NON-HORIZONTAL MERGERS ICN RP CHAPTER

I. Non-Horizontal Merger Analysis

A. A merger, even if it does not involve firms that directly compete, can change the merging companies' or their competitors' ability and incentive to compete, or otherwise diminish competitive constraints, in ways that harm the competitive process. The goal of merger review is to assess whether such a merger may substantially lessen competition.

Comment 1: Competition is a process of rivalry that incentivizes business to offer lower prices, enhance quality and resiliency, innovate, expand choice or improve wages and working conditions, among many other benefits. Mergers that substantially lessen competition or tend to create a monopoly increase, extend, or entrench market power and deprive the public of these benefits. Mergers that interfere with the process of rivalry by combining rivals or potential rivals (typically called "horizontal" mergers) are beyond the scope of this chapter.

Comment 2: A merger between firms that are not current or potential rivals can harm competition when it diminishes competitive constraints or reduces the intensity with which market participants compete. A wide range of non-horizontal relationships can give rise to these concerns, including when a merger involves complements or products or services in other related markets with a connection to competition in markets where the merging firms compete. Such relationships may be of a vertical nature, where the parties are active in markets that form part of a given supply- or value chain, or conglomerate, where the parties are active in otherwise related markets. It is not always possible to clearly identify whether products or services are vertically related or otherwise related to one another. In both cases however, the analyses described below can be applicable.

Comment 3: A merger can involve a combination of horizontal and non-horizontal dimensions. These simple descriptions of the geometry of the relation between the companies involved can sometimes help to understand the potential for anticompetitive effects, but the simple descriptions do not always fit market realities. The analysis of how a merger impacts competition focuses on the risk that a merger will lessen competition, and agencies should examine the available evidence and assess the plausible effects. The recommended practices that follow outline factors that agencies should consider in determining whether a merger may lessen competition.

Comment 4: Merger analysis is an exercise in evaluating if there is a risk that a merger may substantially lessen competition. Accordingly, when evaluating a merger agencies should consider whether there is a risk that the merger may reduce competition and create or extend market power, for example, by restricting access to products or services a rival uses to compete or to a customer base; raising rivals' costs; creating or extending market power; providing the merged firm access to competitors' commercially sensitive information; increasing barriers to - or deterring - entry or expansion; leveraging a strong market position from one market to another via exclusionary practices; or blocking entry points in related markets or ecosystems.

Comment 5: An ecosystem brings together several categories of suppliers, customers, and consumers, and creates an environment for these groups to interact, such as a platform, for instance, in digital ecosystems. The products or services that make up that ecosystem may overlap or interact with each other in a variety of ways. Therefore, acquisitions by players with market power in related markets that add additional services, products, or functionalities to the ecosystem should be assessed in a way that captures the overall impact of a transaction on competition.

Comment 6*:* A non-horizontal merger may weaken horizontal competition or raise competition concerns that are ultimately horizontal in nature. For example, a merger of firms that are not currently direct competitors can raise concerns about potential competition, innovation competition, or entry deterrence in currently developing markets (for example by increasing barriers to entry or blocking entry points in adjacent markets). Such dynamic horizontal concerns can arise either in direct connection with foreclosure or independent of foreclosure concerns. Agencies should pay particular attention to dynamic markets, such as digital, high tech, life science or highly innovative markets or markets where network effects are pronounced.

Comment 7: An evaluation of the effects of a merger on competition should be grounded in the facts of the proposed merger. Agencies should use readily available evidence to assess these effects. Relevant factors that agencies can take into account when assessing mergers include market shares, diversion ratios, and the merging firms' profit margins. In some cases, economic analyses can be carried out with such data to assess the ability and incentive to engage in anticompetitive behaviour. Pricing data, capacity data, or tender (sales) data from the merging firms can be useful elements to assess the transactions' effects on competition. The views from customers, commercial associations, suppliers, or competitors on the relevant markets and on the transaction can also be important elements for the assessment. Internal documents addressing the theory of harm investigated have highly probative value, although the absence of such documents does not prove the absence of harm. Past conduct of the merging firms can also be an important element to be considered.

Comment 8: The risk of competitive harm may be identified on the basis of a credible theory of harm that is supported by relevant facts, which may be inferred from ordinary-course documents, statements from market participants, and other qualitative evidence. While quantitative analyses can, in certain cases, form an important part of such an analysis, an assessment of possible harm does not need to be quantitative in nature. Ultimately, a transaction should be assessed on the totality of the available evidence.

Comment 9: Parties may claim that their merger may generate efficiencies that reduce or eliminate the threat of a substantial lessening of competition. Efficiencies to be considered can include, for instance, complementarities between the merging firm's products that induce the merged firm to decrease prices, for example by eliminating double mark-ups, to boost the sales of these products or improve products through product integration. However, double mark-ups may not exist (for example because the merging firms, albeit active in vertically related markets, are not in a supply relationship) or there might be no incentive for pass-on to consumers (for example because prices are non-linear or downstream competition is limited). Agencies should consider whether a merger is needed to achieve these efficiencies (i.e., whether the efficiency is merger-specific).

Comment 10: A merger may cause anticompetitive effects that materialize in the long run, even when it does not substantially lessen competition in the short run. For example, a merger can eliminate a potential future competitor, subtract necessary resources from future rivals, erect barriers to future entry, or reduce innovation. If such long-run anticompetitive effects may materialise, then transactional short-term efficiencies may be unlikely to offset the long-run competitive damage resulting from the transaction.

II. Non-Horizontal mergers: Vertical effects

A. In vertical mergers, foreclosure is the theory of harm most frequently investigated. Agencies should consider a wide range of foreclosure mechanisms and effects on all dimensions of competition (price and non-price), including partial and full foreclosure as well as static and dynamic effects.

Comment 1: Agencies should evaluate whether a merger may substantially lessen competition when the merged firm can limit access to a product, service, or route to market that its rivals may use to compete (hereafter referred to as "related product"). A merger involving products, services, or routes to market that rivals use to compete may substantially lessen competition when the merged firm has both the ability and incentive to limit access to the related product so as to weaken or exclude some of its rivals in the relevant market. The merged firm could limit access to the related product in different ways. It could deny rivals access altogether, deny access to some features, degrade its quality, worsen the terms on which rivals can access the related product, limit interoperability, degrade the quality of complements, provide less reliable access, tie up or obstruct routes to market, or delay access to product features, improvements, or technical assistance or information relevant to making efficient use of the product. All these ways of limiting access are sometimes referred to as "foreclosure."

Comment 2: Input foreclosure involves the merged entity limiting access to an input that rivals may use to compete, which may include products, services, or any route to market. Input foreclosure may involve denying access to the assets in their entirety to downstream rivals (total input foreclosure) or providing access to the input to downstream rivals on worse terms than pre-merger (partial input foreclosure). 'Worse terms' can include a variety of mechanisms, including higher prices, reduced volumes of supply, a lower quality or service, degraded interoperability, delays in delivery, delays on technical assistance or delays in the release of information on new technologies. For foreclosure to lead to harm, it is not necessary that the merged entity's rivals are forced to exit the market. The relevant benchmark is whether the worsened competitive conditions upstream would impair the ability of actual or potential rivals to compete, including by virtue of changes in their products or services or the term at which they are offered, lessening competitive constraints on the merged firm and threatening higher prices, lower quality or reduced innovation.

Comment 3: Customer foreclosure refers to limiting rivals' access to a customer base. The merged entity may use its control of a downstream firm to switch purchases from rivals to itself, thereby restricting its competitors' access to customers. This could, for example, be achieved by refusing to purchase products or inputs from rival upstream suppliers, which results in these rival suppliers becoming less effective competitors for other customers (for example by denying economies of scale or reducing their incentives to invest). In addition to explicit reductions in purchases, other actions may result in a loss of sales by its upstream rivals. For example, limiting interoperability of certain products resulting in reduced use of rivals' products, purchasing inputs from an upstream rival at a lower price to an extent that would harm the ability of the upstream rival(s) to compete, or increasing the price or degrading the quality at which products that incorporate the inputs supplied from upstream rivals are sold to consumers. Moreover, a distributor may stop offering rivals' products or sell them at higher prices. Self-preferencing strategies may also reduce rivals' access to customers.

Comment 4: While anticompetitive mergers that combine suppliers of complements can lessen competition due to a strategy of raising rivals' costs, agencies should not limit their assessment to price effects and instead assess whether the merger may negatively influence any parameter of competition. For example, reductions in choice, quality, and innovation are important considerations. Agencies should pay particular attention to the effect of mergers on investment and innovation. Reduced incentives to invest (for example, in innovation) can have significant harmful effects on the competitiveness of a market.

Comment 5: In addition to considering the static effects of a merger, agencies should also consider dynamic effects in their assessment. In certain markets, economies of scale and network effects may be important parameters of competition. Agencies should therefore assess whether foreclosure strategies may deny economies of scale or network effects to rival firms such as to hamper their future competitiveness. For instance, rivals' incentives to invest in the development of new or improved products may be reduced. Low customers' switching can be relevant in certain markets, as it is a factor that may reinforce network effects and contribute to deny sufficient scale to rivals.

Comment 6: Agencies should examine the merged entity's presence at all levels of the supply chain. Consolidation may increase the merged entity's incentive to foreclose rivals' access to inputs or a customer base at all levels of the supply chain. An entity enjoying market power on all levels of the value chain and pursuing a foreclosure strategy in one of the upstream levels of the value chain may expect to gain market share not only in the level immediately downstream, but on all levels of the value chain. Moreover, the effects of the merger should be assessed with respect to all market players and not only for the customers of the merging firms. In vertically related industries, when there are also horizontal overlaps between the activities of the parties, horizontal overlaps may reinforce vertical relationships and vice versa.

II.1 Input Foreclosure

A. **<u>General</u>: When evaluating input foreclosure, agencies should assess the ability and incentives of the merged firm to substantially lessen downstream competition by limiting access to inputs that may be used by rivals to compete effectively.**

Comment 1: In assessing the likelihood of anticompetitive input foreclosure, agencies should generally assess whether the merged entity will have the ability to lessen competition by limiting access to inputs that may be used by rivals to compete effectively, whether the merged entity will have the incentive to do so, and whether a foreclosure strategy may have a detrimental effect on competition downstream. In practice, these factors may sometimes be examined together since they can be closely intertwined. Some agencies will assess those elements sequentially, while other agencies may choose to assess them all together.

B. **<u>Ability</u>: Agencies should assess whether the integrated firm has the ability to substantially lessen competition by limiting access to an input rivals may use to compete.**

Comment 1: The merged firm can foreclose downstream competitors if, by limiting access to its own upstream products or services, it could negatively affect competition on the downstream market in terms of price, quality, innovation, or other relevant parameters of competition. To assess this, agencies should consider the following factors.

- Whether there are insufficient substitutes available for an input that rivals may use to compete. For example, competitors to the supplier of an input may be less efficient, offer less preferred alternatives, or lack the ability to expand output in response to a supply restriction (for example, due to capacity constraints or decreasing returns to scale).
- Whether the input is important for downstream firms' competitiveness, such that they will be less able to exert a constraint on the merged firm if their access to the input is curtailed.
- Whether the group of downstream firms that use the input are important for competition in the downstream market.

Comment 2: Agencies should carry out a holistic assessment on the ability of the merged firm to affect the conditions of competition, including industry factors and, in some cases, market structure. Agencies may look at market shares and margins upstream as indicators of upstream market power, which is indicative of the ability to limit access to rivals. The market structure of the related product may inform the merged firm's ability to limit access to an input. If the firm has durable market power over an input that rivals use to compete, it indicates that the merged firm has the ability to weaken or exclude rivals. However, in differentiated product markets, upstream suppliers can sometimes have the ability to limit rivals' access even absent a high market or capacity share. In such cases, agencies assess the degree of the merged firm's ability lessen competition by limiting access in reference to other relevant indicators, for example, profit margins, network effects, barriers to entry, switching costs, brand strength, intellectual property, integration into wider ecosystems, or access to data. Other elements that can be considered are multi-sourcing strategies by customers and security of supply concerns.

Comment 3: When competition upstream is oligopolistic, a decision of the merged entity to restrict access to its inputs may reduce the competitive pressure imposed on the remaining input suppliers. This may allow them to raise the input price they charge to non-integrated downstream competitors, thus exacerbating the effect of foreclosure.

Comment 4: Agencies should pay attention to mergers involving a company that may expand significantly in the near future, for example, because of a recent innovation or because it is developing an important pipeline product. The innovation may occur upstream (increasing the merged entity's ability to foreclose) or in the downstream market (increasing its incentives to foreclose). Moreover, innovation may create horizontal or vertical links that do not currently exist. Agencies should pay particular attention to the acquisition of firms developing an important pipeline in a downstream nascent market, as the merged entity may foreclose rivals downstream at the development stage from reaching the market with their pipeline products.

Comment 5: Agencies will not always give significant weight to contractual protections, for example, to continue supplying both the current version and future upgrades of the input, when assessing the ability of the merged firm to foreclose its rivals. This is because these protections may not completely remove a firm's ability to harm its rivals, given that not all rivals may be covered by these contracts, or these contracts may be renegotiated or terminated over time, or may not protect against all foreclosure strategies (for example, downgrading interoperability, prioritizing tailor-made solutions for its downstream division, reducing cooperation or support, etc), among other reasons.

Comment 6: When assessing ability, some agencies focus primarily on establishing the vertically integrated firm's market power over the assets that rivals may use to compete. Those agencies will then assess the harm to the competitive process primarily when assessing the impact on competition. Other agencies may assess directly the vertically integrated firm's ability to harm the competitive process, which may already encompass an assessment of the materiality of such impact.

C. Incentives: Agencies should assess the merged firm's incentives to foreclose rivals. The vertically integrated firm will take into account how its supplies of inputs to competitors downstream will affect not only the profits of its upstream division, but also of its downstream division.

Comment 1: Agencies should evaluate whether there is an incentive to foreclose firms to the extent that the merged firm competes with them. If foreclosed rivals are less able to compete, the merged firm may benefit from diverted sales or it may be able to profitably raise prices of inputs or outputs. Foreclosure may be more profitable if the merged firm can engage in price discrimination or targeted foreclosure. Artificial intelligence and algorithms can be used by the merged firm to identify price sensitive customers and their use increases the ability to price discriminate.

Comment 2: The merger may change the trade-off faced by the upstream division when setting the price or other terms on which it sells its product to the downstream divisions' rivals. Prior to the merger, the upstream firm balanced the profit lost due to a potential reduction of input sales and the profit gained from increased input prices or lower marginal costs. After the merger, the merged firm will also take into account the benefit to the downstream division from higher downstream sales or prices. This is usually a static or short-term analysis**.** The greater the proportion of upstream units likely to be lost following a foreclosure strategy, the more upstream profits are harmed when attempting to foreclose downstream rivals. Other things equal, the lower the (absolute) margin upstream, the lower the loss from reduced input sales. However, different foreclosure strategies (for example, raising prices, slowing delivery or removing features) may have different diversion and cost effects in the short and long run. The incentive to engage in partial or targeted foreclosure strategies may be particularly large, as such strategies can be tailored so as to limit losses relative to gains from foreclosure. When assessing incentives, agencies should evaluate the overall effect on competition, and not just the profit arithmetic of one specific strategy.

Comment 3: It may be possible to assess the merged firm's incentives and likelihood that the merged firm may follow a course of behaviour directly from its past conduct, business strategy, and deal rationale. The merged entity may be more likely to pursue input foreclosure if the acquiring firm's business strategy involves this approach, it has a history of doing this with other products, or the deal rationale involves plans to do so post-merger, in which case it may not be necessary to infer behaviour from financial incentives. For example, if the merging firms' internal documents show that it would be strategically beneficial to stop supplying rivals, this would be highly informative about the incentive to foreclose.

Comment 4: The merged firm may have additional incentives to foreclose, for example, by eliminating a possible long-term competitive threat, increasing the switching costs of existing customers, positioning themselves prominently in high-growth markets, impeding pipelines being developed by rivals from reaching the market, gaining customers to obtain direct or indirect network effects, obtaining access to customer data, or enabling cross-selling within a broader ecosystem to strengthen market power. This may be particularly pronounced in dynamic markets. In such markets, agencies should pay attention to innovation in the downstream market, including pipeline products. The long-term gains from foreclosure often exceed the short-term costs of losing sales discussed above. For example, a merging firm may have an incentive to foreclose rivals in the future if it is developing an innovation downstream. If there is an innovation race downstream, a merging firm may have incentives to foreclose competitors even if it is not yet active downstream, for example, to gain a first mover advantage or to be the only company able to develop a product downstream for a new or nascent market.

Comment 5: Incentives for input foreclosure tend to be greater if downstream margins are high relative to upstream margins, while downstream rivals cannot switch to other upstream suppliers and customer switching from downstream rivals to the merged entity is high. These incentives might be affected by:

- diversion ratios upstream and downstream (i.e., evidence of switching behaviour),
- the share of the upstream product in the downstream product's costs;
- the ability to increase the effectiveness or profitability of foreclosure through price discrimination,
- the strength of scale or network effects (to gauge the likelihood that foreclosure may impede the competitive strength of actual and potential rivals upstream or downstream),
- share of the market subject to foreclosure,
- the quality and costs of products from competitors, and
- whether customers multisource, security of supply considerations and switching costs.

Some of these elements may be also useful in the analysis of the ability to foreclose. Some agencies may choose to do an overall assessment of the ability and incentive to foreclose instead of assessing them separately.

The purpose of the incentives analysis is to assess the likelihood that the merged firm may follow this course of behaviour, which may be possible to understand directly from its past conduct, business strategy, and deal rationale.

II.2 Customer foreclosure

A. <u>General:</u> To evaluate customer foreclosure, agencies should assess the merged firm's ability and incentive to harm competition by limiting access to customers that rivals may use to compete.

Comment 1: In assessing the likelihood of an anticompetitive customer foreclosure scenario, agencies should generally assess whether the merged entity will have the ability to harm competition by foreclosing access to a customer base, whether the merged entity will have the incentive to foreclose independent upstream suppliers, and whether such a strategy may have a detrimental effect on competition. In practice, these factors may sometimes be examined together since they can be closely intertwined. Some agencies will assess each of these elements sequentially, while other agencies may choose to assess them all together.

Comment 2: If the merged entity stops or reduces its purchases from rivals in the upstream market, this may negatively affect their ability or incentive to compete in the upstream market. In turn, this may raise downstream rivals' costs by making it harder for them to obtain supplies of independent upstream inputs. Moreover, customer foreclosure may hamper an upstream producer's ability to access customers in the downstream market (for example, if the downstream firm is a retailer it may charge higher agency fees, or if it is a distributor, it may increase retail prices for rivals' products or stop distributing such products), thereby raising rivals' costs in the upstream market or reducing their sales. The merged entity may also implement self-preferencing strategies, which would reduce rivals' sales. These different foreclosure strategies may allow the merged entity to increase prices or reduce choice, quality, or innovation efforts along the vertical chain to the detriment of consumers. Moreover, the mechanism of customer foreclosure can sometimes be similar to input foreclosure. Indeed, in some cases, the definition of what is "upstream" and "downstream" can be difficult or even interchangeable.

B. <u>Ability</u>: Agencies should evaluate whether the merged firm has the ability to limit access to rivals' customers and can exert influence on the conditions of competition upstream by reducing or eliminating its purchases from upstream rivals, implementing self-preferencing strategies or by limiting access to downstream distribution.

Comment 1: Agencies should consider whether upstream rivals would lose sales overall if the merged firm bought fewer units from them or limited their access to distribution. For example, the sales of upstream rivals might be largely unaffected if the downstream firm acquired an input maker whose capacity exceeded the merged firm's requirements, even if the merged firm stopped buying from rival input makers altogether, provided that the merged firm cannot expand its capacity downstream.

Comment 2: If customer foreclosure impacts the scale or profitability of upstream rivals, it may reduce the rivals' ability and incentive to compete in the short term and to invest in cost reduction, research and development, and product quality, reducing their ability and incentive to compete in the long run. The impact on competitors' scale or profitability can possibly hamper them to compete effectively or even cause their exit from the market especially in the long term, harming downstream rivals that depend on them.

Comment 3: Agencies should examine whether the merged firm's rivals will have adequate sales opportunities post-merger to maintain or improve their competitive strength. Customer foreclosure can lead foreclosed rivals to charge higher input prices or offer less attractive products in situations such as economies of scale or scope in the input market or when demand is characterised by network effects. If existing upstream rivals operate at or close to their minimum efficient scale, the corresponding loss of output for the upstream rivals increases their variable costs of production. This may result in an upward pressure on the prices they charge to accessible customers operating in the downstream market, which may allow the merged entity to increase its own upstream prices or to increase downstream prices as well. Moreover, when the integrated downstream firm has market power, limiting access to distribution for rival upstream producers may raise their costs of reaching customers on the downstream market, thus allowing the integrated upstream firm to face less competition.

Comment 4: Agencies should carry out a holistic assessment on the ability of the merged firm to affect the conditions of competition. An important element to consider in this analysis is the degree of downstream market power as evidenced by share of purchases of the upstream product, downstream margins, scope of alternative customers downstream, network effects, economies of scale, brand strength, control of intellectual property or the importance of access to large amounts of data.

Comment 5: When assessing ability, some agencies focus primarily on establishing the vertically integrated firm's ability to limit access to rivals' customers. Those agencies will then assess the harm to the competitive process primarily when assessing the impact on competition. Other agencies may assess directly the vertically integrated firm's ability to harm the competitive process, which may already encompass an assessment of the materiality of such impact.

C. <u>Incentives</u>: **Agencies should assess the degree to which it is profitable to engage in conduct leading to foreclosure. The vertically integrated firm will take into account how its strategy would affect the profits of both its upstream and downstream division.**

Comment 1: The incentive to engage in foreclosure comes from the potential to weaken competitors in the upstream market or markets, the downstream market or markets, or both.. Agencies should evaluate how closely the merged firm competes with the potentially weakened rivals, and whether it might benefit from diverted sales or higher prices if the rivals faced higher costs.

Comment 2: The merged firm likely will not have an incentive to increase the costs of upstream rivals if it cannot supply all its input needs from its own upstream division. If the merged firm relies on rival input providers for incremental output, then it will face the same increase in marginal costs as downstream rivals do if the costs of rival input makers are higher.

Comment 3: The costs of the foreclosure strategy from reduced purchases from rival upstream suppliers are higher when the upstream division of the integrated firm is less efficient than the foreclosed suppliers due to lower quality or higher prices. Such costs are also higher if the upstream division of the merged firm is capacity constrained or sales utilizing rivals' inputs are more attractive to some consumers due to product differentiation. Incentives can be particularly significant if foreclosure hampers the long-term competitiveness of upstream rivals (for example, if it reduces their ability to produce at an efficient scale, or if a reduced addressable market makes it less worthwhile to invest in product improvements or innovation), because this may allow the merged entity to raise prices and thus earn larger profit margins post-merger. The long-term effects are often more important than the short-term costs of losing sales discussed above.

Comment 4: It may be possible to assess the merged firm's incentives and likelihood that the merged firm may follow a course of behaviour directly from its past conduct, business strategy, and deal rationale. The merged entity may be more likely to pursue customer foreclosure if the acquiring firm's business strategy involves this approach, it has a history of doing this with other products, or the deal rationale involves plans to do so post-merger, in which case it may not be necessary to infer behaviour from financial incentives. For example, if the merging firms' internal documents show that it would be strategically beneficial to foreclose rivals' access to customers, this would be highly informative about the incentive to foreclose..

Comment 5: The merged firm will be more likely to pursue a customer foreclosure strategy if its broader strategy or deal rationale involves self-supply. The merged firm may pursue objectives such as self-preferencing, increasing the switching costs of existing customers of the upstream division, positioning itself strongly upstream, gaining customers to obtain direct or indirect network effects, or obtaining access to customer data.

Comment 6: When the merged firm is a distributor or retailer, it may have an incentive to raise the retail price of rival products, place them in less advantageous positions in the store, reduce the commissions paid to sales staff for selling rival products, or otherwise hamper rival retail sales through its stores. This incentive will be greater when customers are more loyal to the store and might switch to buying one of the merged firms' products in the store instead. The incentive will be smaller when customers are more loyal to the brand and might leave the store to buy their preferred brand elsewhere.

Comment 5: Incentives for customer foreclosure tend to be greater if upstream margins are high relative to downstream margins, while upstream competitors cannot switch to other downstream rivals and customer switching from the merged entity to other downstream rivals is low. These incentives might be affected by:

- diversion ratios upstream and downstream (i.e., evidence of switching behaviour),
- the ability to increase the effectiveness or profitability of foreclosure through price discrimination,
- the strength of scale or network effects (to gauge the likelihood that foreclosure may impede the competitive strength of actual and potential rivals upstream or downstream),
- share of the market subject to foreclosure,
- the quality and costs of products from competitors, and
- whether customers multisource, security of supply considerations and switching costs.

Some of these elements may be also useful in the analysis of the ability to foreclose. Some agencies may choose to do an overall assessment of the ability and incentives to foreclose instead of assessing them separately.

The purpose of the incentives analysis is to assess the likelihood that the merged firm may follow this course of behaviour, which may be possible to understand directly from its past conduct, business strategy and deal rationale.

II.3. Likely Impact of Input or Customer Foreclosure on Competition

A. A merger can raise competition concerns because of foreclosure when it may worsen the conditions of competition in the upstream or downstream market.

Comment 1: Where the assessment of the ability to foreclose includes the ability to affect the competitive process, and incentive to foreclose derives from the reduction in competition, no separate analysis of the impact on competition is required. When it has been established that the merged entity may foreclose competitors, this will often directly imply a harm to overall competition, where the foreclosed firms play a role in the competitive process on the downstream market. The higher the proportion of rivals that would be foreclosed from access to the downstream market, the more likely the merger can be expected to result in negative effects in the downstream market. To assess the extent of the impact on the market, agencies should consider the number and importance of rivals being foreclosed and the importance of vertically integrated competitors. A small player can play a significant role in downstream competition if it is an important innovator, expected to expand, a maverick, or developing a pipeline to enter a nascent market. Moreover, the competitive effect of foreclosure will be larger, the larger it is the part of the market that is foreclosed, the more difficult it is for foreclosed rivals to substitute the foreclosed product or service with alternative offers, and the larger the impact of such foreclosure on rivals' overall ability to compete. For example, harm will be likely to be more significant in markets with scale or network effects, where access to a large customer base is critical for a competitive offering.

Comment 2: Even if current competitors are not immediately foreclosed, competition may be substantially lessened if the risk or threat of foreclosure raises barriers to entry to potential competitors. The mere likelihood that the merged entity could carry out a foreclosure strategy may create a deterrent effect on potential entrants. This is particularly so if foreclosure would entail for potential competitors the need to enter at both the downstream and the upstream levels to compete effectively on either market. The potential threat of foreclosure can also reduce incentives to innovate downstream for non-vertically integrated firms, in particular if it would be difficult for them to grow absent access to the input or customer base.

Comment 3: By limiting rivals' access to an input or customer base, the merger may also reduce their ability to compete in the foreseeable future or force them to exit the market. This may allow the merged entity to compete less aggressively, such as by profitably raising prices or reducing output, quality or innovation. The negative impact on consumers may take some time to materialise when the primary impact on the scale or profitability of upstream rivals reduces their incentives to make investments in cost reduction, product quality, innovation, or in other competitive dimensions to remain competitive in the long run.

II.4 Access to competitively significant information

A. Agencies should assess whether the merger will threaten competition by enabling the merged firm to gain or increase access to rivals' competitively sensitive information.

Comment 1: New post-merger relationships among rivals may enable the merged entity to learn information such as competitors' pricing, sales volumes, or commercial strategy; a rival's intention to launch new or improved products; or information about the technical performance of products developed by competitors. The merged firm may use access to a rival's competitively sensitive information to adjust its competitive response to rivals' actions, which may result in a less competitive market. For example, this access may facilitate coordination among competitors or undermine incentives to compete. The risk of unlawful coordination may be especially pronounced in highly concentrated markets or where there is evidence of prior, actual or attempted attempts to coordinate in the relevant market.

Comment 2: The merged firm could use commercially sensitive information about its competitors to undermine or counteract its rival's actions and limit competitive opportunities. Access to rivals' competitively sensitive information may put rivals at a competitive disadvantage, which may dissuade them from investing, expanding, lowering prices or even entering a market in the first place.

III. Non-Horizontal mergers: Conglomerate effects

A. <u>General</u>: Agencies should assess whether the combination of products in different markets may confer on the merged entity the ability and incentive to leverage its market position from one market to another by exclusionary practices that substantially lessen competition.

Comment 1: In assessing the likelihood of a merger that combines products in related markets to lessen competition, agencies should generally assess whether the merged entity will have the ability to lessen competition, whether the merged entity will have the incentive to do so, and whether such a strategy may have a detrimental effect on competition. In practice, these factors may sometimes be examined together since they can be closely intertwined. Some agencies will assess those elements sequentially, while other agencies may choose to assess them all together.

Comment 2: When a merger combines products in related markets, a possible theory of harm is that the merged entity may foreclose its rivals in one market from accessing customers by leveraging its strong position in another market. This leveraging typically entails linking the sales of products belonging to separate markets to the detriment of competitors in a way that harms consumers. Foreclosure is also a mechanism that may deter entry or undermine incentives for future investments, meaning the effects of such foreclosure may only materialise in the future.

Comment 3: Different types of practices could lead to foreclosure effects.

- Technical tying: the tying product is designed in such a way that it only works, or works better, with the tied product, but not with the alternatives offered by competitors (for example, an interoperability issue).
- Contractual tying: customers are contractually obliged to purchase the two products together.
- Pure bundling: the merged entity would not sell products separately, but only jointly to customers in fixed proportions.
- Mixed bundling: the products are offered both separately and as a package deal, where the package price is lower than the sum of the stand-alone prices of the products.

Such potentially exclusionary practices can sometimes arise jointly with horizontal concerns (for example, the elimination of potential competition or dynamic competition).

B. <u>Ability</u>: Agencies should assess the merged entity's ability to foreclose its rivals via practices such as tying or bundling or other potentially exclusionary practices.

Comment 1: Agencies should assess whether the merged entity has the ability to lessen competition by foreclosing its rivals in a related market. This assessment can include the calculation of market shares, but also an analysis of the implications for related products if access to such products were to be eliminated, i.e. the competitive significance of the related product(s) and the effect on competition in the relevant market(s). Elements that should be considered as part of a holistic assessment of market power include brand strength, profit margins, the existence of network effects, the presence of barriers to entry, switching costs, the control of intellectual property, access to data, integration into wider ecosystems and market structure, the competitive landscape, customers' actual switching, or the ability of competitors to expand output.

Comment 2: The relationships between the markets should be assessed. Critical elements include whether customers have an incentive to buy the two products or services together, and whether there is a pool of common customers in the related markets.

Comment 3: The ability of the merged entity to engage in exclusionary practices could also depend on the economies of scale or network effects which prevail in the relevant markets. The ability to foreclose rivals via bundling or tying can be stronger in industries with economies of scale or network effects. Foreclosure into markets with scale effects can be particularly damaging if these are so pronounced that there is a risk that the market may "tip" (i.e., leading to an environment in which rivals of a dominant firm can no longer compete effectively due to lack of scale).

Comment 4: When assessing ability, some agencies focus primarily on establishing the firm's market power in the related market. Those agencies will then assess the foreclosure of rivals primarily when assessing the impact on competition. Other agencies may assess directly the firm's ability to foreclose rivals, which may already encompass an assessment of the materiality of such impact.

C. <u>Incentives</u>: **The merged entity's incentives to foreclose depend on the profitability of the strategy. Therefore, the assessment considers the foreclosure strategy's potential costs and its likely benefits.**

Comment 1: An incentive to foreclose companies active in a related market may exist if the merged firm competes with them. The assessment focuses on whether a potential gain in sales from foreclosing rivals in one market would be outweighed by a loss of sales in the related market(s). Agencies should undertake a holistic assessment of any relevant factors.

Comment 2: It may be possible to assess the merged firm's incentives and likelihood that the merged firm may follow a course of behaviour directly from its past conduct, business strategy, and deal rationale. The merged entity may be more likely to pursue a combined offering if the acquiring firm's business strategy involves this approach, it has a history of doing this with other products, or the deal rationale involves plans to do so post-merger, in which case it may not be necessary to infer behaviour from financial incentives. For example, if the merging firms' internal documents show that it would be strategically beneficial to foreclose rivals, this would be highly informative about the incentive to foreclose.

Comment 3: The analysis of incentives may include gains in sales, losses of sales in related market(s) and relative profits in both markets, similar to the case of vertical foreclosure.

Gains in sales may be greater if:

- the merged firm has a more attractive offering,
- it competes closely with the rivals that may be foreclosed, or
- the merged entity has a strong ability to foreclose, as this would likely result in a large volume of switching from the affected rivals.

Losses in sales in related market(s) are likely to be greater if:

- many customers have little interest in also purchasing the other product, and
- the merged entity would need to pursue an aggressive strategy to foreclose competitors.

However, losses may be lower if the merged entity can provide the combined offering on a targeted basis to only those customers who would be likely to accept it.

Foreclosure is more likely to be profitable if the sales diverted away to the merged entity have high margins. A successful foreclosure strategy may also increase the profit margins of the merging parties.

Comment 4: The analysis may include other costs and benefits including the extent the transaction leads to increasing the stickiness of existing or future customers; the merged entity benefitting from future market growth; gaining customers to obtain direct or indirect network effects; obtaining access to customer data; or enabling cross-selling within a broader ecosystem.

Comment 5: The analysis may also take into account other factors, including the ownership structure of the merged entity.

Some of these elements may be also useful in the analysis of the ability to foreclose. Some agencies may choose to do an overall assessment of the ability and incentives to foreclose instead of assessing them separately.

The purpose of the incentives analysis is to assess the likelihood that the merged firm may follow this course of behaviour, and it may also be possible and equally important to understand this directly from its past conduct, business strategy and deal rationale.

D. <u>Likely impact on competition</u>: Agencies should assess whether the foreclosure strategies may result in a reduction in rivals' ability or incentive to compete and ultimately affect competition.

Comment 1: When assessing the impact on competition, agencies will build on similar evidence as in the assessment of the ability and incentive to foreclose. The assessment of the impact on competition focuses on the impact on the competitive process, including the materiality of this impact.

Comment 2: Foreclosure strategies may limit sales by rivals. This may lead to a reduction in rivals' ability or incentive to compete and allow the merged entity to subsequently acquire market power (in the market for the tied or bundled good) or to maintain market power (in the market for the tying or leveraging good). When assessing the impact on competition, agencies will build on similar evidence as the assessment of the ability and incentive to foreclose. The transaction may impede competition only when a sufficient fraction of market output is affected by foreclosure resulting from the merger. Rivals can be impacted in their ability and incentive to compete on prices and quality, and the foreclosure practices may increase (actual or potential) competitors' barriers to entry and expansion or reduce their incentive to innovate, which in turn may impact effective competition.

Comment 3: Unlike its single-component competitors, the merged entity's pricing strategy may be tailored to the specific bundle to acquire or maintain market power. When complementary goods are priced independently, suppliers would not take into account the positive effect of a drop in the price of one product on the sales of the product in the related market(s). Depending on the market conditions, a merged firm may do so. By internalising this effect, the merged entity may have a certain incentive to lower margins if this leads to higher overall profits (this incentive is often referred to as the Cournot effect, which is the conglomerate equivalent of the elimination of double marginalisation in vertical markets). In most cases, the merged firm will make the most out of this effect by means of mixed bundling, i.e., by making the price drop conditional upon whether or not the customer buys both products from the merged entity. Conversely, the merged entity may have an incentive to increase standalone prices of its products, since these will be combined with rivals' products post-merger.

Comment 4: Besides harming existing competitors, foreclosure practices may also deter entry by potential competitors. They may do so by reducing sales prospects for potential rivals in a market to a level below minimum viable scale.

Comment 5: A merger that combines products in related markets may be of greater concern in markets where new customers may be easily diverted to the merged entity, scaling is particularly critical, competitors are easily marginalised, entry can be deterred, incentives for investment can be undermined, and the future benefits of controlling these markets are large. However, these anticompetitive effects may not emerge until after the market has reached maturity and entry has been limited. Therefore, the impact on the market and competition on those markets may need to be assessed over the longer term. For example, this is the case when foreclosure in a related market has the objective of protecting the acquiring firm's own strong market position against future entry or innovation from nascent rivals in another market.

IV. Non-Horizontal mergers: Dynamic effects and potential competition beyond or around foreclosure

A. Non-horizontal mergers may cause dynamic horizontal concerns or have dynamic effects, which can impact potential or future competition, or reinforce market power, including by raising barriers to entry or expansion, lessening innovation competition or blocking entry points in related markets.

Comment 1: A non-horizontal merger may raise concerns beyond foreclosure by eliminating potential competition from the target or from the acquirer, innovation competition or entry deterrence, in particular in currently developing markets or within ecosystems where at least one of the merging firms already has market power the merger may protect or entrench.

Comment 2: A merger can have additional dynamic effects, for example, by protecting or entrenching a dominant position through raising barriers to entry or expansion; raising customers' switching costs; or interfering with the use of competitive alternatives; by depriving rivals of economies of scale or by reinforcing network effects, beyond static exclusionary effects. These effects may deter entry by reducing the sales prospects for potential rivals in a market to a level below minimum viable scale or to a level that decreases incentives to innovate. When a competitor could be impacted due to the dynamic effects of the transaction, agencies should assess for example, whether the decrease of the competitor's scale of production or sales would lead to an increase of the average unit cost, resulting in a loss of economies of scale or a competitive disadvantage for the competitor relative to the merged entity (i.e., reinforcing network effects).

Comment 3: Agencies should consider in their analysis whether, irrespective of any foreclosure conduct, a merger potentially harms competition, for example as it—

- allows the acquirer to protect or entrench a core product with strong market power from future entry by blocking entry in related markets or by eliminating a potential competitor;
- allows the acquirer to leverage market power from one market into another market to expand market power (within its ecosystem);
- increases barriers to entry or expansion, for example, by increasing switching costs, interfering with the use of competitive alternatives, or depriving rivals of scale economies or network effects;
- decreases access to and interoperability with the ecosystem to block entry points and harm dynamic competitors;
- gives access to commercially sensitive information of competitors and consumers; or
- leads to an accumulation of data to the detriment of competition and consumers.

Comment 4: Data can be a material input or barrier to enter. In assessing the importance of data as an entry barrier agencies may take into consideration what kind of data is held or collected by the parties, how frequently the parties collect data, how relevant the data held or collected by one of the parties is for the improvement of the service provided by the other party, or how advantageous the data held or collected by one of the parties is compared to the data that is available to competitors.

B. Competition concerns can arise from the existence of at least one party being part of a group whose activities form a business ecosystem with complementary, or otherwise related activities.

Comment 1: When a firm with a business ecosystem acquires a target that is active in (a) related market(s), it may raise potential competition concerns in the market of the acquirer or of the target; it may raise dynamic competition concerns in existing or future markets; it may increase barriers to entry and expansion; or it may block entry points into the core market from related markets.

Comment 2: If the acquirer has a business ecosystem, agencies should consider whether the target has capabilities that are scarce; it has or would acquire a strong position in the related market; or whether the transaction strengthens network effects or increases customer switching costs. Such factors may protect, entrench or extend market power within an ecosystem through a dynamic combination of horizontal and non-horizontal effects.

Comment 3: Acquisitions in related markets to a digital ecosystem may allow the merging firm to add a large amount of traffic and customer access to their ecosystem. This consolidation may reinforce network effects. In markets where consumer switching is low, this may work to the benefit of large digital ecosystems. While increased traffic can be the result of an improved product offering, the additional traffic generated with such acquisitions in related markets may entrench a dominant position or increase barriers to entry. Such acquisitions may also block entry points into the core market from related markets. For example, absent the transaction, rivals may have grown in related markets to subsequently enter the market in which the acquirer has market power.