Vertical mergers

Behavioural remedies: Rising trend or wishful thinking – Part I

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Recent merger decisions point to a greater willingness on the part of European national competition authorities (NCAs) to accept purely behavioural remedies in order to address competitive concerns arising in vertical mergers, ie mergers between companies in the same supply chain. The adoption of behavioural remedies aiming to regulate the commercial and strategic conduct of the merged entity, instead of structural solutions bringing a permanent change in the structure of the market, is not new. However, there is traditionally a very strong preference on the part of the European Commission (Commission) and on most European NCAs for one-off, clear-cut solutions offered by structural or quasi-structural remedies which do not require potentially complex ongoing monitoring mechanisms, and a corresponding reluctance to accept purely behavioural undertakings. The Commission makes clear in its Merger Remedies Guidelines that "commitments relating to the future behaviour of the merged entity may be acceptable only exceptionally in very specific circumstances."[1]

Part I of this article[2] outlines the basic theories of harm which competition authorities focus on in their investigations of vertical mergers, and the distinction between structural and behavioural remedies and how that has played out in practice in the Commission's review of vertical deals. Against this background, we consider the approach of some of the major NCAs. In Part II we will examine in detail some recent cases at national level in Ireland, Austria and the Netherlands, which demonstrate a more creative and, in some regards, more intrusive approach than we have seen in other behavioural remedies cases, although ultimately this is the price companies have been willing to pay to gain approval for a complex deal without having to sacrifice the deal synergies through divestments or other more far reaching structural remedies.[3]

Vertical mergers – where's the harm to competition?

Vertical mergers involve companies in an actual or potential supplier-customer relationship, generally allowing them to achieve greater efficiencies. In contrast to horizontal mergers involving the combination of direct competitors and therefore more prone to producing anticompetitive effects, the combination of two companies, one of which is active upstream in the supply of an input which the other purchases for the manufacture of its product or development of services downstream, or which it purchases for distribution, is, in general, more likely to produce procompetitive effects. Such procompetitive effects can arise through streamlining processes and lowering costs, in particular, by potential elimination of double mark-ups (pre-merger, the supplier will generally apply as high a possible mark-up on its sales of the input to the downstream company, and, similarly, the downstream company will in turn charge a mark-up to the buyer of the integrated product or service). The procompetitive effects of vertical mergers are emphasised in the guidelines on the assessment of vertical mergers issued by the Commission,[4] and most national authorities in Europe,[5] and in the recent draft vertical merger guidelines issued by the US Department of Justice and Federal Trade Commission.[6]

However, in cases where one or both parties to a vertical merger enjoy a certain degree of market power,[7] the vertical combination may change the merging companies' and their competitors' ability and incentive to compete post-merger and thus result in harm to consumers. The focus in assessing vertical mergers is generally on the following three types of potential harm to competition:

(a) Input foreclosure. This tends to be one of the primary concerns in vertical deals and involves an assessment of the merging company's ability and incentive to disadvantage downstream competitors by foreclosing their access to necessary inputs or raising downstream competitors' costs for those inputs. Pre-merger, the independent supplier of an input has every incentive to supply downstream customers. However, when the supplier merges with a company active downstream who is its actual or potential customer, those incentives can change. Post-merger, it may ultimately be profitable to forego sales upstream by withholding inputs or charging higher prices to downstream competitors of the merged entity, to win market share away from those competitors and to increase prices to customers of the downstream product.

(b) Customer foreclosure. Anticompetitive effects can also arise if, pre-merger, the company active in the downstream market is an important customer of rival suppliers for inputs and, as a result of the merger with a new supplier, those input needs would be met wholly or partly by internal supply, depriving upstream rivals of an important customer.

(c) Exchange of competitively sensitive information. Another common concern in vertical mergers is the merged entity's access to confidential information of competitors. For example, when a company buys its supplier, it may have access to competitively sensitive information on the supplier's other customers, who are competing with the merged company in the downstream market.

In principle, since most vertical mergers are generally procompetitive and do not raise serious antitrust concerns, the vast majority are cleared unconditionally. Among the small minority of mergers that are found likely to result in anticompetitive effects, authorities impose remedies in most cases to address the concerns, whereas a prohibition decision is usually a measure of last resort.[8]

Structural versus behavioural remedies in vertical mergers

There are two main categories of remedies in merger control, structural and behavioural, which can be either applied separately or combined into a hybrid remedy. The primary objective of a structural remedy is to restore the competitive dynamics that existed prior to the merger in a permanent way, and it is for this reason that structural remedies are widely used in horizontal mergers (as they bring structural changes to the market). The main type of structural remedy is the divestiture of assets or entire stand-alone business units to third parties. Beyond divestments, there is not always a bright line in the classification of a remedy as either structural or behavioural, and other types of remedy, such as the assignment of patents or perpetual royalty-free licenses of IP, or the release of production capacity to competitors, can be classified as structural or quasi-structural, at least when they are structured in a way that does not require a material ongoing link between the merging parties and the company receiving the benefit of the remedy.

Behavioural remedies aim to regulate the future business conduct of the merged entity by imposing on it an obligation to engage in (or refrain from) certain actions for a given (sometimes considerable) period of time following the merger. Behavioural remedies encompass a very broad range of measures, from access remedies such as licensing of IP or content to competitors on fair, reasonable and non-discriminatory (FRAND) terms, undertakings to provide non-discriminatory access to other types of inputs or to ensure interoperability for competitors' products and technology, to undertakings not to engage in retaliatory action to force competitors to purchase more from the merged company, not to enter into certain types of agreements, and the implementation of firewalls in the merged company to restrict access to competitively sensitive information on competitors.

In the context of vertical mergers, divestments may not be necessary or even possible. Behavioural remedies can often be the best and most proportionate solutions, since they offer great flexibility, can be tailored to the specific requirements of each case, can adapt to rapid changes in the market environment and, most importantly, can mitigate the risk of anticompetitive harm without sacrificing valuable efficiencies that would be lost through a divestiture.

Commission practice – remedies in vertical mergers

The Commission has consistently expressed a general preference for structural remedies from the point of view of the objective of the EU merger control rules.[9] According to statements of its officials, more than three-quarters of the remedies adopted in recent years were structural in nature, in accordance with the Commission's aim to ensure that "the remedies fully replicate the competition lost through the merger".[10] However, in its Merger Remedies Guidelines, the Commission acknowledges that certain access remedies may be appropriate to address antitrust concerns arising from vertical mergers, where the access remedy has equivalent effects to a divestiture. Access remedies can span a broad range from granting competitors access to critical infrastructure to licensing of content and access to digital applications and interfaces[11] and the Commission has accepted these types of remedies in several cases, particularly in the sector of technology, media and telecommunications.[12] That said, increasing concerns about the efficiency of such remedies in preserving effective competition in telecoms have led to a shift towards more robust remedies, crafted around the transfer of assets and licences.[13] A recent example of access remedies facilitating approval of a vertical telco/media deal is the merger between a major Nordic telecom operator, Telia, and a large media house, Bonnier Broadcasting,[14] which controls several popular commercial TV channels. In order to address the Commission's concerns on input foreclosure, identified following a lengthy investigation, Telia committed to license certain of Bonnier's TV channels to rival TV distributors for 10 years on FRAND terms and to license stand-alone OTT ("over the top") rights to one other market player.

However, while the Commission is open to access remedies to address vertical concerns, it draws a distinction between access remedies that have the potential to achieve the same effect as structural remedies and "behavioural promises" to engage in or abstain from a particular conduct. For example, in the proposed combination between Deutsche Boerse and London Stock Exchange, which raised both horizontal and vertical issues, the Commission rejected the proposed remedies that consisted of a bundle of behavioural commitments combined with the divestment of LSE's clearing house and prohibited the merger.[15] As regards the behavioural commitment offered to provide the divestment buyer with access to trade feeds of LSE's Italian operator of trading venues, MTS, for three years, the Commission found several flaws with the proposal, including its lack of specificity and challenges in monitoring a complex set of behavioural commitments. It rejected the parties' argument that the proposed remedy was similar to FRAND commitments accepted in other cases, noting that "behavioural commitments imposed by the Commission in other cases cannot be compared to purely commercial arrangements that could be changed at any time in the future".[16] Its major concern was that "the commitment not to sever the link between the Divestment Business and MTS during a three-year period, which resembles a type of access commitment, fundamentally amounts to nothing more than a promise [...]" and it "clearly does not produce the same effect as the transfer of ownership on a lasting basis".[17]

In addition to access remedies, the Commission has accepted firewalls in a number of cases to address concerns in vertical mergers about access to confidential information of competitors.[18] In some cases, the Commission has accepted other types of remedies including termination of certain agreements,[19] structural modifications to the corporate structure of a joint venture,[20] and commitments not to acquire certain patents and not to enforce rights under other patents.[21]

Overview of major NCA approaches to behavioural remedies

In general, there is no consistent approach among NCAs with regard to behavioural remedies in vertical mergers. European NCAs are in principle willing to accept behavioural remedies,[22] however, there is significant divergence in the approaches of different authorities.

In recent cases in Ireland, Austria and the Netherlands, the authorities have accepted a broad range of behavioural remedies, from FRAND access to a platform, to commitments not to retaliate against competitors, undertakings to conduct certain dealings on an arms-length basis within the newly merged company, to provide discounted products, and to give advance notice to the authority of any intended acquisitions. We will look at these cases in more detail in Part II of this article; however, while they are noteworthy in terms of the openness of the authorities to use a variety of behavioural undertakings, this is not yet a widespread trend.

At the European level, the French Competition Authority stands out as the NCA that has so far accepted the greatest number of mergers subject to behavioural remedies compared to the other NCAs although it is reviewing its approach.[23] Based on a recent study on behavioural remedies conducted by the French Competition Authority, the proportion of behavioural remedies out of the commitments accepted by the French authority is 36 per cent (55 per cent if mixed commitments are included), while the rate of acceptance of behavioural remedies is less than 20 per cent for the Commission and 16 per cent for the UK.[24]

The UK Competition and Markets Authority (CMA) has stated its preference for using structural remedies, and behavioural remedies are used (on their own or in combination with structural remedies) much less frequently. In its Merger Remedies Guidance, the CMA states that in vertical mergers which are expected to result in substantial consumer benefits, it could take access and/or firewall provisions, rather than structural remedies but "such cases are rare" since these remedies are likely to be "highly complex to set up and monitor and may be rendered ineffective by possible behaviour of the merger parties."[25]

The German authority has regularly accepted divestments even in vertical mergers while purely behavioural remedies are only rarely accepted and will not be considered if they "require a constant control of the merging parties' conduct" whether by the authority or a third party. In this context, and in contrast to the Commission and several NCAs, the German authority considers that firewalls are not a suitable remedy to address concerns in a vertical merger regarding the disclosure of sensitive information on competitors.[26]

Conclusions

Merger decisions adopted in recent months by certain European NCAs show flexibility and some creativity around the use of behavioural remedies to address competition concerns in vertical deals. However, divergence in approaches among authorities remains a challenge in securing the best outcome in vertical transactions, one which provides adequate solutions to address competitive concerns, while being proportionate and preserving the main synergies of the deal.

More recently, the rise of the digital era, and the growing concerns about the increased market power of big tech companies, has led to further uncertainty as regards the future of behavioural remedies. On the one hand, the adaptability to rapidly changing market conditions and the immediate effects of behavioural remedies make them particularly appropriate in remedying anticompetitive vertical effects in fast-moving digital markets, contrary to structural remedies that can be disproportionate and impractical.[27] Most importantly, remedies adopted in mergers related to digital markets should be able to address issues related to data portability, interoperability, limitations on use of information, and access to data and changes to market structures. On the other hand, the Commission still maintains a conservative stance towards behavioural remedies, including in the context of digitisation, and even the French competition authority seems to be rowing back from its more favourable stance, referring in its recent study to the inconveniences of monitoring behavioural undertakings, stating that "a monitoring system that is too complex and time consuming can eliminate any procedural advantages gained by the initial acceptance of the commitments".[28] Recently, the head of mergers at the French Competition Authority argued that "tech cases are not actually better suited to behavioural remedies," questioning the adaptability of behavioural remedies to fast-moving industries, given their lengthy application which might at a certain point no longer reflect the market structure for which they were conceived.[29]

As policy in the field of regulation of digital markets continues to develop, and as competition agencies are called to investigate an increasing number of mergers in sectors where vertical relations are the main concern, it remains to be seen whether the benefits of behavioural remedies will gain wider acceptance and will convince their critics to revisit their approach, or whether the focus on the shortcomings of such remedies and obsession with the challenges of monitoring mechanisms will limit their application. Right now, the outcome for a vertical deal, which raises competition issues, could change significantly depending on the reviewing authority. A greater openness and flexibility would certainly be welcome. To quote Martijn Snoep, head of the Dutch Competition Authority, competition authorities should try to "overcome their aversion to behavioural remedies and use the merger control tools that are available to them".[30]

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Endnotes

1. Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 (2008) ("Merger Remedies Guidelines"), at para 17.

2. This is a two-part article on behavioural remedies. The second part will look in more detail at national cases involving Dutch, Austrian and Irish NCA merger cases.

3. Irish Competition and Consumer Protection Commission (CCPC) Decision in Case M/18/067 – LN-Gaiety/MCD Productions (July 2019), Dutch Authority for Consumer and Markets Decision in the acquisition of Iddink Group by Sanoma Learning (ACM/19/035555) (August 2019) and Austrian Competition Authority Commitments Decision in Case BWB/Z.4651 – Eventim Live GmbH/Barracuda Holding GmbH (December 2019).

4. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008XC1018(03)&from=EN, issued in 2008.

5. See, for example, the UK competition authority's Merger Assessment Guidelines, https://www.gov.uk/government/publications/merger-assessment-guidelines, at p 50.

6. https://www.justice.gov/opa/press-release/file/1233741/download. The draft Guidelines were published on 10 January 2020 for public consultation. The agencies will review and consider the public comments before issuing the final Vertical Merger Guidelines.

7. Under EU guidelines on vertical mergers, when the market share of the vertically merging companies is below 30% on both the upstream and downstream markets, there is a presumption that the parties have little or no market power that would enable them to harm competition.

8. Bundeskartellamt Decision of 23 November 2017 in Case CTS Eventim/Four Artists Booking Agentur (B6-35/17), prohibiting a vertical merger. See also OECD Roundtable on "Agency decision-making in merger cases: Prohibition and conditional clearances" (2016) at https://www.oecd.org/daf/competition/agency-decision-making-in-merger-cases.htm

9. See Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 (2008), at para 15.

10. Statement from Carles Esteva Mosso, former Director of the Commission's DG Competition, 23 October 2018. (https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1033375&siteid=190&rdir=1).

11. M.8744 Daimler/ BMW/Car Sharing JV (2019).

12. M.8314 – Brocade/Broadcom (2017), M.8665 – Discovery/Scripps (2018), M.9064 – Telia Company/Bonnier Broadcasting Holding (2019).

13. M.8864, Vodafone/Certain Liberty Global Assets (2018), M.9041 – Hutchison/Wind Tre (2018). See also "Ex-post Analysis of Mobile Telecom Mergers: The Case of Austria and The Netherlands," by L. Aguzzoni, B. Buehler, L. Martile, R. Kemp, A. Schwarz, published by the Commission in 2018.

14. M.9064 – Telia Company/Bonnier Broadcasting Holding (2019).

15. M.7995 – Deutsche Boerse/London Stock Exchange Group (2017).

16. *Ibid*, at para 867.

17. *Ibid*, at paras 1004, 1013.

18. M.6844 – GE/Avio, M.8314, Brocade/Broadcom (2017), M.8948 – Spirit/Asco (2019).

19. M.8951 – Suzano Papel E Celulose/Fibria Celulose (2018).

20. M.8948 – Spirit/Asco (2019).

21. M.8306 – Qualcomm/NXP (2018).

22. OECD, Remedies in Merger Cases (2011), at http://www.oecd.org/daf/competition/RemediesinMergerCases2011.pdf

23. French Competition Authority, Study on Behavioural Remedies in Competition Law, January 2020 at https://www.autoritedelaconcurrence.fr/sites/default/files/2020-01/eng_comportementaux_final_en.pdf

24. *Ibid*, at p 298.

25. CMA, Merger Remedies Guidance (December 2018), at p 19.
(https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/764372/Merger_remedies_guidance.pdf)

26. Bundeskartellamt Guidance in Merger Control, May 2017, paras 24, 26 and 86.

27. See, OECD Note on "Vertical Mergers in the Technology, Media and Telecom Sector (2019), at p 33.

28. French Competition Authority, Study on Behavioural Remedies in Competition Law, at p 245.

29. https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1146000&siteid=190&rdir=1.

30. https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1149031&siteid=190&rdir=1.