may enable the merged entity to profitably increase prices to consumers (paras. 31-57).
- Vertical mergers: customer foreclosure. The Guidelines also address the reverse scenario, "customer foreclosure." Customer foreclosure occurs when a vertical merger could deprive the rivals of the upstream firm (e.g., the acquiring manufacturer) of a downstream customer and leave it without a sufficient customer base. The Commission will focus on whether the downstream entity has market power (taking into account, e.g., market shares, the number of competitors and barriers to entry) and analyze the likely effects of the merger on prices and barriers to entry, especially in the upstream markets (paras. 58-77).
- Foreclosure in conglomerate mergers. Under the Guidelines, conglomerate mergers can also result in foreclosure effects. The Commission will focus on whether the merger enables the merging entity to impede competition in complementary--usually closely related--product markets by leveraging a strong market position in one market into the complementary market (paras. 93 et seq.). The Guidelines suggest that leveraging may occur through tying, bundling or other exclusionary practices (see paras. 96, 97). For example, a dominant producer of razor blades might acquire a producer of shaving foam and attempt to foreclose other foam manufacturers by granting rebates to customers who purchase both razor blades and foam from the merged entity. If the strategy marginalizes or forces rival foam suppliers from the market, the conglomerate might increase its prices in the complementary product market (shaving foam) to the detriment of consumers.

The Guidelines propose a three-step approach to analyzing potential foreclosure effects from vertical and conglomerate mergers. These steps are closely intertwined and will often be analyzed together; however, they provide a simple initial "checklist" to help merging parties to determine whether their vertical or conglomerate merger might attract detailed Commission scrutiny:

- Under the Guidelines, the Commission will first examine whether the merged firm would

be **able** to foreclose access to inputs, customers or complementary markets (paras. 33 et seq., 60 et seq., 95 et seq.). In a vertical merger, for example, the merged firm is unlikely to be able to foreclose downstream competitors (e.g., other retailers) if the products of the upstream firm are not important to downstream market participants or the merged firm has no market power upstream.

- Second, the Commission will ask whether the merged firm would have an incentive to foreclose (paras. 40 et seq., 68 et seq., and 105 et seq.). As the Guidelines rightly note, this depends on whether foreclosure would be profitable. For example, in a vertical merger, the merged firm would have no incentive to foreclose if it could not recoup lost profits from upstream sales by increasing profits downstream.
- Finally, the Commission will analyze whether foreclosure of inputs, customers or complementary markets raises barriers to entry or otherwise impedes effective **competition** (paras. 47 et seq., 72 et seq., 111 et seq.). For example, if a vertically integrated firm with market power is likely to refuse to deal with downstream rivals post-merger, the Commission will examine whether new entrants would therefore be forced to enter both market levels in order to compete effectively.

Anticompetitive Effects: Access to Information

The Guidelines also observe that a vertical merger might allow the merged entity to gain access to sensitive information about the activities of upstream or downstream rivals (para. 78). For example, an acquired retailer of office supplies may have collected price lists from various office supply manufacturers--sensitive information that now becomes available to the acquiring office supply manufacturer. Unfortunately, the Guidelines provide no indication as to how the Commission will analyze information sharing in practice, or whether the parties can address these concerns proactively through firewalls or other behavioral measures.

Anticompetitive Effects: "Coordinated Effects"

The Guidelines also discuss the possibility that non-horizontal mergers could increase the likelihood of tacit coordination (coordinated effects; see paras. 19; 79-90; 119-121). The relevant sections of the Guidelines recite the four-step test of the Court of First Instance's *Airtours* judgment, [iii] but provide little guidance as to how these factors will be applied in practice. The Guidelines note that coordination is more likely to occur in markets where it is simple to reach a common understanding on the terms of coordination. The Guidelines recognize that vertical mergers are sometimes more likely to destabilize coordination than foster it (see footnote 81), a point that may help some merging parties deflect concerns of potential coordinated effects. The Guidelines also observe that, to raise concerns, the merger must enable or enhance market participants' ability to monitor deviations from the understanding, improve deterrent mechanisms that oligopolists apply, or reduce the possibility that outsiders will be able to take action to constrain coordination (e.g., by eliminating a disruptive buyer through a vertical merger).

What about Efficiencies?

Section II of the Guidelines emphasizes that, in analyzing non-horizontal mergers, the Commission

will consider both possible anticompetitive effects and any pro-competitive benefits that may result from efficiencies (para. 21). The Guidelines recognize that vertical mergers allow the merged entity to internalize double markups. They also list several other potential efficiencies, such as decreased transaction costs; better coordination of product design, production and distribution; and providing customers one-stop shopping opportunities (see paras. 13, 55). The Guidelines cross-reference Section VII of the Horizontal Merger Guidelines (see, e.g., para. 53), which provide additional examples of efficiencies (such as efficiency gains in R&D and innovation).

Overall, the Guidelines' treatment of efficiencies is relatively terse, and the Commission has been criticized during public consultation for its cautious approach and lack of detail in this area. Moreover, an earlier draft of the Guidelines provided that the parties must "identify and substantiate" efficiencies, thus putting the burden of proof on the merging parties. The final version requires the parties to "substantiate," but no longer to "identify," efficiencies (see paras. 58, 77). It is unclear whether this is a material change. Parties to non-horizontal mergers that raise any of the red flags discussed in the Guidelines should be prepared to present the Commission with a comprehensive and verifiable explanation of how the merger will benefit consumers.

Outlook and Transatlantic Perspective

The Guidelines follow the annulment by the Court of First Instance of the Commission's decision in *Tetra Laval/Sidel*^[iv] and the rejection of most of its vertical and conglomerate effects analysis in *GE/Honeywell*.^[v] Many commentators have rightly commended the Commission for its efforts to increase the transparency of this aspect of the merger review process, despite the Guidelines' shortcomings. In line with its usual practice, the Commission has committed to review the Guidelines from time to time (para. 9). The Commission should be encouraged to take this commitment seriously, especially because the analytical framework for identifying those non-horizontal mergers that are likely to lessen competition is far from settled.

From a transatlantic perspective, the Guidelines are a clear indication that non-horizontal merger enforcement in Brussels is far from extinct. The Guidelines also serve as a reminder that the US Department of Justice's non-horizontal merger guidelines, published more than 20 years ago,^[vi] would benefit from updating or, as some suggest, rescission.

In substance, there is general agreement in the United States that non-horizontal mergers typically raise fewer competitive concerns than horizontal ones. However, there is much less agreement about the analytical standards that should apply to the competitive analysis. The US antitrust agencies have adopted a cautious attitude toward challenging non-horizontal mergers, perhaps because of a reluctance to risk impeding efficiencies based on competitive concerns that may be chimerical.^[vii] Conglomerate mergers in particular have received very little attention. The US agencies have not brought a conglomerate merger case for several decades, and the US Antitrust Modernization Commission recently concluded that such mergers "generally do not raise antitrust issues."^[viii] The Department of Justice approved the *TomTom/TeleAtlas* transaction within the initial 15-day waiting period for cash tender offers.

Most US practitioners agree that the 1984 DoJ Guidelines are outdated and provide little help in

predicting which, if any, vertical mergers the agencies will challenge. Indeed, a former Chairman of the Federal Trade Commission (FTC) has said "my guiding principle in deciding which [vertical merger] challenges to initiate was to ignore the vertical merger guidelines. They are hopelessly out of date and they ought to be revisited."^[ix] The US Antitrust and Modernization Commission seconds this view. Other commentators favor complete withdrawal, arguing that it would "not be productive" to update or supplement the 1984 Guidelines in light of the ongoing academic debate.^[x] However, a recent speech by one of the current FTC Commissioners on non-horizontal mergers and the draft EU Guidelines does not indicate that a revision or withdrawal of the 1984 US guidelines is a priority, at least not at the FTC.^[xi]

In conclusion, the Guidelines mark another step forward in the Commission's attempts to articulate a coherent merger policy. While one may fault the Guidelines for their lack of specificity and their terse treatment of efficiencies, they are undoubtedly an improvement over the status quo. Especially given other jurisdictions' reluctance to make affirmative policy statements on the treatment of non-horizontal mergers, the Guidelines will be closely studied in Europe and abroad. The TomTom/TeleAtlas case will provide the Commission with a timely opportunity to shed more light on the Guidelines' interpretation.

[i] Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (<http://ec.europa.eu/comm/competition/mergers/legislation/nonhorizontalguidelines.pdf>).

[ii] Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, available online at (http://eur-lex.europa.eu/LexUriServ/site/en/oj/2004/c_031/c_03120040205en00050018.pdf).

[iii] Case T-342/99, *Airtours v. Commission*, [2002], ECR-II-2585, at para 62.

[iv] Case T-5/02, *Tetra Laval BV v. Commission*, [2002] ECR II-4381.

[v] Case T-210/01, *General Electric v. Commission*, [2005] ECR II-5575.

[vi] Available at <http://www.usdoj.gov/atr/public/guidelines/2614.htm> (1984).

[vii] See Leon B. Greenfield & Jeffrey Ayer, *Vertical Mergers in the United States*, November 2006, p. 8 (available at <http://www.wilmerhale.com/publications/whPubsList.aspx?Attorney=e146e9fd-1e96-4aa0-874c-95933c40866e>).

[viii] Antitrust Modernization Commission--Report and Recommendations, April 2007, p. 68.

[ix] See Robert Pitofsky, *Federal Trade Commission 90th Anniversary Symposium, A Conversation with Tim Muris and Bob Pitofsky* 172 (2004) (<http://www.ftc.gov/ftc/history/transcripts/040922transcript003.pdf>).

[x] American Bar Association Section of Antitrust Law, *The State of Federal Antitrust Enforcement-*

-2004, p. 37 (http://www.abanet.org/antitrust/at-comments/2005/02-05/state_of_fed_enforc.pdf).

[xi] J. Thomas Rosch, The Challenge of Non-Horizontal Merger Enforcement, September 2007 (<http://www.ftc.gov/speeches/rosch/070927-28non-horizontalmerger.pdf>).

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