Organisation for Economic Co-operation and Development

DAF/COMP/WD(2019)24

Unclassified English - Or. English

28 May 2019

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Vertical mergers in the technology, media and telecom sector – Note by Germany

7 June 2019

This document reproduces a written contribution from Germany submitted for Item 10 of the 131st OECD Competition committee meeting on 5-7 June 2019.

More documents related to this discussion can be found at

http://www.oecd.org/daf/competition/vertical-mergers-in-the-technology-media-and-telecom-sector.htm

Please contact Mr. Antonio Capobianco if you have any questions about this document
[E-mail: Antonio.Capobianco@oecd.org]

JT03448061

Germany

1. The assessment of vertical mergers is part of the merger control mission of the Bundeskartellamt (German Competition Authority) under the revised German Competition Act (‘Gesetz gegen Wettbewerbsbeschränkungen’, ‘GWB’). Vertical mergers in the media and telecom sector were not a source of landmark cases in the last years in Germany. Still, the general approach towards vertical mergers and the novel criteria for market power were further elaborated and tested in a recent case. The following introduction to the analytical framework for vertical effects under German merger control in principle also applies to mergers in the technology, media and telecom sectors.

2. This submission provides an introduction into vertical aspects of merger control that may raise competition concerns (**1**).[1] The concepts of input foreclosure (**2**), customer foreclosure (**3**) and their analysis and application in case examples are discussed. The vertical dimension of data relevant for competition is touched upon (**4**). Finally, the challenges of the design of suitable remedies are presented (**5**). The submission closes with conclusions (**6**).

1. Vertical mergers

1.1. Introduction

3. In a vertical merger, the merging parties are active on different levels along the value chain of a product. Consequently, they have at least a potential supplier-customer relationship. The company active on the downstream market sources from the company active on the upstream market to use the input for its own production. A vertical merger exists, for example, where a company takes over a supplier by means of a so-called backward integration, or a customer of one of its products or services by means of a forward integration.

4. Compared to horizontal mergers, vertical mergers do not lead to a reduction of the number of actual competitors in the market. Nevertheless, vertical mergers can also lead to competitive restraints.

5. Vertical integration can enable a company to be active at several stages of the production chain or supply chain and thus avoid inefficiencies. For example, transaction costs can be reduced or coordination problems and uncertainties with regard to security of supply, product quality, etc. can be avoided. Such efficiencies usually strengthen the competitive position of the company but - provided there is enough competitive pressure - these efficiencies can also be beneficial for customers.[2]

6. Vertical integration also changes the incentives of suppliers which are relevant for their market behaviour. A vertical merger may reduce double marginalisation. In this

[1] Parts of this paper are based on the Bundeskartellamt’s 2012 Guidance on Substantive Merger Control, the Bundeskartellamt’s publications are available at: www.bundeskartellamt.de

[2] Bundeskartellamt, Guidance on Substantive Merger Control, p. 48.

respect, vertical integration tends to have a dampening effect on prices and may contribute to an improved supply situation.

1.2. Competition concerns

7. Anticompetitive effects may arise if the merger enables the company to impede actual or potential competition. Such impediments can be the result of strategies that raise rivals' costs, lower rivals' revenues or raise barriers to entry.

8. Depending on the type of vertical merger, there are different ways for these anticompetitive effects to emerge: Input foreclosure denotes a scenario where competitors' access to an upstream market or to products sold thereon is hampered or eliminated. Customer foreclosure denotes a scenario where competitors' access to a downstream market or customers who purchase goods thereon is hampered or eliminated. By means of vertical integration a company may in addition expand its data harvesting activities or gain access to confidential business information on the activities of its competitors which may impede them in their competitive activities. To assess the effects of a vertical merger, it has to be considered in which way the merger affects the ability of and incentives for such strategies.[3]

9. Anticompetitive effects may not be limited to circumstances in which the merger creates new links to upstream or downstream markets for the acquiring company. Competition may also be impeded if the acquiring company safeguards or strengthens pre-existing business or contractual relations by establishing a structural link.[4]

10. A vertical merger will only give rise to competition concerns if at least one of the merging parties has some degree of market power on at least one of the affected markets. The stronger the pre-existing market position of one or both of the merging companies, the greater the risk that the merger will lead to anticompetitive vertical effects.

11. Market transparency may increase as a consequence of a vertical merger if vertical integration provides access to sensitive information on competitors or if it increases price transparency. If, for example, price transparency is higher on the downstream market than on the upstream market, a vertical merger may improve the ability of the upstream manufacturer to effectively monitor price deviations. It may also become easier to mutually monitor market conduct if the number of market participants decreases due to the merger. Where structural links between the coordinating companies are established, information exchange between these companies can facilitate effective monitoring. Hence, a vertical merger may improve the ability to punish deviations, which has a deterrent effect.

12. Competitive constraints exerted by fringe players or by potential competitors may be weakened by a vertical merger. For example, barriers to entry may be raised. In addition, a vertical merger may reduce countervailing buyer power. A major customer may be in a position to induce upstream companies to deviate from the terms of coordination by promising substantial or long-term contracts.

[3] Bundeskartellamt, Guidance on Substantive Merger Control, p. 49.

[4] Bundeskartellamt, Guidance on Substantive Merger Control, p. 50.

2. Input foreclosure

2.1. Ability to foreclose

13. If a company acquires a major supplier of an essential input, this may lead to foreclosure effects on the upstream market. The vertically integrated company may hamper the access of its competitors on the downstream market to these inputs by, in particular, raising prices, degrading quality, making supply conditions less favourable, supplying with a significant delay or refusing to supply at all.

14. The ability to hamper competitors on the downstream market by foreclosing access to essential inputs is mainly determined by two factors, the relevance of the input with regard to production costs in the downstream market and the possibilities for competitors to switch to alternative suppliers. The Bundeskartellamt cleared the acquisition of the HERE mapping service by a consortium of German car manufacturers since the potential for input foreclosure for the supply of digital maps could be ruled out. Other automobile customers could still buy digital maps from TomTom and they were likely to have an interest in keeping this alternative open.[5]

15. The lower the respective input's share of the total cost of downstream production, the less the integrated company is able to effectively harm its competitors e.g. by raising prices. In contrast, the more the competitors on the downstream market depend on the input from the vertically integrated company, the more likely it is that their market position may be negatively affected. This is the case, for example, if there is no equivalent supplier on the upstream market or if switching costs are substantial.[6]

2.2. Incentive to foreclose

16. The incentive of the integrated company to foreclose its competitors from essential inputs depends on the degree to which such a strategy would be profitable. As a rule of thumb, a foreclosure strategy has two effects on profits, which point in opposite directions: If the vertically integrated company raises prices and reduces sales to its downstream competitors, this may lead to reduced profits on the upstream market. On the other hand, its sales and profits on the downstream market may increase to the extent that it succeeds in hampering its competitors, capturing at least some of their customers, and diverting (all or part of) their sales to its own products. If sufficient sourcing alternatives exist and if suppliers are interested in a high capacity utilization, the risk that the integrated company will pursue a foreclosure strategy is low. The same applies if the integrated company is mainly active on the upstream market and does not have (and will not be able to develop in the short term) the necessary capacities in the downstream market to entice customers away from their previous suppliers. A foreclosure strategy is profitable if the rise in profits on the downstream market outweighs the fall in profits on the upstream market.[7]

---

[5] Bundeskartellamt, press release of 6 October 2015.

[6] Bundeskartellamt, Guidance on Substantive Merger Control, p. 51.

[7] Bundeskartellamt, Guidance on Substantive Merger Control, p. 52.

2.3. Decisional practice

17. Vertical mergers that cause competitive concerns are rare in the Bundeskartellamt’s decisional practice. The *Stihl/Zama*[8] decision concerned the planned divestment of a business unit and patent licences for important input products for handheld power tools. The remedy package involved the patent portfolio of the merged entities which illustrates the technology dimension of the case. According to the Bundeskartellamt’s investigation, Stihl had a dominant position in the German markets for petrol chainsaws, petrol brushcutters, blowers and hedge trimmers. The target company, Zama, manufactured diaphragm carburetors for use in handheld power tools. The acquisition of Zama would have strengthened Stihl's dominant position in the market. According to the Bundeskartellamt’s investigation, Stihl would have had the ability and the economic incentive to (fully or partially) foreclose other manufacturers of the power tools described above from access to diaphragm carburettors after the merger. Pre-merger Zama USA developed diaphragm carburetors for Stihl’s competitors. Thus, Zama's business in the USA had to be divested to a suitable purchaser which was independent of the merging parties.

18. In addition to the divestment of Zama’s business unit located in the USA, the clearance decision provided that the independent purchaser of the divestment business was to be granted an irrevocable licence for an unlimited period for certain patents and other intellectual property rights owned by Zama. In order to eliminate the competition problem it was sufficient to ensure that a second independent supplier of this important input product would remain available as an alternative source.

3. Customer foreclosure

3.1. Starting point

19. Customer foreclosure may occur if a manufacturer acquires an important customer of its products or acquires control of a significant distribution channel because of the merger. Other foreclosure effects are possible if a customer acquires shares in an input supplier and thus gains an incentive to purchase from this supplier, since it will also have a share of the supplier's profits. The vertically integrated company could impede access to customers to the detriment of its competitors. The acquired customer or distributor may cease or reduce purchases from competitors on the upstream market or purchase products only at terms that are less favourable for them. In addition, the vertically integrated distributor may hamper the sales of its competitors on the upstream market by selling their products only at a higher price or less favourable terms on the downstream market.

3.2. Ability to foreclose

20. The ability of the integrated company to impede its competitors on the upstream market by foreclosing access to (potential) customers depends in particular on the competitors’ ability to switch to alternative customers, the extent to which their sales may

[8] Bundeskartellamt, decision of 18 July 2008, B5-84/08 – *Stihl/Zama*.

be reduced as a consequence of the foreclosure strategy and the resulting effects on their costs.[9]

21. The possibilities for competitors to switch to alternative customers are the more limited, the more market power the merging company already has on the downstream market. This applies in particular if the vertically integrated company is an indispensable customer on the downstream market. To assess whether foreclosure is feasible it has to be taken into account whether and to what extent competitors still have access to a sufficient number of customers or whether the latter are already locked-in to the vertically integrated company or other competitors.[10]

22. If, as a result of a foreclosure strategy, the sales volumes of the competitors on the upstream market are reduced, their competitive position may even further deteriorate in cases where efficiencies of scale and scope or network effects exist.

3.3. Incentive to foreclose

23. As in the case of input foreclosure, the incentive to foreclose customers is determined by the potential benefits (additional profits) of hampering or eliminating competitors on the upstream market and the costs (foregone profits) such a strategy entails on the downstream market.

24. If the vertically integrated company reduces the quantities it purchases from its competitors on the upstream market post-merger in order to raise its own sales on this market, it has to consider the following: On the one hand, production and distribution costs on the downstream market may rise if its competitors can offer the input at a lower price. On the other hand, the company may strengthen its market position on the upstream market. This may enable the company to raise its prices and thus its profits on the upstream market.

3.4. Decisional practice

25. The latest vertical merger that triggered an in-depth assessment of the relevant market conditions involved important aspects of customer foreclosure. The case did not concern a media merger in the classical sense but entailed elements of the relationship between vertically integrated platform providers and content providers that go beyond the actual industry concerned. The *CTS Eventim/Four Artists*[11] decision concerned the prohibition of the acquisition of the majority of shares in a live entertainment organizer and promoter by a ticket system service provider.

26. CTS is known particularly for its ticket online shop “eventim.de”. Further to this, CTS provides ticketing services for promoters and advance booking offices and organizes live events, especially rock/pop tours and festivals. CTS’ ticketing system is a platform that enables promoters on the one side of the platform to sell tickets via different advance booking offices and online shops, and advance booking offices on the other side to book

[9] Bundeskartellamt, Guidance on Substantive Merger Control, p. 52.

[10] Bundeskartellamt, Guidance on Substantive Merger Control, p. 53.

[11] Bundeskartellamt, decision of 23 November 2017, B6-35/17 – *CTS/Four Artists*; see also German contribution to the OECD Roundtable on Quality considerations in the zero-price economy on 28 November 2018 (DAF/COMP/WD(2018)13), p. 10.

tickets for different events. To this end the ticketing system provides the technical connection to a database containing the various events on the basis of contracts against payment with the promoters on the one side of the system. Advance booking offices can then directly access the events entered in the system to sell tickets to end customers. The target company, Four Artists, promotes and organizes live entertainment events, and provides marketing and production services for events.[12]

27. The Bundeskartellamt defined a national multi-sided product market for ticketing system services in which both market sides, the promoters and advance booking offices constitute separate markets. The ticketing systems act as an intermediary and facilitate the direct interaction of two or more user sides between which indirect network effects exist. The group of promoters on one side and that of the advance booking offices on the other are the relevant user groups, linked by mutually positive indirect network effects.

28. Indirect network effects come into play where the benefit or gain of the users in one group depends on the number of users from another group.[13] The benefits that advance booking offices derive from ticketing systems increase with the number of promoters and events entered into the system as they can offer a wider selection of tickets to end customers, which enhances the chances of bookings.

29. According to the Bundeskartellamt’s investigation, CTS already had a dominant position in the German market for ticket system services. The indirect network effects would have been further strengthened by the proposed vertical integration with Four Artists. This could have led to potential customer foreclosure and a lock-in effect for users on both sides, since it reduced users’ willingness to switch providers.

30. 60-70 % of all tickets which were sold via ticketing systems in Germany were sold through CTS's system. The other ticketing system providers were significantly smaller, operated mainly regionally and sometimes depended on cooperation with CTS. CTS’s competitors already found it difficult to access customers due to CTS’s vertical integration with promoters.

31. With Four Artists, CTS Eventim would have integrated an important promoter into its company, tying additional ticket quotas of around 500,000 – 1 million tickets to its ticketing system. Post-merger CTS would have controlled 10-15% of the total volume of tickets sold via ticketing systems in terms of value. This would have weakened the possibilities of competing ticketing system providers to expand. With the merger, CTS would have been able to influence the demand behavior of a major customer of ticketing system services and block this customer’s availability to CTS’s competitors.

32. The merger would also have increased CTS’s negotiating power vis-a-vis promoters, which would have equally strengthened its dominant position. The exclusive availability of tickets for Four Artists events in CTS’s network would have raised the system’s attractiveness for advance booking offices with the result that it would have become even more attractive for promoters due to the increase in sales possibilities. Neither barriers to entry nor lock-in effects would have been lessened to a relevant extent by the parallel use of ticketing systems (“multi-homing”) on both market sides.

[12] Bundeskartellamt, decision of 23 November 2017, B6-35/17 – *CTS/Four Artists*, Case Summary, p. 1

[13] Bundeskartellamt, Working Paper on Market Power of Platforms and Networks 2016, p. 45.

33. In this context the Bundeskartellamt had to consider that in the recent past CTS had already gained control of significant ticket volumes after the clearance of several mergers by the Bundeskartellamt. It was therefore possible for it to acknowledge CTS's merger with Four Artists as part of an overall customer foreclosure strategy.

34. In addition to this, at the time of the decision there were exclusivity agreements in place between CTS and promoters, meaning that CTS would have controlled at least 35-45% of the value-based transaction volume on the market. [14] As the Bundeskartellamt classified the examined exclusivity agreements as conducive to abusive customer foreclosure, the same had to apply to its merger control assessment of CTS's merger with an important promoter customer.

35. Finally, no specific innovation-driven competitive pressure that could limit CTS's powerful market position was observed. The market dominance of online platforms with substantial market positions cannot be denied simply on the assumption that these positions can be challenged by the innovative power of the internet and its potential for disruptive change. Only concrete innovative dynamics that are identifiable can actually control the scope of action of a merged entity.

36. In the Bundeskartellamt's view, CTS's planned acquisition of shares in Four Artists would have therefore strengthened CTS's dominant position on the multi-sided market for ticketing system services and thus have significantly impeded effective competition on this market. In its assessment the Bundeskartellamt applied the new provision of Section 18 (3a) of the German Competition Act (GWB) introduced with the 9th Amendment to the GWB.

4. Relevance of data

4.1. Starting point

37. Vertical effects with regard to a merged data trove and sources may arise from two angles. Firstly, after the vertical merger, the merging company may get access to confidential data on the business activities of its competitors with a chilling effect on competition. From the perspective of the vertically integrated company, competitors on the downstream market are at the same time customers on the upstream market. By acquiring a supplier, the merged company may gain competitively-relevant information on its competitors on the downstream market, provided it supplies or continues to supply them with inputs.

38. By acquiring a customer, the merged company could for example gain information on its competitors' offers (on the upstream market). It would thus be able to detect their competitive initiatives at an early stage and react accordingly. This may have a negative impact on the ability and incentive of the merging parties' competitors to compete. Counter strategies may be feasible, e.g. the termination of supply relationships with the vertically integrated company. However, this depends on how easy it is in the particular market and for the particular companies to switch to alternative suppliers.

[14] See also Bundeskartellamt, prohibition decision of 4 December 2017, B6-132/14-2, on the exclusivity agreements.

39. Secondly, mergers in data-based markets could also cause vertical effects if the access to the combined data set gives an artificial competitive edge. Competition concerns may appear more likely if the particular data treasure is not easily duplicable for competitors on the upstream or downstream level. Generally, vertical integration in the form of a vertical merger can entail discriminatory access to strategic information with the effect of distorting competition. For instance, the vertical integration of platforms may turn them into hybrid ones, e.g. operating as online retailers and market places or app stores at the same time. Accordingly, the merged platform may get access to information about their competitors selling on it and about the behaviour of consumers. By identifying the range of products or services that are more in demand globally, an integrated platform could then be able to more efficiently adjust the range of its portfolio as well as the pricing of its products. A similar effect could be achieved by such a platform if it restricted the information that its competitors operating on it get about the transactions they are involved in.[15]

4.2. Decisional practice

40. In examining CTS's dominant position in the above-mentioned case, the Bundeskartellamt took the additional criteria of the newly introduced Section 18 (3a) GWB into account. Besides network effects and economies of scale, CTS's market position was additionally strengthened by particular access to data relevant for competition via its successful online ticket shop. Such data could be used to improve marketing and customer loyalty, thus strengthening CTS's sales network for promoters. Competing ticketing systems could not easily duplicate this data. As their online shops were far less frequented and used, they had considerably less customer data. The exclusive control over specific data can therefore represent a barrier to entry for competitors on the market.[16]

5. Remedies

5.1. Starting point

41. Remedies are an important instrument of merger control. With the help of commitments the parties to a merger can modify their project post-notification in such a way that the merger no longer has to be prohibited. This requires that the parties' proposals are suitable to remedy the competition concerns. The design of appropriate remedies in a vertical merger scenario must reflect their specifics. At the same time, the general principles of tailoring remedies under German merger control remain relevant.

42. Certain guiding principles have to be taken into account when drafting remedies in order to ensure their effectiveness: In most cases, divestiture remedies are the most appropriate instrument. Insofar as behavioural commitments can be considered to provide an effective solution in the particular case, they must not subject the conduct of the companies involved to continued control. As a rule, divestiture remedies in the form of an

[15] Autorité de la concurrence/Bundeskartellamt, Competition Law and Data, p. 19.

[16] Bundeskartellamt, decision of 23 November 2017, B6-35/17 – *CTS/Four Artists*, Case Summary, p. 4.

up-front-buyer divestiture are better suited to remove competitive concerns than a condition precedent, as they help to avoid harmful effects to competition in the first place.[17]

43. However, divestments are not a practicable solution in every single case. In some cases, they are not an acceptable option for the merging parties because they would completely undermine the rationale of the transaction.In some of these cases, behavioural remedies can be a possible solution, provided they are suitable and effective. When compared to the effects of a divestment remedy as a benchmark, the expected impact of a particular behavioural remedy on competition has to be similarly effective. Pro-competitive effects have to be sufficiently likely.[18]

44. In a vertical merger scenario, the possible remedies must naturally reflect the specific competitive concerns. If post-merger input foreclosure appears likely, a commitment package will have to address that issue. If the merger will primarily raise barriers to entry through vertical integration, market access remedies may sometimes be sufficient to compensate for the negative impact on competition.

5.2. Licences and interfaces

45. In exceptional cases, granting a licence (without the divestment of a business) can also constitute a suitable remedy if the effects of the merger are limited to raising entry barriers, and provided that licensing technology as such is sufficient to enable the entry of a competitor or to facilitate entry to an extent that is sufficient to compensate for the competitive harm.

46. Licences are to be designed as irrevocable and non-expiring in order to facilitate a lasting market entry. They have to be granted in a non-discriminatory and transparent procedure. If the licensor is a competitor, the licensing terms have to be phrased in such a way as to exclude the transfer of sensitive information to the licensor. The terms of the licence must not impede the licensee's competitiveness in any other way either. In particular, the terms of the licence may not place the licensor in a position where it can influence the licensee's competitive behaviour.[19]

47. The disclosure of relevant information on software or hardware interfaces can have a comparable impact in cases where non-vertically integrated firms cannot enter an upstream or downstream market without access to information on these interfaces.[20]

5.3. Chinese wall obligations

48. A commitment sometimes proposed by the parties to a merger is to implement a so-called "Chinese wall" within the merged entity. The idea is to shield sensitive information provided by competitors to one of the merging parties from business units which will be part of the company after the merger. This plays a role, inter alia, in vertical mergers, when a company buys its supplier and, as a result of the merger, gains access to

[17] Bundeskartellamt, Guidance on Remedies in Merger Control, p. 10.

[18] Bundeskartellamt, Guidance on Remedies in Merger Control, p. 11.

[19] Bundeskartellamt, Guidance on Remedies in Merger Control, p. 44.

[20] Bundeskartellamt, Guidance on Remedies in Merger Control, p. 45.

competitively sensitive information on the supplier's other customers, who are also the company's own competitors. As a consequence, competition may be impaired because the unilateral access to information reduces uncertainty with regard to certain aspects of the competitors' behaviour, from which the merging parties will benefit at the expense of their competitors.[21]

49. According to the Bundeskartellamt's practice, the obligation to implement firewalls to protect information is not an acceptable remedy. Such measures do not effectively address the impact on market conditions brought about by the change of market structure resulting from the merger. They are also not effective because they would require a level and intensity of monitoring that cannot be achieved in practice.[22]

6. Conclusions

50. In assessing the potential competitive concerns of a vertical merger, the availability of suitable switching alternatives post-merger for input sourcing and the customer base are important elements of the investigation.

51. With the rise of data-driven business models and digitalisation, access to data relevant for competition may gain further significance for identifying the raise of merger-specific barriers to entry under the control of vertical mergers.

52. The antitrust toolbox concepts of input and customer foreclosure are suitable for application to multisided markets and remain relevant for the digital economy.

53. In most cases, divestiture remedies are the most appropriate instrument. Insofar as behavioural commitments can be considered in a vertical merger scenario, they must not subject the conduct of the companies involved to continued control.

[21] Bundeskartellamt, Guidance on Remedies in Merger Control, p. 49.

[22] Bundeskartellamt, Guidance on Remedies in Merger Control, p. 50.