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REGULATION OF VERTICAL MERGERS UNDER EUROPEAN UNION LAW: LESSONS TO BE LEARNT BY OTHER JURISDICTIONS

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Regulation Of Vertical Mergers Under European Union Law: Lessons To Be Learnt By Other Jurisdictions

Mrudul Dadhich*

Abstract

Companies active in different levels of the supply chain may perceive it lucrative to integrate their businesses into a single entity. They may be motivated to do so owing to the expected efficiency gains, improvements in the quality of their products or increased variety and innovation. However, this may not be the sole reason for firms to merge vertically. A merged entity could be able and willing to foreclose access to supplies or markets for its rivals on account of its consolidated position. Such 'anti-competitive' effects may significantly impede the competition in the relevant markets and thereby, can lead to escalation of the prices to the detriment of customers.

The competition authorities (the European Commission and the CCI respectively) are primarily entrusted with the task of assessing the competitive effects of a proposed merger having a Union-wide dimension (territorial nexus for Indian system) and shall prohibit those proposed mergers which are not compatible with European competition law.

In its merger assessment, the competition authorities must try to balance the competitive conditions that prevail prior to the proposed merger against the competitive conditions that would occur after the merger.

This thesis illustrates what lessons Indian competition law can draw from the European Union as a role-model for an efficient system.

Keywords: Anti-trust Law, Mergers, Non-Horizontal Mergers, Non-Horizontal Merger Guidelines, European Commission, CCI, Anti-competitive effects, Efficiency, Lessons to be learnt.

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TABLE OF CONTENTS

LIST OF ABBREVIATIONS I

A. Introduction 1

1. Prefatory 1

2. Research Questions 3

3. Significance of the Study 3

4. Outline of the Analysis 4

B. Defining the concepts: A broad outlook 6

1. Understanding the dynamics of mergers 6

1.1 Distinction between different types of mergers 6

1.2 Definition of concentrations/combinations 8

1.3 The 'community dimension' or the local nexus requirement 10

1.4 Threshold limits 11

1.5 Market share and concentration levels 13

2. Reasons for control of vertical mergers 15

3. Challenges encountered in the control of vertical mergers 16

C. Regulation of Vertical Mergers under the European Union Regime 19

1. Legal basis for vertical merger control under the European Union Law 19

2. Non-coordinated effects arising out of vertical mergers ... 20

2.1 Foreclosure 20

2.1.1 Input foreclosure 21

2.1.1.1 Capability to foreclose access to inputs 22

2.1.1.2 Incentive to foreclose access to inputs 25

2.1.1.3 Overall likely impact on effective competition 26

2.1.2 Customer Foreclosure 29

2.1.2.1 Ability to foreclose access to downstream market 30

2.1.2.2 Incentive to foreclose access to downstream markets 32

2.1.2.3 Overall likely impact on effective competition 34

2.2 Other non-coordinated effects 35

3. Co-ordinated effects arising out of a vertical merger 36

4. The 'efficiencies' justification 38

4.1 Increase in the pricing efficiency 40

4.2 Improvement in the productive efficiency 41

4.3 Incomplete contracts and transaction costs 43

D. The regulation of vertical mergers under Indian Law 46

1. Legal basis for vertical merger control under Indian Law 47

2. Competitive problems from vertical mergers 48

2.1 Facilitating coordination through vertical mergers 49

2.2 The possibility of elimination of specific potential entrants 50

2.3 Barriers to entry due to the vertical merger 51

3. Merger efficiencies under the *Competition Act, 2002* 54

E. Comparative Analysis: Major takeaways for the Indian jurisdiction 59

1. Pre-merger notification requirement 60

2. Substantive analysis of vertical mergers: test and criteria for merger control 61

3. Criteria for assessment of the vertical mergers 62

3.1 Market share and market concentrations 63

3.2 Barriers to entry 65

3.3 Welfare objectives and benefits to consumers 66

4. Efficiency Consideration 67

F. Conclusion 70

APPENDICES II

BIBLIOGRAPHY/LIST OF DOCUMENTS IIV

List of Abbreviations

AAEC	Appreciable Adverse Effect on Competition
Art.	Article
CoI	Constitution of India
CBS LJ	Copenhagen Business School Law Journal
Colum. J. Eur. L	Columbia Journal of European Law
CCI	Competition Commission of India
DPSP	Directive Principles of State Policy
ECLR	European Competition Law Review
ECR	European Court Reports
ELR	European Law Review
EC	European Community
ECJ	European Court of Justice
ECMR	European Community Merger Regulation
eds.	editors
et sqq.	and the following
EU	European Union
fn.	footnote
J.L. & Econ.	Journal of Law and Economics
p.	page
para.	paragraph
R&D	Research and Development
s.	Section
SIEC	Significantly Impeding the Effective Competition
v.	versus

A. Introduction

1. Prefatory

Mergers are normal activities within the economy and afford a suitable instrument for enterprises for the expansion of business. A merger may be defined as the combination of two or more independent business corporations into a single enterprise, usually involving the absorption of one or more firms by a dominant firm.

Mergers offer numerous benefits. It facilitates in achieving the economies of scale and scope[1] to be utilized for more efficient management and other efficiency objectives. They provide a base for the business entities to prosper and grow; to delve into new markets and diversify without starting afresh and thereby avoiding many market related risks. However, irrespective of their multiple advantages mergers attract the attention of competition policy makers because they generally have implications for the concentration of, and ability to use, market power, which, in turn can have an adverse effect upon the competition in the market and eventually dent the consumer welfare by foreclosing market entry for other players.

As Goldberg (in 1973) said that mergers have an impact upon the concentration levels and utilisation of market power because mergers tend to pave way for:

a) the gradual decline in the number of market players; and

b) the growth of the market share of the conglomerated entities.[2]

This spells out the basic principle for exercising merger control, that if a merger is likely to give rise to market power, it is better to prevent

[1] Economy of scale implies the decrease of the average cost per unit of output with increase in the scale of output.

[2] *Goldberg*, in: *Dhall* (ed.), Competition Law Today: Concepts, Issues and the Law in Practice, pp. 88-101.

this from happening than to control the exercise of market power after the merger has taken place, that is to say prevention is better than cure.[3] Further, enterprises should be prohibited from evading the competition law by using the merger route to achieve an agreement between themselves which otherwise is likely to be deemed as anti-competitive or a market distorting practice by the relevant competition authority. It is for these reasons that competition law is concerned with the mergers and many of the jurisdictions having an anti-trust law regime incorporate provisions on control of mergers.

As it has been already submitted that provisions on merger control/regulation in most competition laws essentially seek to prevent mergers that would negatively affect competition, this is achieved either:

a) by reviewing the mergers to determine their effects on competition and undertaking remedial measures to ensure that the anti-competitive impact can be averted, and

b) where such remedial measures are not effective enough, the mergers are prevented from taking effect.

Having said this, it has to be kept in mind that all mergers do not bear a negative impact on the economy. Mergers can also be an effective means of generating efficiencies, achieving public interest benefits and can also facilitate the achievement of national policy objectives by promoting growth in national markets and exports.[4] Therefore, it is imperative that the merger control regime scrutinize the effects of mergers carefully and ensure that the beneficial mergers are not unduly hampered by the regulations. This requires a delicate balancing

[3] *Dhall*, in: *Dhall* (ed.), Competition Law Today: Concepts, Issues and the Law in Practice, pp. 1-23.
[4] *Tiwari*, Bond Law Review 2011, p. 119.

act of prohibition and permission in merger control.[5]

This thesis proposes to study the statutory provisions, relevant regulations and other literature of provisions related to vertical merger regulation in the European Union jurisdiction and lessons to be imparted to Indian legal system.

2. Research Questions

a) What is the significance of a dedicated mechanism for regulation of vertical mergers? If the Indian legal system does not provide for a separate vertical mergers regulation, which law in India regulates the same?

b) What changes does the Indian vertical mergers regulation regime need to incorporate from the European Union?

3. Significance of the Study

Keeping in mind the nascent stage of the competition law regime in India, the topic which has been selected for the thesis is very relevant considering the fact that a very little analysis of *Competition Act, 2002* has been undertaken academically, especially with the view of controlling the vertical mergers aspect. It becomes imperative to discuss and analyze the assigned topic because of the simple fact that the Indian laws on mergers are more or less designed to regulate mergers in general and the corresponding implications of the same for vertical merger control is more or less an undiscovered territory. Although the Competition Commission of India ("**CCI**") has taken steps to address the concerned issues and with this study, the idea is to analyze the efforts put in by the CCI and suggesting any modifications by analytical study of corresponding provisions across the globe. So it is the most opportune time for the Indian authorities to understand the

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[5] *Goldberg* (fn. 2), p. 94.

importance of specific provisions for regulation of vertical mergers as an independent aspect and take a cue from the formidable European Union regime on vertical mergers.

4. Outline of the Analysis

After the insight into the basic concepts relevant for this study (covered under **Part B**), the focus shifts on the qualitative analysis of the existing merger control regimes implemented in the European Union and Indian jurisdiction. The next part (**Part C**) of this thesis is dedicated to the analysis of the control of the vertical mergers in the European Union. The *Non-Horizontal Merger Guidelines* of the European Commission has been the guiding source as to how the European Commission treats a situation of a vertical merger. The chapter discusses the different criteria including the efficiency justification that the European Commission takes into consideration while assessing a vertical merger.

The next part of the thesis discusses the situation in India (**Part D**) and how the CCI deals with vertical merger cases. Parallel to its European counterpart, the Indian system too takes into consideration a variety of factors. Additionally, the competition authority has identified certain factors as a precondition for the analysis of mergers in India. An attempt has been made to understand the practice employed by CCI.

Following the discussions on the existing practices in India and European Union, a comparative analysis has been made citing out the key differences in the interpretation and application of the merger control provisions in the two jurisdictions (**Part E**). Since, Indian law is still in a developing stage, certain lessons which may be incorporated from the European Union jurisdiction have been highlighted in this part of the thesis. This study is capped off with

some challenges and the possible roadmap ahead (**Part F**) which may be implemented to counter the existing problems of vertical merger control in India.

B. Defining the concepts: A broad outlook

1. Understanding the dynamics of mergers

In an endeavour to study mergers under the purview of competition law, the first logical step would be to demarcate the transactions which fall within the ambit of merger control, i.e., the definition of mergers. Within the context of company law, mergers are ordinarily understood as 'the absorption of one company (especially a business entity) into another so that the merging entity loses its identity and the latter retains its own name and identity and acquires the assets and liabilities of the former'.[6] Many competition laws/regulations, including those forming the core of the present study, do not in fact use the term mergers alone; rather they use a 'synthesized' expression such as 'combinations' (India) or 'concentrations' (European Union) to categorize the transactions that are dealt with or can be dealt with by the relevant merger control laws.

1.1 Distinction between different types of mergers

Mergers can be classified on the basis of the position of the merging parties in the economic chain prior to the merger, acquisition or the joint venture, as the case may be.[7] On this basis, there are two types of mergers: horizontal mergers and non-horizontal mergers. Horizontal mergers occur when actual or potential competitors in the same relevant market combine together.[8] In horizontal mergers, entities which are active in the same market merge i.e. a merger between two manufacturers constitute horizontal merger. Unlike horizontal mergers, non-horizontal mergers occur when the firms concerned are

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[6] *Black,* in: *Garner* (ed.), Black's Law Dictionary, p. 652.
[7] *Tiwari* (fn. 4), p. 129.
[8] Council Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations Between Undertakings, 2004 O.J. (C 31) endnote 5. ("**Horizontal Merger Guidelines**").

active in different markets. Non-horizontal mergers can be further demarcated into vertical mergers and conglomerate mergers.[9]

An illustration of a vertical merger is when a manufacturer (called the "upstream firm") acquires one of its distributors (called the "downstream firm"). In this example, the manufacturer is not operating in the same relevant market, as the distributor is on a different level of the supply chain.

Unlike vertical mergers, conglomerate mergers can neither be categorized as horizontal nor vertical. The European Commission's *Non-Horizontal Merger Guidelines* state that an example of such a merger would be when a merger occurs between companies that are active in closely related markets; that is, the merger could involve suppliers of complementary products or products that belong to the same product range.[10] For example, a merger between a supplier of photocopy machines and a producer of ink could be considered as a conglomerate merger. In the current world scenario, where focus is mainly on specialization, conglomerate mergers have become a rarity. The firms perceive that focusing on a main business is more profitable for them.[11]

While evaluating the anti-competitive effects of a vertical merger, the regulation authorities must compare the competitive conditions that would occur without the proposed merger to the competitive conditions that would prevail after the merger.[12] Significantly, the merger control system in European Union and Indian jurisdiction is based on a statutory requirement of a prior notification for

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[9] Commission Notice, Guidelines on the Assessment of Non-Horizontal Mergers under the Council Regulation on the Control of Concentrations Between Undertakings, 2008 O.J. (C 265) part I 3. ("**Non-Horizontal Merger Guidelines**").
[10] *Ibid.*, part I 5.
[11] *Monti*, EC Competition Law, p. 272.
[12] Non-Horizontal Merger Guidelines (fn. 9), part II 20.

concentrations/combinations with a 'market dimension'[13]. Firms, which fall beyond the relevant threshold limit, are supposed to notify the European Commission of the proposed merger to avoid risk of fines and having the legal validity of the transaction called into question.[14] The Indian legal system on control of merger entails similar position of a mandatory notification in case of surpassing the stipulated threshold limit.[15]

1.2 Definition of concentrations/combinations

While defining 'concentrations'[16], the *ECMR* includes the acquisition of direct or indirect control of the whole or parts of one or more undertakings, whether by the purchase of securities or assets, by contract or any other means, by (i) either one or more persons already controlling at least one undertaking or (ii) one or more undertakings.[17] Therefore, under the European Union, for the purpose of ascertaining 'concentrations', it is the acquisition of control which is of greater significance and the acquisition of assets or shares would come within the purview of the definition of 'concentration', only if they lead to an acquisition of the control.

A specific definition of 'control' has been further clarified by the *ECMR* in article 3(2). It stipulates that control shall be constituted by rights, contracts or other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on the undertaking, in particular by, (i) the ownership of the right to use all

[13] Market dimension in context of the European Union jurisdiction is to be understood to cover the impact on the common market of the European Union.
[14] *Cook/Kerse*, EC Merger Control, p. 6.
[15] Section 6(2), *Competition Act, 2002*.
[16] Article 3, Council Regulation (EC) No. 139/2004 of 20 January 2004 on the Control of Concentrations between Undertakings ("**ECMR**").
[17] *Ibid.*, at article 3(1).

or part of the assets of undertaking or (ii) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking.[18]

As regards the Indian law, the term ‘combinations’ is defined under section 5 of the *Competition Act, 2002* so as to include acquisitions by persons and groups as well as acquiring of control by a person over an enterprise in certain circumstances. The *Competition Act, 2002* further defines ‘acquisition’ as including ‘acquiring or agreeing to acquire’, directly or indirectly, (i) shares, voting rights, or assets of an enterprise or (ii) control over management or control over the assets of an enterprise.[19] Thus, this inclusive definition encompasses all forms of acquisitions above the prescribed threshold limit. Additionally, the definition of combinations includes ‘acquiring of control by a person over an enterprise’,[20] where such a person has already direct or indirect control over an enterprise engaged in the production, distribution or trading of similar or identical or substitutable goods or provision of a similar or identical or substitutable service.

The *Competition Act, 2002* sets out an inclusive definition of ‘control’ which is stated to include, (i) one or more enterprises either jointly or singly, over another enterprise or group, or (ii) one or more groups, either jointly or singly, over another group or enterprise.[21]

The primal difference in the two jurisdictions in this regard lies on the issue of control. On one hand, in *ECMR*, the acquisition of control (direct or indirect), is a primary requirement for an acquisition to be recognized as a ‘concentration’, and on the other hand, control is only

[18] *Whish/Bailey*, Competition Law, p. 12.
[19] Section 2(a), *Competition Act, 2002*.
[20] Section 5(b), *Competition Act, 2002*.
[21] Explanation (a) to section 5, *Competition Act, 2002*.

one of the criteria for determining whether an acquisition is a concentration, as per the Indian law.

1.3 The 'community dimension' or the local nexus requirement

A very important criterion for triggering the role of competition law authorities in merger control is hinged upon the threshold limits. In both, European Union and Indian jurisdiction, there is a specific prescribed threshold limit which is further aligned with the requirement of a local nexus.

Article 1(1), *ECMR* provides that the merger control system is only to be applied if concentrations have a 'community dimension'.[22] The term 'community dimension' is not to be misunderstood to mean that the undertakings must be having their principal place of business or so to say the real seat within the European Union; even if they have a 'substantial' part of their business activity being conducted within the European Union, they come under the ambit of the *ECMR* merger control regime. Thus, the European Commission has the competence to assess mergers when an impact on the European Union's internal market, earlier known as the common market, may occur. This could be the situation in a variety of industries; for example, the European Commission can examine a merger between two firms in the computer manufacturing sector that may have a 'community dimension' even though the involved companies do not have their seat or main fields of activity in the European Union.[23]

Similar to the 'community dimension' principle in the European Union, the requirement of local nexus is imbibed within the threshold

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[22] In light of the TFEU, the "Community dimension" should now be understood as the "Union dimension".
[23] *Navarro*, Merger Control in the EU, p. 4.12.

limit provisions itself under the *Competition Act, 2002*. In addition to the stipulated threshold limits in terms of the assets or turnovers of the merging firms, there is an additional condition that a certain substantial part of such assets or turnover, as the case may be, has to be in India. This provides for the local nexus provision. The idea behind prescribing such a rider in the threshold limit is to ascertain the real possibility of the potential anti-competitive effects in the relevant Indian geographical market. Thus, the CCI monitors those vertical combinations which have an Indian market aspect as well. Just like the European Union, the vertical merger control is triggered only if there is likely to have an effect within the Indian market which could be reflected by consolidation of the position of the merging firms within India which is in turn gauged by their assets and turnovers in the domestic market.

1.4 Threshold limits

In order to determine which merger qualifies as a combination or concentration or the transaction which is required to be notified to or which may be reviewed by the relevant competition authority, the merger control provisions of competition statutes prescribes the threshold limits, in terms of assets or turnover. As remarked by Goldberg (in 1973) that as compared with the compulsory notification for all mergers, the application of thresholds for notification significantly reduces the administrative burden for the competition authorities. Another impact of setting the threshold limits is that it enables the competition authorities to focus on those mergers which are most likely to affect the competition.[24]

Threshold limits have been set out in various jurisdictions in terms of assets of the undertakings involved, their turnover and the net sales in

[24] ICN Recommended Practices on Merger Notification Procedures, (2002) at 3-4, available at: http://www.internationalcompetitionnetwork.org (22 March 2015).

the preceding financial years. In India, assets are the core criterion along with the net sales; it is the turnover which serves as the criterion in the *ECMR*. The threshold limits vary in different jurisdictions though the laws/regulations in all the jurisdictions provide for periodic revision of the limits on account of inflation.[25]

Article 1(2), *ECMR* provides turnover thresholds. Pursuant to Article 1(2)(a), *ECMR*, a concentration is deemed to have a 'community dimension' when:

> "…the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 5.000 million and (b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State."

This implies that the aim for the first threshold i.e. a worldwide turnover in excess of EUR 5 billion is to examine the overall world element of the merging entities. The second threshold the community-wide stipulation of a turnover of greater than EUR 250 million aims to quantify, whether the proposed merger includes a minimum level of community-wide activities. Finally, the motive behind setting the 'two-thirds rule' is to distinguish transactions which are of purely domestic nature from those of the community jurisdiction.[26]

Under the *Competition Act, 2002*, section 5 imposes the obligation to notify only under circumstances where the proposed merger has a

[25] *Tiwari* (fn. 4), p. 126.

[26] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the Control of Concentrations Between Undertakings, 2008 O.J. (C 95) 125.

nexus with markets in India.[27] Further, the combinations referred to in section 5 of the *Competition Act, 2002* which are taking place entirely outside India with insignificant local nexus and effect on markets in India are considered as transactions not likely to have any appreciable adverse effect on competition in India.[28] Both non-group[29] and group entities[30] carrying out transactions outside India have an obligation to notify the CCI in case the proposed transaction exceeds the prescribed threshold limits.

In India, the threshold limits prescribed in the context of any merger, amalgamation, acquisition or control by any party (not being a group) is the parties jointly having in India assets of or more than the value of INR 1,000 crore or turnover of or more than the value of INR 3,000 crore in India or outside India, in aggregate, assets of or more than USD 500 million or a turnover of or more than USD 1,500 million, with a local nexus provision requiring at least INR 500 crore of assets or INR 1,500 crore of turnover in India. In the case of group, the corresponding thresholds are in India, assets of or more than INR 4,000 crore or a turnover of INR 12,000 crore in India or outside India, an aggregate value of assets of or more than USD 2 billion or turnover of USD 6 billion of which assets of INR 500 crore or turnover of INR 1,500 crore must be in India.[31]

1.5 Market share and concentration levels

Market shares and concentration levels reflect the possible anti-competitive risks and are often used as the indicator for assessment of

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[27] Section 5, *Competition Act, 2002*.

[28] Exemption 10 under Schedule 1 to the CCI (Procedure in regard to the transaction of Business relating to Combinations) Regulations, 2011 ("**Indian Merger Regulations**").

[29] Section 5(a)(i)(B), *Competition Act, 2002*.

[30] Section 5(a)(ii)(B), *Competition Act, 2002*.

[31] Section 5, *Competition Act, 2002*.

a potentially dangerous merger. They disseminate important information about the prevailing market power and competitive significance of the entities involved in a merger as against their competitors.[32] In its *Non-Horizontal Merger Guidelines*, the European Commission avers that if a vertical merger creates or is likely to create a post-merger entity that holds less than a 30% (thirty percent) market share in each relevant market, both upstream and downstream, then such a merger is to be perceived as not posing any significant market distortion or competition concerns. Another precondition for the European Commission to clear a merger is that there must be a post-merger HHI below 2000.[33] Both these conditions are cumulative as the HHI is a very useful indicator in a market where a large number of small firms/entities are operating.[34]

It has been contended that the 30% (thirty percent) market share threshold is too low and that the HHI test should be dropped, because it is less relevant in assessing likely competitive effects of non-horizontal mergers.[35] Another argument in favor of dropping the market share element is that this yardstick is not always an efficient evaluation method in unstable markets, where a lot of innovation is taking place, a more comprehensive market analysis is required for a proper market power assessment.[36]

In India, the *Indian Merger Regulations* sets out that the cases where the parties to the combination are engaged at different stages or levels

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[32] Non-Horizontal Merger Guidelines (fn. 9), part III 24.

[33] Herfindahl-Hirschman-Index: The HHI is a measure of the size of firms in relationship to the industry and an indicator of the amount of competition amongst them. It is defined as the sum of squares of the market shares of each individual firm. The index's range is between 0 and 10.000, moving from a very large amount of very small firms to a single monopolistic producer. More information on: http://www.justice.gov/atr/public/guidelines/hhi.html (5 April 2015).

[34] *Petrasincu*, ECLR 2008, p. 222.

[35] *Bishop*, ECLR 2008, p. 29.

[36] *Monti* (fn. 11), p. 251.

of the production chain in different markets, in respect of production, supply, distribution, storage, sale or trade in goods or provision of services i.e. if the proposed transaction is a vertical merger, and if the individual or combined market share of the combining entities is less than 25% (twenty five percent) in the relevant markets, there is no need to file a notification to the CCI as such a merger is appraised to be not having an appreciable adverse effect on effective competition in the relevant markets.[37]

2. Reasons for control of vertical mergers

The national systems of merger control seeks to ensure effective competition as a means to protect customers against negative competitive effects (e.g. price fixing or increase in price) with improvement in the respective welfare as the ulterior aim.[38]

Unlike horizontal mergers, vertical mergers are less likely to have an adverse effect on the competition in the relevant market. As the merging firms in horizontal mergers are active in the same relevant market, it is more likely to inflict harm on direct competition in the prevailing market.[39] On the contrary, in some cases, vertical mergers have proved to be beneficial to both firms and consumers in terms of facilitating long term investment, enhancement of the quality of the product, among other advantages.[40] The intended objective and the corresponding effect of vertical integration, including through mergers, may be reduction of costs and where relatively high transaction costs of buying and selling between two vertical levels is prevalent, greater efficiency can be achieved by such integration.

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[37] Regulation 5(3)(b) of the Indian Merger Regulations.
[38] *Cook/Kerse* (fn. 14), p. 19.
[39] Non-Horizontal Merger Guidelines (fn. 9), part II 12.
[40] OECD/World Bank, A Framework for the Design and Implementation of Competition Policy and law, 43 (1991), available at: http://www.oecd.org/dataoecd/10/30/27122278.pdf (10 April 2015).

Vertical mergers, in some cases, also serve as a defensive tool to avoid being a price victim of a monopolist.[41]

This does not imply that vertical mergers shall not be declared incompatible or potentially dangerous for market competition by the competition law authority. By virtue of vertical mergers a situation of market distortion may arise where such a merger leads to or is likely to lead to foreclosure of a competitor's access to stock/supplies, the so-called 'input foreclosure', or when a merger gives rise to a so called 'customer foreclosure', which will be discussed in detail in a separate chapter of this thesis.

3. Challenges encountered in the control of vertical mergers

Unlike horizontal mergers, it is much more difficult to analyze the potential effects of a vertical integration. In vertical mergers, there is a lack of considerable change in the HHI, which makes it a less reliable indicator for vertical merger assessment.[42] For illustration, the combining firm which is active in the upstream market may currently have a large market share, and if the other competitors have the capacity and motivation to expand at a rapid pace without any capacity constraints, the large market share may not give a clear indication of the market power enjoyed by the combining firm. Similarly, there may be a situation wherein the upstream merging firm may currently have a small market share, but its ability and incentive to rapidly expand may be dictating the pricing of other upstream firms. If that is the case, the merger might propel an advantageous input foreclosure by allowing the other upstream firms a liberty to raise their prices, thereby handicapping the downstream firm's

[41] *Jones/Sufrin*, EU Competition Law: Text, Cases, and Materials, p. 337.
[42] *Gans*, J.L. & Econ. 2007, p. 661.

rivals.[43]

Market shares also may provide poor proxies for certain types of concerns about coordination. For instance, a low market share is not inconsistent with the upstream merging firm being a maverick or disruptive firm, or with the downstream merging firm being a disruptive buyer.[44] Similarly, market shares are not generally relevant to the ability and incentive to use one of the divisions to exchange competitively sensitive information with rivals in the other market, although the HHIs and market shares may provide some indication about the likely gains and harmful effects from doing so.[45]

Thus, the two most important criteria used by the competition law authorities for assessment of the possible anti-competitive effects may not be of great help when it comes to vertical mergers.

Then there are other ways in which vertical mergers can harm consumers and competition like potential competition effects; exclusionary effects which may lead to harm not only to the downstream competitors,[46] but also to the customers of the downstream firms; unilateral effects in the form of a unilateral incentive for the downstream division to raise its price in order to increase the input sales and incremental profits of the upstream division[47]; coordinated effects; regulation evasion; and facilitating harmful price discrimination.

Some of these harmful effects of the vertical mergers have been

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[43] *Salop/Culley*, Potential Competitive Effects of Vertical Mergers: A How-to Guide for Practitioners, Georgetown University Law Center, available at http://dx.doi.org/10.2139/ssrn.2522179 (13 April 2015).

[44] *Chen*, RAND Journal of Economics 2001, p. 674.

[45] *Chen* (fn. 44), p. 674.

[46] *Acemoglu/Aghion/Griffith/Zilibotti*, Journal of the European Economic Association 2010, p. 1016.

[47] *Moresi/Salop*, Anti-trust Law Journal 2013, p. 185.

discussed in this thesis. However, in order to stick to the objective of this thesis i.e. to understand the merger control regime, the study has not delved into specifics of each of these harmful effects.

C. Regulation of Vertical Mergers under the European Union Regime

As illustrated in the preceding parts, vertical mergers can lead to pro-competitive and anti-competitive effects, both of which the European Commission is committed to balance in order to make an appropriate merger decision. Section II, para. 21 of the *Non-Horizontal Merger Guidelines* provide that:

> "The Commission examines the various chains of cause and effect with a view to ascertaining which of them is the most likely. The more immediate and direct the perceived anti-competitive effects of a merger are, the more likely the Commission is to raise competition concerns. Likewise, the more immediate and direct the procompetitive effects of a merger, the more likely the Commission is to find that they counteract any anti-competitive effects."

The main focus of this part is to highlight how such balancing is done in practice. The study scrutinizes the anti-competitive effects that result from vertical mergers, including the non-coordinated and the coordinated effects. Following the analysis of the anti-competitive effect, the thesis discusses the efficiency considerations to round off the approach adopted by the European Commission while assessing a vertical merger case.

1. Legal basis for vertical merger control under the European Union Law

The legal basis for European Union merger control is the Council Regulation (EC) No. 139/2004. The regulation prohibits mergers and acquisitions which would significantly reduce competition in the single market.[48]

[48] European Commission, Merger procedures available at

The European Commission has published a series of guidelines and notices to assist in the interpretation of a number of key issues under the *ECMR*, including guidelines in the assessment of non-horizontal mergers 2008 (the *Non-Horizontal Merger Guidelines*), a notice on remedies 2008 (the Remedies Notice), and a notice on each of case allocation and ancillary restrictions (restrictions directly related to and necessary for concentrations). The *ECMR* is based on the principle of the one-stop shop whereby, once a transaction has triggered the application of the European Commission's powers, the national authorities of the member states are precluded from applying their own competition laws to the transaction, with certain exceptions.[49]

2. Non-coordinated effects arising out of vertical mergers

Unlike horizontal mergers, vertical mergers do not lead to a loss of direct competition between the merging firms in the same relevant market. The main sources of anti-competitive effects stemming from vertical mergers are the non-coordinated effects. Non-coordinated effects arise when the merged entities are profitably able to reduce value for money[50], choice or innovation through its own acts without the need for a co-operative response from the competitors.[51]

2.1 Foreclosure

The most important non-coordinated effect that can occur after a vertical merger is foreclosure. The European Commission has explained foreclosure as a situation wherein the access to supplies or markets for potential or actual rivals is denied or impeded owing to the merger. The direct consequence of such a situation is the reduction

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http://ec.europa.eu/competition/mergers/procedures_en.html (2 May 2015).

[49] *Buch-Hansen*, CBS LJ 2008, p. 112.

[50] Value for money is a reflection of price and quality.

[51] *Geradin*, Colum. J. Eur. L. 2002, p. 9.

in the concerned firms' competitiveness.[52] For a situation of foreclosure to arise, the foreclosed firms are not necessarily compelled to leave the market completely. As per the European Commission, if the rivals are placed at disadvantaged position and consequently led to compete less effectively, it is sufficient to prohibit such vertical merger on grounds of foreclosure. Foreclosure is viewed as anti-competitive when the merging firms are able to profitably increase prices to the disadvantage of consumers.[53] If prices decrease less or are less likely to decrease than they would have been without the merger, and if prices increase more than they would have without the merger, then such effects are regarded as anti-competitive and are attributed to the merger.[54] Now we shall discuss the two forms of foreclosure: input foreclosure and customer foreclosure.

2.1.1 Input foreclosure

Input foreclosure occur when a vertically integrated upstream firm forecloses its downstream rivals by restricting or foreclosing access to inputs or by making access to inputs more expensive than would be the case without the merger.[55] The term 'input' is not only limited to goods, but can cover services, access to infrastructure, and access to intellectual property rights.[56]

An input foreclosure is perceived as anti-competitive in a situation where an upstream firm, which is a strong market power in the relevant market, merges with a downstream firm. This upstream firm could be a manufacturer or a supplier to the downstream firms. Prior to the merger, the upstream firm supply its products to all downstream

[52] Non-Horizontal Merger Guidelines (fn. 9), part IV 29.
[53] Non-Horizontal Merger Guidelines (fn. 9), part IV 29.
[54] *Monti* (fn. 11), p. 479.
[55] *Bellamy/Child,* in: *Roth/Rose* (eds.), Bellamy & Child: European Union Law of Competition, p. 2216.
[56] Non-Horizontal Merger Guidelines (fn. 9), part IV 24.

firms under same conditions.[57] After the merger the previously upstream firm will now become an indirect competitor for the other downstream rivals. For the downstream competitors, it is likely that the upstream entity will restrict access to supplies or make it harder to get supplies.[58] Since the upstream firm is a strong market power the downstream rivals will find it difficult to switch to an alternative supplier (illustrated in the *Appendices*). Such a scenario of input foreclosure is likely to lead to higher prices for the consumers.

Now the European Commission is faced with the task of ascertaining whether any efficiencies resulting from the merger may, however, lead the merged entity to reduce price, so that the overall likely impact on consumers is neutral or positive.[59] The European Commission applies a three step test to assess the possible anti-competitive effects of such a proposed merger. Firstly, it tests the merged entity's capability to substantially foreclose access to inputs. Secondly, it evaluates whether the merged entity has the incentive to foreclose access to inputs. Finally, the European Commission has to adjudge whether the merger could lead to a significant detrimental effect on downstream competition.[60] Since all these factors are interwoven so closely, all of them have to be taken into account cumulatively.

2.1.1.1 Capability to foreclose access to inputs

An input foreclosure can be achieved by employing different measures by the merging firms. For example, potential competitors could be completely cut off from the supply delivery, restrictions may be imposed to their access, or they could be forced to purchase the supplies at an escalated price. Another form of enforcing foreclosure

[57] *Cini/ McGowan*, Competition policy in the European Union, p. 172.
[58] *Cini (fn. 57)*, p. 174.
[59] Non-Horizontal Merger Guidelines (fn. 9), part IV 31.
[60] *Ibid.*, part IV 32.

could be subjecting the rival firms to unfair trading conditions.[61] An interesting form of foreclosure was observed by the European Commission in its decision in the *Johnson & Johnson/Pfizer Consumer Healthcare*[62] case, wherein degradation of the quality of inputs supplied to the competitors was used as the means of foreclosure. In such a case the dominant upstream firm intentionally distinguishes supplies in terms of quality between its own downstream entity and other downstream competitors after a merger.[63]

An essential prerequisite for input foreclosure is the involvement of an input which is important for the production/supply of the downstream product. In most cases it is difficult to establish whether the said input is really important for the downstream product. In practice, the European Commission has considered that if the input represents a significant cost factor as compared to the price of the downstream product, it could be an indicator for this precondition.[64]

However, this is not the indicator for ascertaining whether an input may be significant or not, it might be the case that the input in question is a critical component required by the downstream rivals for their production process. For instance, an engine starter would be a critical component without which the engine manufacturer could not profitably sell its product.[65]

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[61] *Maydell*, Stanford-Vienna European Union Law Working Papers 2012, p. 26 available at http://www.law.stanford.edu/program/centers/ttlf/papers/maydell_eulawwp3.pdf (2 May 2015).

[62] Commission decision on case COMP/M.4314 - Johnson & Johnson/ Pfizer Consumer Healthcare, points 127-130 (11 December 2006).

[63] Non-Horizontal Merger Guidelines (fn. 9), part IV 33.

[64] Commission decision on case COMP/M.4561 - GE/Smiths Aerospace, point 48 (23 April 2007).

[65] Judgment of 14 December 2005, *General Electric* v. *Commission*, T-210/01, EU:T:2005:456, para. 298.

Furthermore, in order to be treated as an input foreclosure, it is incumbent that the merged entity enjoys a considerable market power in the upstream market, because only in such a scenario the merged entity enjoys the dominant position over other upstream firms and has a capacity to influence the applicable price and supply conditions.[66] The merged entity must be in a position to negatively affect the total availability of inputs for the downstream market and only then it possesses the ability to foreclose the relevant market for its competitors. This would amount to the dependence of other downstream firms on the merged entity's products. The upstream entity could influence the inputs in terms of price and quality, assuming there were too few competitive input suppliers or other input suppliers were unable to increase their output due to production processes, and the downstream competitors could not switch to alternative suppliers.[67]

Additionally, dedicated contracts between neutral input providers and the merged entity could serve as a source of enhanced capability to foreclose access to supplies/inputs, as the neutral input providers being privy to such a contract are obliged to comply with such contractual obligations.[68]

The European Commission shall adopt a holistic approach while assessing such mergers and must consider all possible anti-competitive effects of a merger. The European Commission must also keep in mind the possible counter-strategies of the merging parties' rivals. For instance, the competitors may modify their production processes so as to be less dependent on the merged entity's final

[66] *Baake/Kamecke/Normann*, International Journal of Industrial Organization 2004, p. 188.
[67] *Maydell* (fn. 61), p. 29.
[68] Non-Horizontal Merger Guidelines (fn. 9), part IV 35.

products.[69]

2.1.1.2 Incentive to foreclose access to inputs

The possibility of a foreclosure by the merged entities will arise only if it is beneficial for the entity to foreclose access to inputs. For example, whenever the upstream firm curtails its output level to that of the downstream competitors, it analyses how the anticipated profit losses in the upstream market could be balanced by the increased demand in the downstream market or by the escalated prices.[70]

The merging firms also have to take a call, after careful strategic consideration, whether a foreclosure strategy to the disadvantage of their competitors is a viable option or whether it is not attractive in terms of maximizing the entity's profit. The firms also take into consideration the altered profit margins in the downstream and upstream markets after the merger. If only an adequate reward is on offer, the firms go forward with the foreclosure strategy.[71] The quantitative volume of the downstream demand which a firm could seize from its downstream competitors is another significant factor while deciding whether there is a substantial incentive to foreclose inputs. In a nutshell there is a great incentive to foreclose inputs if it puts the merged entity in a position to stop consumers from buying competitors' products. The more demand the merged firm is able to take from competitors, the higher the incentive to apply a foreclosure strategy.[72] From the European Commission's perspective, if the input is not a critical component to the downstream product, then raising the input's cost would not have a serious impediment to a fair competition.

[69] Non-Horizontal Merger Guidelines (fn. 9), part IV 38-39.
[70] Non-Horizontal Merger Guidelines (fn. 9), at part IV 40.
[71] It has to be considered that upstream and downstream margins may change as a result of the merger. This may impact upon the merged entity's incentive to engage in foreclosure.
[72] Non-Horizontal Merger Guidelines (fn. 9), part IV 42.

Apart from these, the European Commission also takes into account several other factors while evaluating the potential foreclosure incentives for a firm. Ownership structure of the merged entity could be one such factor. The company, or companies, that control a merged entity could give a useful insight as to whether the firm in question is likely to apply a foreclosure strategy.

2.1.1.3 Overall likely impact on effective competition

Under the *ECMR*, the European Commission shall declare a concentration incompatible with the common market if the proposed merger is likely to significantly impede effective competition in the common market or in a substantial part of it.[73] With the revamping of the European Union merger control regime in 2004, a new test was introduced to evaluate whether a concentration impedes competition. The traditional 'dominance' test was replaced by the so-called 'Significant Impediment to Effective Competition' ("**SIEC**") test. In the current merger control regime, creation or strengthening of dominance is no longer a necessary prerequisite. The European Commission has to assess whether effective competition is impeded or not regardless of the dominance of the merged entities.[74]

As stated above, while evaluating mergers, it is critical to adjudge whether effective competition is significantly impeded. For such an impediment to take place, it is normally required that the foreclosed rivals play an important role in the downstream market.[75] A merger is more likely to disturb effective competition when more rivals are affected by foreclosure, because it is likely that prices will increase in the downstream market after a merger leads to input foreclosure.[76]

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[73] Article 2(2), *ECMR*.
[74] *Bellamy/Child* (fn. 55), p. 3297.
[75] Non-Horizontal Merger Guidelines (fn. 9), part IV 45.
[76] *Maydell* (fn. 61), p. 34.

A firm having a small market share as compared to other competitors too can play a decisive role in maintaining effective competition. This can be the case when a firm is a close competitor of the merged entity, or when it is an aggressive competitor, a so-called 'Maverick'[77] firm.[78]

Creating barriers to entry for the potential competitors also lead to a substantial impediment to effective competition. A significant apprehension by the competitors that the merged entity may apply a foreclosure strategy is a sufficient reason to be considered as an anti-competitive behavior.[79] Before entering a market firms always include such risks in assessing whether it is reasonable to enter the market. If private companies plan to enter a market, they evaluate all relevant risks before starting a business, more so if it includes/requires large investments, because their ultimate aim is to strive for a good return on investment with as few risks as possible.[80]

Another example of entry barriers could be when the potential competitors are impelled to enter both the upstream and the downstream market by the vertical integration. Such an obligation for potential competitors to enter both markets in order to achieve the desired results is especially significant in markets that are being recently liberalized from the previously existing market monopoly.[81] The dominant position and market power of a monopolistic entity causes serious deterrence for the competitors from entering the market, which shall be avoided for the growth of the economy.

On the other hand, after the merger, if a sufficient number of downstream competitors still operates and there is increase in their

[77] A maverick firm is one that has a greater economic incentive to deviate from competitive practices than most of its rivals and constitutes an unusually disruptive force in the market.
[78] Non-Horizontal Merger Guidelines (fn. 9), part IV 48.
[79] *Church/Gandal*, Journal of Economics and Management Strategy 2000, p. 31.
[80] *Maydell* (fn. 61), p. 35.
[81] Non-Horizontal Merger Guidelines (fn. 9), part IV 49.

costs owing to the merger, effective competition is not impeded. It is possible that costs will not be raised when the competitors are themselves vertically integrated or are able to switch input suppliers, such that they can get input from an alternative and more cost-effective source.[82] In such a scenario, competition may not be impeded, because a strong competition from the competitors may keep a check on the merged entity and for preserving its consumer base (from the stiff competition), the merged entity will be reluctant to increase the prices post-merger.[83]

It is highly unlikely that a merger could pose threats to fair competition if market entry is so easy that it is sufficiently possible for potential rivals to enter the market. The European Commission has to satisfy itself whether potential entry is likely and whether it is appropriate to constrain the behavior of the incumbents post-merger. The possibility of entry is much higher if it is more profitable for the potential firms to enter the market as compared to the financial risk of failing to enter the market.

There could be several ways in which entry barriers are created, sometimes intentionally by the firm. The list is not exhaustive but for instance, there could be legal advantages that limit the number of market participants, such as a limited number of licenses issued per year or quota restrictions in certain industry sectors. Another example is that incumbents could benefit from technical advantages, like preferential access to important facilities, natural resources, innovation and research and development ("**R&D**").[84]

The European Commission also has to be careful about the growth of the market in question. It may be an essential requirement of some

[82] *Maydell* (fn. 61), p. 37.
[83] *Ibid*, p. 38.
[84] *Ibid.*, p. 46.

industries to have reputation and sufficient know-how for successful entry to the market. Markets that are expected to grow rapidly exert a strong incentive for firms to enter, which then limits the incumbent's incentive to raise prices. Conversely, when a market is expected to shrink, the incentive for a potential entrant may not be attractive enough to gain access to such a market.

2.1.2 Customer Foreclosure

When an upstream manufacturer/supplier combines with an important customer in the downstream market, a situation of customer foreclosure may arise. A downstream entity may foreclose access to a relevant customer base to its competitors in the upstream market, which, in turn, reduces rival firms' capacity or business advantage to compete in the market. A likely consequence of such an arrangement is an increase in operational costs for the competitors. In such a case, the downstream competitors face greater difficulty in procuring the input supplies at the similar prices and conditions as they used to get prior to the merger (illustrated in the *Appendices*). Since, the downstream rivals find it difficult to obtain adequate access to supplies, the merged entity has an opportunity to escalate prices on the downstream market.

The European Commission's task remains the same, i.e., to take action for preserving fair competition which may result in lowering of prices to the benefit of consumers. Unlike the input foreclosure, the necessary consideration for customer foreclosure is not that consumer harm results from the forced exit of the merged entity's rival; instead, it is relevant whether such a foreclosure strategy will lead to higher prices for consumers.[85]

The principal distinction between customer foreclosure and input

[85] Non-Horizontal Merger Guidelines (fn. 9), part IV 58.

foreclosure is that input foreclosure results from the actions of a dominant upstream firm, whereas in customer foreclosure the dominant downstream entity is responsible for foreclosure of an upstream competitor. After the merger, customer foreclosure can result if the downstream entity refuses to buy from the upstream rivals.

While evaluating, the European Commission implement the same three step approach in merger control examination as in an input foreclosure situation.[86] Firstly, the European Commission examines whether the merged entity possess the capacity to foreclose access to downstream markets by reducing or stopping purchases from the competing firms in the upstream market. Secondly, the European Commission analyzes the incentives which could motivate the merged entity to adopt customer foreclosure. Lastly, the European Commission examines whether such a foreclosure strategy would have a significant detrimental effect on competition in the downstream market.[87]

2.1.2.1 Ability to foreclose access to downstream market

The merged entity has the potential to affect its upstream rivals when the costs for access to downstream customers rises or a restriction is imposed on their access to a considerable pool of customer.[88] A possible scenario could be where the downstream entity is dependent on all key inputs from the merging upstream entity and, consequently, other upstream rivals are disbarred to sell goods to the concerned downstream entity. Rather than a complete discontinuance of purchases from upstream competitors, the downstream entity may

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[86] Non-Horizontal Merger Guidelines (fn. 9), at part IV 59.
[87] Commission decision on case COMP/M. 4389 - WLR/BST, point 31 (5 December 2006).
[88] *Hart/Tirole*, Brookings Papers on Economic Activity 1990, p. 258.

have to trade with other upstream competitors on worse terms and conditions than prior to the merger.[89]

While assessing about the capacity of the combined entity to foreclose access to upstream rivals, the European Commission investigates whether there are enough alternative purchasers in the downstream market to which an upstream competitor could supply/sell its products. This essentially signifies that the merged entity ought to include an important downstream firm enjoying substantial market power.[90]

A customer foreclosure strategy not only poses the danger of a potential increase in input prices, but it could also postulate the peril of heightened entry barriers for prospective entrants. When the downstream entity having a considerable market power stops or diminishes its purchases from the upstream rivals, shrinking of any prospective profits is the direct consequence. This could serve as a deterrent for potential entrants, resulting in the customer foreclosure strategy significantly impeding effective competition.[91]

Furthermore, these higher input costs emanating as an effect of the vertical merger may have the potential to radically reduce upstream competitors' incentive to improve product quality, invest in R&D, or invest in cost reduction due to the decreased profits.[92] Market exits become inevitable and more frequent on account of such reduced investment incentives and weakened competition. Additionally, despite application of a customer foreclosure strategy in only one of several markets, its negative effects may have a spill over in other markets as well. For example, an upstream competitor facing such

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[89] Non-Horizontal Merger Guidelines (fn. 9), part IV 60.
[90] *Ibid.*, part IV 61.
[91] Non-Horizontal Merger Guidelines (fn. 9), part IV 64.
[92] *Riordan*, in: *Buccirossi* (ed.), Handbook of Antitrust Economics, pp. 145-182.

higher input costs for one market may be compelled to elevate prices appreciably in all markets in which it is active. Hence, when a significant portion of the downstream market is foreclosed, the upstream competitor becomes unable to operate at low costs in other markets; and in order to nullify the losses occurred in one of the markets, it is imperative for such upstream rival firm to operate at higher costs in all markets where it is active. On the other hand, it may be possible for an upstream rival to find alternative uses for goods, making the loss from higher input costs tolerable.[93]

2.1.2.2 Incentive to foreclose access to downstream markets

As per the *Non-Horizontal Merger Guidelines*, the merged entity needs to strike a bargain between the possible costs associated with not sourcing goods from upstream rivals and possible gains from doing so in order to assess its incentive to implement a customer foreclosure strategy.[94]

However, during the public consultation process before the finalization of the drafts of the *Non-Horizontal Merger Guidelines*, the European Commission received heavy criticism on these provisions. Many commercial organizations, like the Federation of German Industries and the German Chambers of Industry and Commerce voiced their concerns[95] on this. They remarked that such balancing procedures are highly complex due to the comparison of several factors that have to be considered by the firms. Such factors include profit margins and market shares in the relevant markets and the

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[93] Non-Horizontal Merger Guidelines (fn. 9), part IV 65-66.
[94] Non-Horizontal Merger Guidelines (fn. 9), at part IV 68.
[95] *Lau/Reppelmund*, Entwurf der EU-Kommission von Leitlinien zur Bewertung nicht horizontaler Fusionen nach der Verordnung (EG) Nr. 139/2004 des Rates vom 20. Januar 2004 über die Kontrolle von Unternehmenszusammenschlüssen (2007), point 4 available at http://ec.europa.eu/competition/mergers/legislation/files_non_horizontal_consultation/bdi.pdf (14 May 2015).

impact of consumers' and competitors' reactions to the firms' alternative strategies.[96] It was averred that following this model, the European Commission would be acting on the assumption of a theoretically perfect system of information exchange. Usually, it is not always possible even for the business leaders to collect all the relevant information necessary to render such a consideration. Additionally, large conglomerate entities are composed of many separate profit earning business units. This implies that no business unit will waive its own profit simply for the uncertain hope that another business unit will make up for that lost profit. Having said this, managers usually get paid for the performance of their business units and not for the profits of other units, and, therefore, it is likely that they will not agree to such a strategy.[97]

Regardless of such objections and criticism, the European Commission continues to opt for this method of evaluation for assessing the incentives to foreclose access to downstream markets. The reasoning by the European Commission on this point is that the firms themselves implement a balancing strategy for taking decisions on application of a foreclosure strategy. From the European Commission's perspective, firms are likely to consider that reducing purchases from upstream competitors will lead to higher costs for the merged entity if the upstream entity of the integrated firm works less efficiently than the foreclosed upstream firms.[98] Similar is the approach applicable to upstream firms that are capacity constrained or when they are competing against a more valuable product line from its rivals which effectively renders a foreclosure strategy unfruitful. Nevertheless, a vertically integrated company still evaluates whether a foreclosure strategy would lead to the possibility of increased profits

[96] *Ibid.*, point 4.
[97] *Lau/Reppelmund* (fn. 95), at point 5.
[98] *Maydell* (fn. 61), p. 51.

from raising prices in the upstream market. And it is an added incentive for such firms to apply such a foreclosure strategy if its downstream unit is advantaged by the increase in prices.[99]

2.1.2.3 Overall likely impact on effective competition

The European Commission has to examine whether foreclosing rivals in the upstream market entails negative effects in the downstream market, which subsequently may lead to consumer harm or not.[100] Unlike in case of input foreclosure, the task of the European Commission is much more complex while assessing the overall impact of a customer foreclosure strategy on effective competition.

The upstream competitors of the merged firm may face great business challenges if they are precluded from access to an important customer base, as they will no longer be able to sell their products. In the long run, they will lose their competitiveness. The rivals will be required to purchase their products from upstream firms that may not be as competitive as the upstream entity of the merged firm. Hence, a higher price will have to be paid for the required inputs. Thus, the merged entity is able to increase prices or, conversely, to reduce output in the downstream market, which would have the same effect due to fewer choices.[101]

As opposed to the evaluation of competition for input foreclosure, where a strategy to raise prices can be directly and instantly perceived by the competitors in the downstream market, a customer foreclosure strategy is far more complex to comprehend. A foreclosure of the access to its customer base by a merged downstream entity for the upstream competitors leads to increased costs for the upstream firms.

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[99] Non-Horizontal Merger Guidelines (fn. 9), part IV 69-70.
[100] *Week/Scheidtmann*, ECLR 2008, p. 484.
[101] *Maydell* (fn. 61), p. 53.

In response the upstream firms, then, either increase their prices for the customers or have to be content with lower profit margins. In either case, the effect is not good for a fair and effective competition. A considerable time has to elapse before such negative effects influence the consumers.[102]

The competition in the upstream market must be strong enough that competition concerns will not arise when one or more upstream rivals are affected by foreclosure. Similar to the input foreclosure assessment, customer foreclosure concerns are only eliminated when those upstream firms not affected by foreclosure are also not confronted with barriers to expansion. As explained in the preceding section on input foreclosure, such barriers signifies that prospective competitors are impelled to enter both upstream and downstream markets for competing in an efficient manner.[103] The concern of raising entry barriers is particularly relevant in those industries that are opening up to competition or are expected to do so in the foreseeable future.[104]

2.2 Other non-coordinated effects

In addition to the foreclosure effects, a vertical merger entails other non-coordinated effects. Another consequence of entering into a vertical combination is the sharing of the information gains by the firms involved. Practically, this is a very critical factor which motivates firms to merge vertically. Firms generally tend to preserve their trade secrets or other confidential information from other players. With vertical mergers, the rivals could lose this comparative advantage.

[102] Non-Horizontal Merger Guidelines (fn. 9), part IV 72-73.
[103] It is important that regulatory measures aimed at opening a market are not rendered ineffective through vertically-related incumbent companies merging and thereby closing off the market, or eliminating each other as potential entrants.
[104] Non-Horizontal Merger Guidelines (fn. 9), part IV 75.

For instance, a downstream entity could discover sensitive information about its competitors from its counterpart upstream entity which is also the supplier for other downstream competitors. Being a supplier, the upstream entity may have good insights into the business activities of the downstream competitors.[105] Such information could range from the pricing strategies to the purchases patterns, marketing policies among other information gains. Thus, the combined firms could use such information to price less aggressively and, as a result, cause harm to consumers. The same holds true for the information gains which an upstream firm may enjoy in relation to information gains about its rivals in the upstream market.[106]

3. Co-ordinated effects arising out of a vertical merger

An implication of mergers is that a merger may change the nature of competition in such a manner that the entities which were not coordinating their behavior prior to the merger becomes appreciably more interested in coordination with other market players. The result could be increase in prices or otherwise harmful anti-competitive effects. Also, for the firms already coordinating prior to the merger may have a more stable or more effective relation after the merger.[107]

Vertical mergers may also increase the degree of symmetry between firms active in the market.[108] This significantly improves the probability of greater synchronization between the firms as it facilitates the entities to reach a common understanding.[109] Similarly,

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[105] Commission decision on case COMP/M.2510 - Cendant/Galileo, point 37 (24 September 2001).

[106] Non-Horizontal Merger Guidelines (fn. 9), part IV 78.

[107] Commission decision on case COMP/M.3101 - Accor/Hilton/Six Continents, points 23-28 (16 May 2003).

[108] Commission decision on case COMP/M.2389 - Shell/DEA, points 83-87 (20 December 2001).

[109] Commission decision on case COMP/M.2533 - BP/EON, points 74-77 (20 December 2001).

vertical integration, by imparting greater transparency in the market makes it easier for the remaining market participants to coordinate and cooperate.

Market coordination may come into being when the competitors, without entering into an agreement or resorting to a concerted practice, are able to recognize and pursue their common objectives. In such an arrangement the coordinating entities successfully elude the normal mutual competitive pressure. A usual competitive practice is characterized with a fair competition among each firm. The firms have an incentive to exert this competitive pressure and it is this incentive which consequently keeps the prices in check. The coordinated effects take effect when the expected profit which the firms can make by an aggressive competition in the short term are likely to be less than the expected reduction in revenues owing to the coordination in the long run.

Conditions for implicit collusion: Apart from the relative ease of entering into cooperation in a market, there are conditions precedent for sustenance of this coordination. Firstly, the colluding entities must be in a position to constantly monitor and reasonably assess whether the agreed terms of coordination are being complied with. Secondly, there must be a clearly drawn out mechanism to deter any form of deviation from the agreed terms. Finally, it has to be ensured that the expected results of the coordination remain unaffected by any riposte of the non-participating parties.[110]

Incentives to adhere: Vertical mergers may play a significant role in influencing coordinating firms' incentives to comply with the agreed terms of collusion. For example, a vertically integrated firm enjoys a stronger position to take strict actions against the partners to the

[110] Judgment of 28 June 2004, *Airtours* v. *Commission,* T-342/99, EU:T:2002:146, para. 62.

coordination that choose to deviate from the terms of coordination. Since this merged firm is either a critical customer or supplier, it can inflict severe punishments on such deviating rivals.[111]

Influence of non-participants to the coordination: A vertical combination is more likely to significantly limit the scope for the non-participants, including both present and potential competitors, to disrupt the coordination as the vertical merger may increase entry barriers for prospective competitors or may limit their capacity to compete.

Vertical mergers provide the apt opportunity and platform for fostering coordination in the market. However, it is pertinent to mention here that in some cases, a vertical integration may even prove beneficial with the coordination of some market players.

Disruption of a maverick firm: A vertical merger may prove to be extremely detrimental in disrupting the strong hold of a maverick firm in the market. A vertical merger can also lead to ousting of a disruptive buyer from the relevant market. If the upstream firms perceive sales to a specific purchaser considerably significant, they may be lured to divagate from the conditions of the collusion arrangement so as to secure their business.

4. The 'efficiencies' justification

Continuing the discussion on the positive effects of a vertical merger, the European Commission while assessing the effects of a non-horizontal merger on effective competition has to also take into account the efficiencies consideration which prompts the rival firms to merge. Firms can enjoy efficiency gains by merging their businesses.

[111] Commission decision on case COMP/M.3267 - CRH/Cementbouw, point 14 (29 September 2003).

Consequently, this may be the very reason for merging, which must be demonstrated. Efficiency gains not only cover benefits attained through reduction in the costs and prices, but also quality improvements or an increase in the variety and innovations in the market.

According to a report by RBB Economics[112] the assessment of vertical mergers shall not be carried out in the same manner as that of the horizontal mergers. It has been averred that, contrary to the usual approach of the assessment of efficiencies in case of the horizontal mergers, efficiencies produced by vertical mergers shall be conducted as a unified assessment.[113]

It is further argued that in the unified assessment approach for balancing of efficiencies and anti-competitive effects in a vertical merger, the economic presumption shall be in favor of the efficiencies generating pro-competitive effects unless it is proved otherwise.[114] This puts greater responsibility on the European Commission to demonstrate strong evidence and reasons for adjudging a merger anti-competitive.

After this discussion on the approach to be adopted by the European Commission for assessment of efficiencies as a justification for mergers this next section of the study focusses on the most probable efficiencies generated by vertical mergers. It has also been explained

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[112] Final Report by RBB Economics for the European Commission on the Efficiency-Enhancing Effects of Non-Horizontal Mergers, at ii, (2005) ("**RBB Report**"), available at http://ec.europa.eu/enterprise/newsroom/cf_getdocument.cffn?doc_id=413 (1 June 2015).

[113] The approach used for evaluation of efficiencies generated in horizontal mergers is a two-step approach. The first step entails assessment of any likelihood of potential anti-competitive effects, while in the second step it is considered whether efficiencies outweigh the anti-competitive effects. For vertical mergers, it is contended that both these steps shall be initiated simultaneously.

[114] *Grossman/Hart*, Journal of Political Economy 1986, p. 703.

how the efficiencies generated by vertical integration bring out the pro-competitive effects.

4.1 Increase in the pricing efficiency

When firms in the same supply chain sell their products, they often set the sale price by adding a margin to the cost of production incurred by them so as to make profits. Now if these firms are operating independently, both of them set separate profit margins, which in effect is a double addition of profit margin to the original cost of production. Consequently, the consumers have to pay keeping in view these double profit margins. However, if in this illustration, these two firms merged vertically, then there will be coordination in price setting and they will just add one profit margin to the cost of production. As a result, the consumers will have to pay a lower price which in turn leads to a higher demand for the products. Contrary to the independent firms' price setting, a reduction in the profit margin would still be lucrative to the integrated firm. Hence, a vertical merger brings about improved pricing efficiency and thus, inspires the firms to indulge in vertical mergers.[115] And from the perspective of the European Commission, such an approach may still outweigh the negative effects of the merger on effective competition and not prove to be harmful for the consumers.

Another pro-competitive effect of a vertical merger is the lowering of costs by its competitors to compete against (now) a stronger vertically integrated firm. As depicted above, vertical combination leads to an increased efficiency and cost-effective production for the merged firm. Consequently, the merged entity has access to the requisite inputs at a cheaper price since the upstream firm will reduce its profit margin on the supplies, and the downstream firm will no longer be

[115] Commission decision on case IV/M .1383 - Exxon/Mobil, points 30-39 (29 September 1999).

required to purchase the supplies from other upstream firms. The competing firm in order to combat their reduced demands and boost the input sales will have to price more aggressively. Thus, the vertical integration of its competitors compels it to reduce its prices. This example clearly illustrates the spill-over effect of the increased pricing efficiency of a vertical integrated entity on the non-integrated firms.

Lastly, price discrimination is another element of efficiency gains. A firm possessing substantial market power and striving for greater profits tend to charge different prices to different customers. This tendency is also dependent on the capacity and willingness of different customers to pay for a product. This also throws in the substitutability of the inputs for different customers. For certain customers, the input in question could be so critical for manufacture of their products that despite the increased prices, they will still buy the inputs at such higher prices. In such a scenario, it could be gainful for an upstream firm to merge with a downstream firm to affect price discrimination.

4.2 Improvement in the productive efficiency

An improvement in the productive efficiency is another possible positive effect of a vertical merger. If the production of different goods is pooled together, economies of scope[116] could be achieved in the form of productivity efficiency. The total costs for production are significantly lower for integrated firms as compared to the individual firms since by combing the technological synergies, a merged entity can produce its products in a more cost-effective way.[117]

An important consideration for many businesses is the timely delivery of the raw materials. This becomes considerably significant during

[116] Economies of scope refers to lowering the average cost for a firm in producing two or more products.
[117] RBB Report (fn. 112), p. 47.

phases of high demand when delay in supplies may result in hefty damages for downstream firms. However, if such firms combine with their suppliers, this enables them to more control over the production process and resultantly, more assurance of a timely delivery of the supply. A practical example of the importance of such efficiencies can be seen in the airline business, where airlines combined with the petroleum refiners in order to get stable supplies and prices for jet fuel.[118]

Productive efficiency could be further enhanced with more coordination and exchange of information after the merger. A better utilization of the unique skills or market knowledge possessed by independent firms can be made, if information is commonly shared.[119] Such a transfer of information leads to better quality products which is an added premium to vertically integrate firms. Sharing the information and more coordination plays a decisive role in various sectors, like R&D, distribution and marketing among others. Pursuant to a vertical merger, the information exchange and synchronization between the merging entities improve, which in turn forces the other competitors to improve the quality of their products to make it more attractive to consumers and compete with the merged entities' improved products.

From the management considerations for a business to prosper and expand, the role of capable managers is immense. With mergers, an acquiring firm may also get an opportunity to replace less capable managers with more successful ones. This could also account for an improvement in the productive efficiencies of the concerned firm.

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[118] Exxon/Mobil (fn. 115), point 42.
[119] *Mano*, Office for Official Publications of the European Communities 2002, p. 47.

4.3 Incomplete contracts and transaction costs

It is a usual business practice for business entities to enter into contracts with other firms. However, it is extremely difficult to anticipate each and every problem which may arise in future in great detail. So many times the contract may not be able to include solution to every possible issue, as some issues are unforeseeable. In business parlance, such a problem is referred to as 'incomplete contracts'[120]. Such incomplete contracts generally brings about high costs for the parties involved, as they may warrant greater monitoring of the contracted actions since sometimes the contracting parties may be inclined to take advantage of contractual loopholes. This problem could be curtailed if the firms were merged, as the incentives to deviate would be non-existent.[121]

A merger could also be beneficial if the two firms share a specific relationship and are commercially interdependent. If a firm makes an investment that has no value to other firms, then it makes the firm susceptible to exploitation. This problem is called the 'hold-up'[122] problem.

An example of this problem is if a manufacturer develops and produces a product that is only applicable to one client's products. In order to produce, the manufacturer has to make investments. After such investments have been made, the manufacturer is in a weak bargaining position, because it is very dependent on a client who

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[120] As per the contract theory, incomplete contracts reflects that a contract may not be able to specify the legal consequences of every possible state of the world, some of which may be by virtue of the incentives for the contracting party to deviate from the terms of the contract.

[121] *Bolton/Whinston*, Review of Economic Studies 1993, p. 17.

[122] The hold-up problem is a situation where two parties may be able to work most efficiently by cooperating, but refrain from doing so due to concerns that they may give the other party increased bargaining power, and thereby reduce their own profits.

could threaten to switch to another manufacturer. The client could take advantage of this problem and try to renegotiate supply terms and lower prices, even when prices were set before the production process began. Since the manufacturer's product is very specific, it could not sell the product to another client. As such it would have to agree to the lower price or face a useless investment.[123]

It is possible to prevent such concerns by concluding a very specific contract however, contracts can never align the exact interests of the two firms to the same extent which could be achieved by a vertical merger. Also, contracts are required to be monitored closely and at all times, which inevitably raises the costs.[124]

It is too early to assess the true impact of the efficiencies and to what extent it could neutralize the anti-competitive effects. It has to be adjudged on a case by case basis and a straightjacket formula for such evaluation cannot be outlined. Nevertheless, the consideration of efficiencies as a possible reason for vertical merger, at from the theoretical perspective, can be perceived to have expanded the possibility of extensive use of efficiencies under the vertical merger control in the European Union.

The regulation of vertical mergers in the European Union is quite comprehensively laid out and this highlights the significance of a dedicated mechanism for evaluation of effects of a vertical merger. The *Non-Horizontal Merger Guidelines* play major role in simplifying the assessment process and accords the European Commission a luxury to adopt the same fixed standards for all cases of the same category. The European Commission works on the well-defined parameters for vertical mergers. The elaborate insight on the possibility of non-coordinated and coordinated effects of vertical

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[123] *Maydell* (fn. 61), p. 71.
[124] *Bolton/Whinston* (fn. 121), p. 141.

mergers along with the possibility of efficiency justifications makes the competition law regulation efficient in the European Union.

D. The regulation of vertical mergers under Indian Law

Unlike the European Union law regime for the control of vertical mergers, the Indian law, being relatively new, does not have well defined guidelines or framework exclusively for the regulation of vertical mergers. The governing law for control of vertical mergers in India is the *Competition Act, 2002* and the *Competition Commission of India (procedure in regard to the transaction of business relating to combinations) Regulations, 2011* ("**Indian Merger Regulations**"). These laws empower the CCI to assess the effects of both horizontal and vertical mergers. However, as regards the strategies to be adopted for regulation, they are more explanatory for horizontal mergers. There are certain approaches which the CCI has used for regulation in its decisions on vertical mergers assessment. Thus, the discussion in this part of the study hinges more upon the practices of CCI than the legislations.

In India, the test for deciding whether a merger shall be allowed or not is to assess whether such a combination "causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India".[125] While assessing such effect, the CCI usually places considerable significance upon the market share and market concentration of the merging entities, notwithstanding the fact that the prohibition test is framed in terms of concentration of market power.[126] This approach is also easier to apply because it is relatively simpler for the CCI to measure the market share and market concentration (subject to availability of data), making this an attractive measurement of a merger's likely impact on a market.

So in this section of the study, firstly, the legal basis for regulation of vertical mergers in India will be discussed. Following this, the

[125] Section 6(1), *Competition Act, 2002.*

[126] *Ramappa*, Competition Law in India: Policy, Issues, and Developments, p. 158.

different approaches used by CCI in the assessment of vertical mergers are explained. It is pertinent to note here that unlike the European Commission, the CCI has not categorized the anti-competitive effects as coordinated or non-coordinated, but it is more in the form of potential anti-competitive challenges which vertical mergers may pose. Subsequently, this study also elucidates the role of merger efficiencies under the *Competition Act, 2002* as an important consideration for the approval of a vertical merger.

1. Legal basis for vertical merger control under Indian Law

The basis for merger control in India stems from the *Constitution of India* under the Directive Principles of State Policy. These Directive Principles mandate upon the State to secure a social order for the promotion of welfare of the people.[127] This provision recognized the need to eliminate and minimize the inequalities in income, which applied not only to the individuals but also to the groups in different areas.[128] Further, article 39 provides that the State shall strive to secure that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.[129] Now these principles provide the spirit for imposing the restriction on anti-competitive actions by individuals or entities. The preamble to the *Monopolies and Restrictive Trade Practices Act*, *1969* ("***MRTP Act, 1969***"), the first Indian legislation for regulation of competition, resounded this very principle in its objectives.

After a long and troubled gestation, India's competition law and CCI

[127] *Jain*, Indian Constitutional Law, p. 386.
[128] Article 38, *Constitution of India*.
[129] Article 39, *Constitution of India*.

came into existence.[130] The *Competition Act, 2002* substituted the *MRTP Act, 1969* from January 2003. The *Competition Act, 2002* prohibits anti-competitive agreements, abuse of dominant position and regulates mergers, amalgamations and acquisitions (collectively referred to as combinations). The CCI notified the *Indian Merger Regulations* as the implementing regulation.[131] This regulation empowers the CCI to evaluate mergers beyond the prescribed threshold limits (larger mergers) and acquisitions. After the assessment of the potential effects of the proposed merger, taking into account both pro-competitive and anti-competitive impact, the CCI may either accept without conditions, or accept with certain conditions or reject a proposed combination.

With the expansion of its objectives, from the stage of merely 'curbing monopolies' in the domestic market to the 'promotion of fair and effective competition', the competition regime in India has gained prominence for its progressive ways.[132] The current position of the competition law in India, could thus be successfully classified as a 'means to achieve the end', rather than just an end in itself.

2. Competitive problems from vertical mergers

The CCI is tasked with the responsibility of assessing all the possible anti-competitive impacts which the proposed vertical merger may have on the relevant Indian market. Taking into account these challenges the CCI has to anticipate and adjudge whether a vertical integration is likely to cause or causes an appreciable adverse effect

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[130] The Competition related provisions of the Competition Act, 2002 were barred by a write petition filed in the Supreme Court of India. It was argued in the case of *CCI* v. *Union of India* that the CCI would exercise judicial functions and hence would violate the doctrine of "Separation of Powers". Thus, the Competition Commission and the Competition Act became fully functional only in 2007.
[131] *Mehta*, A Functional Competition Policy for India, p. 142.
[132] *Kumar/Roy*, Competition Law in India, p. 319.

on competition. In this regard, the CCI faces challenges similar to the ones faced by the European Commission faces. However, the procedure in EU is far more expedited yet elaborate than the Indian system.

2.1 Facilitating coordination through vertical mergers

An extensive vertical integration by the upstream firms into the associated downstream market may enable coordination among the upstream firms, thereby making it more convenient to regulate prices in the downstream market. The price setting in the downstream market is generally more easily recognizable than the price regulation in upstream markets. Vertical mergers may increase the level of vertical integration to such an extent that this price monitoring may become significant to have an adverse effect on competition.[133] It is unlikely that there is an appreciable adverse effect on competition unless the upstream market is vulnerable to collusion among the competitors.

Furthermore, vertical merger is generally effective in disruption of a maverick player in the downstream market. Such a vertical combination may thus, facilitate greater coordination in the upstream market. In a situation where the upstream entities perceive sales to a specific purchaser as critically significant, they may find it beneficial to deviate from the terms of the coordination agreement in order to secure that business, which in effect will hamper the effect of the collusion.[134] Now, a merger of such a critical purchaser with an upstream entity may eliminate that competitiveness, providing the upstream firms greater incentive to coordinate effectively. An appreciable adverse effect on competition is less likely in an upstream market which is not so conducive for coordination because in such

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[133] *Ramappa* (fn. 126), p. 238.
[134] *Ibid.*, p. 241.

markets the sellers will be attracted more towards the disruptive firm rather than other competitors.[135]

2.2 The possibility of elimination of specific potential entrants

In certain cases, the vertical merger between a firm already present in a market (acquired firm) with a prospective entrant to that particular market (acquiring firm) may adversely affect competition in that market.[136] Now the proposed vertical merger poses concerns as it effectively removes the acquiring firm from the market completely.

The elimination of an important competitive threat that has the capacity to constrain the conduct of the firms already present in the market by the vertical merger could result in an immediate deterioration of the market. The economic theory of limit pricing suggests that monopolists and groups of colluding firms may find it profitable to restrain their pricing in order to deter new entry that is likely to push prices even lower by adding capacity to the market.[137] If the merging entity from the other market has significant specific incentives to enter this market, the firms in the market would be inclined to set a revised and increased price to eliminate that threat and compete with the merged entity.

In competition law, the problem is not always restricted to the profit-maximizing tendencies of the market players. Because if this was the only problem, then the incumbent firms would have set prices in such a way that the market price would act as an entry deterrent and if information exchange and collusion were sufficient to implement this strategy, the only challenge from the anti-competitive practices would

[135] *Agarwal/Bhattacharjea*, Economic and Political Weekly 2008, p. 12.
[136] *Saharay*, Textbook on Competition Law, p. 157.
[137] *Milgrom/Roberts*, Journal of Economic Theory 1982, p. 289.

have been the possible harm to perceived prospective competition.[138] In practice, however, actual potential competition has independent importance. Those entities which are already operational in the market may not perceive it as a viable option to set price low enough to deter all entry; moreover, those firms may misjudge the entry advantages of a particular firm and, therefore, the price necessary to deter its entry.[139]

Since there is always a close connection between the anticipated prospective competition and actual prospective competition, the CCI has to consider a set of objective factors designed to identify cases in which harmful effects are plausible. In these cases, the CCI then conducts a more concentrated investigation to assess whether the probability and expanse of the potential anti-competitive effect justifies a challenge to the merger. In this regard, the CCI takes into consideration any particular proof/evidence submitted by the combining entities to illustrate that the conclusions concerning the competitive damage derived from the objective factors are ill founded.

2.3 Barriers to entry due to the vertical merger

The vertical mergers may, in certain circumstances, create barriers for the new entrants. Such anti-competitive barriers resulting due to the vertical integration are vehemently objected to by CCI. There are two pre-conditions which lead to such a situation. Firstly, the upstream and the downstream market shall be considerably impacted by this vertical integration in such a manner that entrants to the first market would be compelled to enter the other market[140] simultaneously. Secondly, the

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[138] *Banerjee*, Guide to Competition Law, p. 213.

[139] U.S. Department of Justice, Merger Guidelines, 19 August, 2010, part 4.12, available at http://www.justice.gov/atr/public/guidelines/hmg-2010.html (27 May 2015).

[140] This competitive problem could affect competition in either the upstream market or the downstream market. The term "first market" refers to the market in which the

prerequisites for entering into the other market shall make the entry into the first market more complex and less likely. The CCI employs the following criteria in its approach of evaluating whether the vertical merger is likely to create barriers to entry.

Requirement of entry in both the markets: For instance, if after the vertical merger, the downstream market still has the potential for the unintegrated firms to carry on their business efficiently, the new entrants to the upstream market would not have to enter both markets simultaneously.[141] In such a case, the new entrants of the upstream market can still purchase their inputs from the other suppliers. Thus, if the downstream markets still have enough players to meet the demand of the upstream market, CCI is unlikely to challenge the vertical merger, as the competition is not adversely affected.

Increased difficulty of simultaneous entry into both markets: Further even if there is a need for the new entrants to enter both markets simultaneously, the relevant question that remains is whether the necessity for simultaneous entry to the downstream market is much more onerous as compared to the entry in only the upstream market. Even if there are other difficulties for entering into the downstream market, the CCI is less likely to challenge a vertical merger on this ground provided the competitive conditions for market entry are satisfied and the hardships cannot be attributed to the vertical merger itself.[142] When entry is not possible under those conditions, the CCI is increasingly concerned about vertical mergers as the difficulty of entering the downstream market increases. This theory will be applied by CCI only when the need for entering the downstream market

competitive concerns are being considered, and the term "other market" denotes the adjacent market.

[141] *Bawa*, Law of Competition in India, p. 96.

[142] *Agarwal*, Competition Act, 2002, p. 276.

appreciably increases the costs (which may take the form of risks) of upstream market entry.[143]

It is comprehendible that entry to both the markets simultaneously requires greater capital investment. However, it is pertinent to note that this additional capital requirement cannot be considered as a barrier to entry caused by the vertical merger.[144] If the firms could derive a significant profit for the costs incurred for entering both the markets, it is merely a business risk which cannot be considered as the adverse effect of a vertical merger. In certain cases, however, the investors may doubt that the potential entrants to the upstream market do not possess the requisite skills and knowledge to succeed in the downstream market. This, in turn, is likely to affect their performance in the upstream market as well. Thus, in order to hedge this risk of failure, the investors may be inclined to charge a higher rate of interest for the necessary capital. This issue becomes more significant as most of the capital assets in the downstream market are long term assets and are specialized for that market and, therefore, difficult to recover in the event of a failure.[145] Thus, the CCI in its evaluation of the likelihood of increase in the barriers to entry resulting from increased cost of capital, has to consider both the degree of similarity in the requisite skills in the upstream as well as the downstream market and has to balance it against the economic life and degree of specialization of the capital assets in the downstream market.

Additionally, another possible barrier for simultaneous entry to both markets could be attributed to the economies of scale in the downstream market which may pose additional difficulties for entry into the upstream market. This problem arises when there is a

[143] *Agarwal*, Competition Act, 2002, p. 276.
[144] *Mantravadi/Reddy*, Economic and Political Weekly 2008, p. 71.
[145] *Bhattacharjea*, Journal of Competition Law and Economics 2008, p. 624.

significant difference in the capacities of minimum-efficient-scale[146] plants in both the markets. For instance, if the capacity of a minimum-efficient-scale plant in the downstream market was considerably higher than the requirements of a minimum-efficient-scale plant in the upstream market, the entering firms would have to opt either between the inefficient operation at the downstream level or a larger than necessary scale at the upstream level. Either of these effects could cause a significant increase in the operating costs of the entrant.[147]

3. Merger efficiencies under the *Competition Act, 2002*

Under Indian law, the regulation of combinations requires the merging entities to give a notice to the CCI in the form as may be specified and the fee which may be determined by regulations.[148] As per the *Competition Act, 2002*, a proposal for a merger has to be reported to the CCI within thirty days (30 days) from the date of proposal. For a proposed merger to come into effect, it has to be passed by the CCI or if a period of two hundred and ten days (210 days) has elapsed without any decision by CCI, whichever is earlier.[149]

While efficiencies may be appreciated as a justification for approving proposed vertical mergers, the entities shall refrain from using efficiencies as a tool for concluding anti-competitive vertical mergers. However, the primary question in this regard is what efficiencies have to be considered and when shall such efficiencies be considered. Under the Indian jurisdiction, the competition authorities follow the

[146] In industrial organization, the minimum-efficient-scale is the lowest point where the firm can produce such that its long run average costs are minimized. This is useful for determination of the market structure. For instance, if the minimum-efficient-scale is small relative to the overall size of the market, there will be a large number of firms. The firms in this market will be likely to behave in a perfectly competitive manner due to the large number of competitors.
[147] *Harbord/Höhn*, International Review of Law and Economics 1994, p. 417.
[148] Section 6(2), *Competition Act, 2002.*
[149] Section 6(2A) read with section 31(1), *Competition Act, 2002.*

'merger specificity' approach to evaluate efficiencies. Specificity implies that the alleged efficiencies cannot be achieved in any manner otherwise than by the merger.[150]

The specificity factor ascertains the importance of the alleged efficiencies. While assessing the efficiencies for vertical mergers, the CCI has to deal with two key issues. Firstly, whether the alleged efficiencies emanate as the direct consequence of the proposed vertical merger? Secondly, is it possible to achieve the alleged efficiencies in any other manner apart from the proposed vertical merger? It is to be noted that if the efficiencies alleged are specific to the merger in question, i.e. it could not be achieved in any other way, then the CCI is more likely to appreciate such efficiencies and in turn, approve the vertical merger.[151] But on the contrary, if the alleged efficiencies could be achieved in any other manner apart from the proposed merger then the consideration of efficiencies would be less relevant.

While evaluating whether the proposed merger causes or is likely to cause an appreciable adverse effect on competition, CCI is obliged to have due regard to all or any of the factors mentioned in section 20(4) of the *Competition Act, 2002*.[152] A comprehensive consideration of all these factors illustrates that CCI has to take into consideration both anti-competitive and welfare consequences of the proposed merger. The last five factors mentioned in section 20(4) of the *Competition Act, 2002* indicate the possibility of CCI considering the pro-competitive effects in evaluating whether the proposed merger has or is likely to have an appreciable adverse effect on competition in the relevant market. The relevant five (5) factors for the evaluation of efficiency consideration are as follows:

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[150] *Röller/Stennek/Verboven*, WZB Discussion Paper 2000, p.7.
[151] *Kolasky/Dick*, Anti-trust Law Journal 2003, p. 234.
[152] *Ramappa* (fn. 126), p. 259.

"(j) nature and extent of vertical integration in the market;

(k) possibility of a failing business;

(l) nature and extent of innovation;

(m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;

(n) whether the benefits of the combination outweigh the adverse impact of the combination, if any."[153]

Vertical merger may have both pro-competitive and anti-competitive effects. If the probable consequence of a vertical integration is reduction of competition in the downstream market either due to a dominant position of the merged entity or increased market power over the supply of important inputs, such effects of the vertical merger are considered anti-competitive. On the contrary, a vertical merger is said to be pro-competitive if it facilitates the elimination of 'double marginalization'[154] or expenditure on similar business activities.

With reference to the factor 'nature and extent of innovation', it could also be perceived having both types of effects. In certain cases, a vertical merger may present the prospect of future innovation owing to the economies of scale and scope and incentive to invest in research and development activities. However, if one of the entities to the merger is having some IPRs which may not be utilized by the other entity to the merger for fear of competition with its own existing line of products, then this shall be considered as an anti-competitive effect

[153] Section 20(4), *Competition Act, 2002*.

[154] Double marginalization is the phenomenon in which different firms in the same industry that having their respective market powers but at different vertical levels in the supply chain (upstream and downstream level) apply their own profit margin in the prices.

of the vertical merger.[155] Additionally, the Indian competition law takes into consideration the comparative advantage that may be brought by the proposed merger by making contributions to the economic development of the relevant market as against the possibility of the appreciable adverse effect on competition. In this regard, the CCI enjoys wide powers for evaluation of the effect of vertical merger on competition.

After the analysis of the factor of relative advantage, another important factor is enshrined in section 20(4)(n) of the *Competition Act, 2002*. This factor provides further liberty to the CCI to allow any vertical merger, if, in its opinion, the pro-competitive effects of the proposed combination outweigh the anti-competitive effects of the combination, if any.[156] A holistic reading of the factors stipulated in section 20(4) of the *Competition Act, 2002* clearly indicate that in the Indian legal system the efficiency considerations are widely worded and it is left to the discretion of CCI to decide if the vertical merger shall be allowed or not. The efficiency considerations form an integral part of the competition law regime in India. The Indian merger control regime incorporates efficiencies as a part of its substantive assessment in case of vertical mergers.[157] The CCI considers the welfare standards evaluation for the efficiency appropriation. Keeping in mind the basic objectives provided under the preamble of the *Competition Act, 2002* which states that the CCI has to promote and sustain competition 'keeping in view the economic development of the country', CCI is mandated to ensure that beyond the total surplus considerations, a vertical merger shall not only be pro-competitive but must also make some contribution in the growth and development of the concerned

[155] *Mehta* (fn. 131), p. 259.
[156] *Agarwal* (fn. 142), p. 136.
[157] *Bhattacharjea* (fn. 145), p. 635.

markets.[158] The CCI, thus, need not necessarily limit itself within the bounds of different welfare standards as other world jurisdictions have to confine to. Rather, it takes the welfare standards as ancillary support but goes much beyond and essentially aims at the development of economy of the country with growth of a competitive market as the main objective.

The journey of the competition law regulation in India is a new one though immense progress has been made in this short period. Although, the widely worded provisions of the *Competition Act, 2002* and lack of an exclusive vertical merger regulation mechanism have made the duties of CCI more cumbersome. CCI as the regulatory authority has successfully managed to not only avoid assertion of a monopoly but has fostered fair competition in the market. The challenges of a vertical merger too have been handled impressively. The fundamental principle for the substantive assessment of vertical mergers is similarly modelled as in European Union but there is still a lot of scope for improvement and development of a stable process of assessment. The following chapter of this study emphasizes on the lessons which may be learned by the Indian system from the European legal system.

[158] *Kumar/Rajib*, Vikalpa 2007, p. 37.

E. Comparative Analysis: Major takeaways for the Indian jurisdiction

After the analysis of the applicable law for regulation of vertical mergers in the European Union and India, this part of the study now discusses the differences in the two systems and the changes that shall be incorporated in the Indian system to make the regulatory regime more effective and efficient. Since the European Union competition law regime is more developed, there are certain approaches which may prove helpful for CCI to evaluate the effect of vertical mergers on the competition. However, it has to be kept in mind that the approaches adopted in European Union need not be incorporated in India verbatim, as there are lot of differences in the economy and markets of both jurisdictions.

It is also pertinent to mention that the Indian law is modelled on the regulation framework adopted by the European Union and United States competition law regime in certain aspects. The CCI, just like the European Commission, derives its objectives for regulation and growth of fair competition from the Constitution (the founding treaties in case of the European Union). Furthermore, CCI is also entrusted with the duty to consider both the pro-competitive and anti-competitive effects of a vertical merger, including the efficiency considerations. So the basis is similar to that of the European Commission, it is some of the methods employed by the European Commission, which needs to be implemented in India as well.

The most important action which CCI need to take is to come up with a guideline specific for the regulation of vertical mergers. Learning from the European Union experience, a dedicated guideline gives the system more certainty and uniformity. Also, it helps the merging entities to understand what practices shall be avoided in order to not impede the effective competition. Apart from this, this part of the

thesis also discusses the lessons to be learned from both the procedural and the substantive issues perspective.

1. Pre-merger notification requirement

Most jurisdictions having a strong competition law regime prescribes a pre-merger notification. Both the European Union and Indian legal system impose a mandatory notification requirement on all merging parties. This means that whenever a proposed merger exceeds the stipulated threshold limits, the merging entities shall notify the competition authorities about the proposed merger, and the competition authorities, in turn must carry out an evaluation and review of the proposed merger. The advantage of such a notification is that the obligation to notify is determined by well-defined and identifiable parameters. Further, this minimizes the chance of any anti-competitive mergers escaping from the scrutiny of the competition authorities.

As regards the mandatory notification system in the European Union, the *ECMR* prescribes a simplified procedure for the less threatening cases. The purpose behind the incorporation of such a mechanism is to reduce the workload of the European Commission. On receipt of a notification, the European Commission has to publish such notification in the official journal. This is followed by consideration by the European Commission of the eligibility of the proposed merger for the simplified procedure and a 'summary' decision, within one month, is issued to announce the compatibility of the merger.

Initially, the *Competition Act, 2002* provided for a voluntary notification system. As per the Raghavan Committee[159], the

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[159] Report of High Level Committee on Competition Policy and Law - S.V.S. Raghavan Committee, 2000 (pursuant to the recommendations of which the Competition Act was enacted) available at

requirement of prior approval may give rise to some challenges owing to 'delays and unjustified bureaucratic interventions'.[160] Also, a voluntary notification mechanism accords the benefits of cost saving as well as lesser workload on the CCI. However, mandatory notification was approved and has been incorporated into the *Competition Act, 2002*.

Lessons to be learned: Although the European Union follows a mandatory notification which in turn puts more work burden on the European Commission, however, their system is more structured and well supported with other regulations for reducing the work load. Under the European Union competition law, there is a system of separate department dealing with different category of mergers. More significantly, the fears of Raghavan Committee regarding delays due to bureaucratic interventions have become a reality under the Indian system.

The *Competition Act, 2002* allows CCI to take a decision on the compatibility of a merger within a period of two hundred and ten days (210 days) which slows down the entire procedure and imposes hardships on the merging entities. The Indian law needs to take cue from their European counterparts where the European Commission expedites the process and in certain cases is obligated to give a decision within a period of thirty (30) days.

2. Substantive analysis of vertical mergers: test and criteria for merger control

The substantive test used for the assessment of vertical mergers by the European Commission was revamped in 2004 with the SIEC test replacing the dominance test. The SIEC test accords more flexibility

http://www.ccr.org.in/reports.html (29 May 2015).

[160] *Ibid.*, para 4.7.5.

and provides greater discretion to the European Commission. Although the SIEC test too assess the possibility of dominance, but now it is used only by example and is not considered as the primary criterion for evaluation of a merger. The SIEC test has proved to be a more effective economic measure to analyze the costs and benefits of a proposed merger as regards testing its compatibility with effective competition.

The *Competition Act, 2002* does not allow any vertical merger which cause or is likely to cause an appreciable adverse effect on competition in the relevant market in India.[161] The *Competition Act, 2002* prescribes a series of factors which are to be considered by the CCI to evaluate whether the proposed merger may have an adverse impact on effective competition.

<u>*Lessons to be learned*</u>: The *Competition Act, 2002* lacks in defining or elucidating the meaning of the expression 'appreciable adverse effect'. This leads to uncertainty and non-uniformity as what could be considered as having appreciable adverse effect in one case may be adjudged otherwise in another. Unlike the European Commission, the CCI is tasked with an additional duty to define how large an effect would qualify as an appreciable adverse effect and whether this term would include any term above the *de minimis.* The Indian system needs to take away European approach of explaining such key terms and not to merely enumerate various factors, all or any of which are to be taken into account to determine whether a proposed vertical merger has such an effect. There is a need of guideline or framework like the *Non-Horizontal Merger Guidelines*, in the Indian law.

3. Criteria for assessment of the vertical mergers

The competition law authorities need to adopt several distinct criteria

[161] Section 6(1), *Competition Act, 2002*.

for the assessment of the impacts of proposed mergers on competition. The factors to be considered are decided on a case by case basis. However, the impacts of a particular transaction may not be limited only to a particular category and hence, the proposed combination has to evaluated for its various effects. Again, the European law is more developed in this regard and following are some of the criteria in which Indian law need to learn from the European Union competition law.

3.1 Market share and market concentrations

The market shares of the combining entities prior to the proposed merger and of the combined entity subsequent to the merger, constitute important criteria for determination of the level of concentration in the market which in turn indicates the level of competition in the market.

The European Commission takes into consideration the accretion of market power in the upstream as well as the downstream market. It is difficult to assess the adverse effects of a vertical integration, as only the market share is not a clear indicative of all the possible anti-competitive effects of such a merger. As discussed in the earlier section of this study, the European Commission also takes into account the loss of potential competition that might result from the vertical merger.[162]

In India the *Competition Act, 2002* categorically enumerates, among other factors, the market shares of the persons and/or entities in a combination, both individually and as a combination. The CCI has to adjudge which other factors, in addition to the market share, have to be considered for the evaluation of the proposed merger.

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[162] *Whish/Bailey* (fn. 18), pp. 838-39.

Lessons to be learned: The assessment of a vertical merger is much more complex than horizontal mergers and the same approach cannot be used to adjudge both the types of mergers. However, the *Competition Act, 2002*, does not specify or describe the approach to be followed for the evaluation of vertical merger. The factors enlisted in the legislation are not effective in case of vertical mergers. On the contrary, the European Commission has been more elaborate in specifying the approaches which need to be adopted through its dedicated guidelines for non-horizontal mergers.

In addition to this, the Indian legal system could also take help of the HHI approach (discussed in earlier sections) adopted by the European Commission for assessment of vertical mergers. The market share is not always reflective of the effect a vertical merger may have on the competition. Like the European Union, if there is a dedicated guideline in place, this will render the competition law in India a more definitive character. Also, the merging entities will be aware of the clearly set out parameters on the basis of which their mergers are going to be assessed.

Another addition needed in the Indian legal system is the manner of collection of information about the market power of the merging entities. Currently, CCI mainly depends on the market research and the information furnished by the entities. The European Commission has a provision for seeking relevant information from different market players. Not only the merging entities have to submit the requested information, but the European Commission can also collect information from the competitors and the consumers of the market as well. This is another feature which should be incorporated in the Indian competition law regime and may be modelled on the successful European approach in this regard.

3.2 Barriers to entry

As discussed in detail in the preceding sections, the European Commission gives a lot of importance to understand and assess how a vertical merger may lead to the effect of foreclosure of access to the markets. The article 2 of the *ECMR*, guides the European Commission to appraise the factors for considering the impact of a merger on the access to the inputs and supplies and 'any legal or other barriers to entry'. In addition to the *ECMR*, the *Non-Horizontal Merger Guidelines* provides a great insight in the possible scenarios which could lead to foreclosure of access to the market and other non-coordinated or coordinated effects of a vertical merger.

On the other hand, the *Competition Act, 2002* also stipulate 'barriers to entry' as a factor to be considered by the CCI while determining whether a proposed merger has or is likely to have an appreciable adverse effect on competition.[163] Also, there is a provision for considering the nature and extent of vertical integration in the relevant market to be considered by the CCI.[164] However, there are no guiding principles for the CCI regarding the possibility of foreclosure and the negative effects which may arise due to such foreclosure.

<u>*Lessons to be learned*:</u> The *Competition Act, 2002* has merely listed the factors but there is no description of how and to what extent such factors have to be considered for the evaluation. So it is left to the discretion and interpretation of CCI in every single case to understand the relevance of such factors. This leads to a lot of complexity and vagueness in the application of the parameters set for evaluation. In European Union, this problem has been solved to a great extent by the enactment of the *Non-Horizontal Merger Guidelines*. The said guidelines explain the importance of each of these factors and provide

[163] Section 20(4)(b), *Competition Act, 2002*.
[164] Section 20(4)(j), *Competition Act, 2002*.

a primer of how the European Commission acts in a given scenario. The guidelines also has a lot of illustrations and precedents which reflects the consistency with which European Commission treats a proposed vertical merger of similar type. The *Competition Act, 2002* shall also incorporate a framework of this sort, which will make the system more transparent.

In addition to this, the current law in India does not recognize the critical nature of the non-coordinated effects of a vertical merger like foreclosure of access to inputs and the customer foreclosure. These are some serious impediments to an effective competition in the relevant market, but the *Competition Act, 2002* has no reference for assessing such significant effects. One of the lessons that Indian law needs to learn from the European Union law is the recognition of such effects and empowering the CCI with the requisite measures to evaluate such effects.

3.3 Welfare objectives and benefits to consumers

Primarily the competition law is concerned with promoting economic objectives, however, the competition law authorities also take into consideration the consumer welfare and social welfare objectives. As per the provisions provided under the *ECMR,* the European Commission is required to consider consumer welfare in the analysis of a vertical merger. The European Commission has to take into account the interests of the intermediate and ultimate customers while attaining the goals of technical and economic progress, provided that it is for the benefit of the consumers and does not create any hindrance to the competition.[165]

In the Indian law, significance is accorded to the innovation considerations. The *Competition Act, 2002* specifies the nature and

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[165] *Tiwari* (fn. 4), p. 126.

extent of innovation as one of the factors which has to be considered by the CCI while evaluating a vertical merger proposal and the overall benefits arising out of the proposed mergers have to be weighed against the possible anti-competitive effects which may arise from the merger. However, consumer interest[166] is not mentioned as one of the factors in the law. Since the objective of the *Competition Act, 2002* is to promote economic growth it is likely that evaluation of the benefits of the merger includes the advancement of consumer interests.

Lessons to be learned: Once again it is the lack of clarity in the legislation itself which makes it difficult to understand the importance of consumer interest as a factor for allowing a vertical merger. It has been discussed above that in the European Union a vertical merger is likely to reduce the double mark-up factor for the profit margin, which in turn reduces the prices for the customers. This factor is a prominent criterion which the European Commission considers while balancing the anti-competitive effects of a vertical merger against its pro-competitive effects. The *Competition Act, 2002* needs to adopt this principle from the European Union. Giving prominence to consumer interests will be a crucial step for growth of the market and regulated prices, which in turn will foster an effective competition.

4. Efficiency Consideration

The overall assessment of a vertical merger proposal includes the European Commission considering the efficiencies which are generated by such integration.[167] A merger may also lead to the

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[166] 'Benefits to consumers' is a factor to be considered in the context of anti-competitive agreements, where the question for determination is whether an agreement has an appreciable adverse effect on competition. The issue also involves the assessment of promotion of technical, scientific and economic development by means of production or distribution of goods or services, if any, through the agreement in question.

[167] *Colley*, European Competition Law Review 2004, p. 345.

development of technical and economic progress benefitting the consumers and if the efficiency generated by the merger outweighs the potential anti-competitive effects, such a merger cannot be said to significantly impede effective competition in the common market.[168] As noted earlier, the European Commission follow a three step procedure for assessing the positive effects of the efficiencies emanating from a vertical merger.

As for CCI in its assessment, certain factors in this regard have been set out in section 20(4) of the *Competition Act, 2002*. It includes the factor requiring CCI to adjudge whether the benefits of the combination outweigh the adverse impact of the combination, if any. Thus, it is clear that efficiencies of a merger form an important consideration in Indian law as well.

Lessons to be learned: Unlike the European Union, the Indian law merely provides for consideration of the benefits arising out of a merger. However, there are two major differences from the European Union law. Firstly, the factor regarding efficiencies is generic in nature. There is no distinction for treating horizontal merger and vertical mergers in a different manner. The importance of a dedicated guiding principle for vertical mergers becomes all the more significant for the efficiencies consideration. A vertical merger affects both the upstream and the downstream market, so there is a possibility of impact in each of these markets. Secondly, there is no approach recommended for the CCI to adopt. In this regard, the *Non-Horizontal Merger Guidelines* serves as a sound foundation for the European Commission to systematically analyze the efficiencies conjured by the vertical merger. India too needs an approach similar to the three step test implemented in Europe.

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[168] Article 2(1)(b), *ECMR*.

Further, sometimes, the doctrine of ‘failing firm’ is also invoked to allow a merger in order to save a ‘failing firm’, even though there will be less competition in the market after the merger than before. It is based on the premise that if a firm is likely to go out of business anyway, the consumer would not be harmed if that firm were to be acquired by an existing competitor. In Indian law, this factor is rarely considered by the CCI. Taking a leaf out of the European Union’s book, Indian competition law regime shall also have a consideration for this justification, as this will be instrumental in maintaining the stability of a competitive market.

The competition law in India is relatively a new law and there is a big scope of development for effective implementation of the legal principles. The European Union not only has a more compact legal structure for regulation of vertical mergers, but also being the union of 28 different states the European Commission has a rich source of precedents for different types of situations which needs to be encountered while assessing a vertical merger. The need of a dedicated legal framework for vertical merger is imminent for the Indian competition law regime. A guideline on the lines of the *Non-Horizontal Merger Guidelines* will be extremely helpful in according more legal certainty, less complexity, consistency and transparency in the Indian law.

F. Conclusion

The competition law on the regulation of vertical mergers in India and the European Union have an identical mechanism and have various common characteristics as regards the different stages of the merger analysis and measures adopted by the respective competition authorities in this behalf.

However, pursuant to the discussion in the preceding section, there are also considerable differences in the applicable provisions in the context of the definitions, the notification requirements, time limit for assessment of the pre-merger notifications by the competition authorities, and the substantive test applicable for the determination of the potential effects on effective competition.

The European Commission has the task of evaluating the pro-competitive and anti-competitive effects of a proposed vertical merger. The *Non-Horizontal Merger Guidelines* provide an insight into the principles to be adopted during the assessment. The significant anti-competitive effects of a vertical integration could be either non-coordinated or the coordinated effects. The combining firms may adopt the strategy of foreclosure to the access of supplies or in some cases the foreclosure of customer. A vertical integration also facilitates the coordination between the market players which significantly impede effective competition in the market. The European Commission has to try and balance such anti-competitive impacts against the efficiencies which are generated by the proposed vertical merger. Once the European Commission has established that the efficiencies brought about by the vertical merger in question overshadow the potential anti-competitive effects, the proposed merger is approved, sometimes subject to certain conditions.

The *Competition Act, 2002* targets the protection and promotion of effective competition and not only disrupting or repressing monopolies and dominant positions. Thus, the merger control provisions are accordingly formulated to prohibit such vertical integrations which are likely to have an appreciable adverse effect on competition. The CCI also balances the positive and negative effects of the vertical merger. However, unlike the European Commission, in absence of a dedicated mechanism for assessment of vertical mergers, the challenges faced by the CCI are a bit more complex. The *Competition Act, 2002* has indeed stipulated certain factors and yardsticks to be followed by CCI during its evaluation. However, sometimes there is not much clarity about the extent and interpretation of such factors and it is left to the discretion of CCI as regards the applicability of such factors in different types of cases. The competition law in India is still in the stage of development and the competition law regime of the European Union could be of great guidance.

This study was initiated with the aim of ascertaining the significance of a dedicated mechanism for regulation of vertical mergers. After the analysis of the applicable provisions in the competition law system of India and the European Union, the study finds it extremely important to have an exclusive guidelines or framework for the assessment of vertical mergers. Furthermore, as discussed in the preceding section of this study, the Indian legal system could draw a lot of guidance from their European counterpart that will help in making the regulation of vertical merger effective and more efficient.

However, there are certain issues that must be addressed in order that the law can effectively deal with mergers.

Firstly, threshold limits have been prescribed on the basis of assets or turnover and the definition of 'combinations' includes these threshold

limits and as a result the mergers below this threshold limit, are not scrutinized by the CCI, although even such mergers may have a negative impact on the competition.

Secondly, in absence of a dedicated mechanism for regulation of vertical mergers, there are certain issues which have remains unaddressed or unclear. There is an urgent need for a framework to assist the CCI for regulation of vertical mergers.

Thirdly, the biggest challenge regarding the regulation of vertical mergers is the time limits stipulated for the evaluation of merger notifications. The prescribed time period of two hundred and ten days (210 days) for making the final decision is significantly longer than that in the European Union. This sometimes poses undue hardships on the merging entities and eventually has an effect on the market itself. Hence, under all circumstances, the CCI will be well advised to use its discretionary powers judiciously and with the sole objective of promoting economic democracy.

Finally, the mandatory pre-notification mechanism is likely to appreciably increase the workload of CCI in this regard. Prompt steps are needed to be taken to ensure that the proposed merger notification are assessed and adjudged without any unreasonable delay.

For a smooth and effective functioning of CCI the abovementioned issues should be resolved at an early stage.

As George Bernard Shaw is credited to have said "*We are made wise not by the recollection of our past, but by the responsibility for our future*", and the future of Indian competition law is indeed bright.

APPENDICES

Figure 1 - Input foreclosure

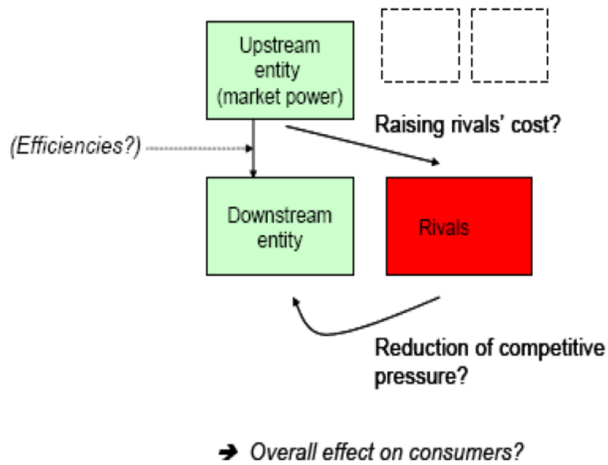
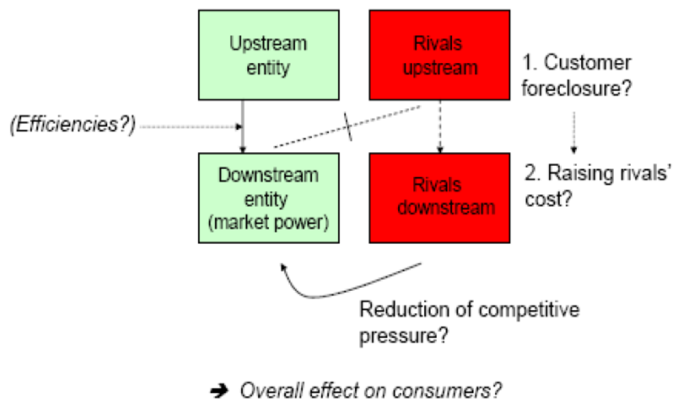


Figure 2 - Customer foreclosure



Source: Non-Horizontal Merger Guidelines.

- Statistics: Number of merger cases reported to the European Commission since 1990

21 September 1990 to 31 May 2015

I.) NOTIFICATIONS

	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07	08	09	10	11	12	13	14	May 15	Total
Number of notified cases	11	64	59	59	95	110	131	168	224	276	330	335	277	211	247	318	356	402	348	259	274	309	283	277	303	118	5844
Cases withdrawn - Phase 1	0	0	3	1	6	4	5	9	5	7	8	8	3	0	3	6	7	5	10	6	4	9	4	1	6	3	123
Cases withdrawn - Phase 2	0	0	0	1	0	0	1	0	4	5	5	4	1	0	2	3	2	2	3	2	0	1	1	0	0	0	37

II.) REFERRALS

	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07	08	09	10	11	12	13	14	May 15	Total
Art 4(4) request (Form RS)															2	14	13	5	9	8	6	10	13	11	16	4	111
Art 4(4) referral to Member State															2	11	13	5	9	6	7	10	12	9	14	6	104
Art 4(4) partial referral to Member State															0	0	0	1	0	0	0	1	0	2	0	0	4
Art 4(4) refusal of referral															0	0	0	0	0	0	0	0	0	0	0	0	0
Art 4(5) request (Form RS)															20	28	38	51	23	23	26	18	22	12	19	13	293
Art 4(5) referral accepted															16	24	39	50	22	25	24	17	22	11	19	12	281
Art 4(5) refusal of referral															2	0	0	2	0	0	1	0	1	0	0	0	6
Art 22 request	0	0	0	1	0	1	1	1	0	0	0	0	2	1	1	4	4	3	2	1	3	1	3	1	1	0	31
Art 22(3) referral (Art 22. 4 taken in conjunction with article 6 or 8 under Reg. 4064\89)	0	0	0	1	0	1	1	1	0	0	0	0	2	1	1	3	3	2	3	1	2	2	2	1	1	0	28
Art 22(3) refusal of referral																1	1	0	0	0	1	0	1	0	0	0	4
Art 9 request	0	1	1	1	1	0	3	7	4	9	4	9	8	10	4	7	6	3	5	3	11	2	2	2	2	1	106
Art 9.3 partial referral to Member State	0	0	1	0	1	0	0	6	3	2	3	6	7	1	1	3	1	1	2	0	3	0	1	0	0	0	42
Art 9.3 full referral	0	0	0	1	0	0	3	1	1	3	2	1	4	8	2	3	1	1	2	1	4	2	1	0	0	0	41
Art 9.3 refusal of referral	0	1	0	0	0	0	0	0	0	1	0	0	0	1	0	0	0	1	0	1	1	0	0	0	3	2	11

Source: European Commission, available at

http://ec.europa.eu/competition/mergers/statistics.pdf

- Statistics: Number of merger cases reported to the CCI

Break-up of Sample of Mergers

Merger Type	Number of Mergers	% of Total Sample
Horizontal	64	67
Vertical	8	8
Horizontal	24	25
Total	96	

Number of same group company mergers in the sample was 60.

Source: *Mantravadi, Pramod/Reddy, Vidyadhar*, Economic and Political Weekly 2008, p. 70.

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