FAIR TRADING COMMISSION OF SEYCHELLES
GUIDELINES ON MERGER

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1. INTRODUCTION

Mergers are important for the efficient functioning of the economy. Mergers allow enterprises to achieve efficiencies, such as economies of scale or scope and diversify risk across a range of activities. Mergers also provide a mechanism to replace the managers of underperforming enterprises.

Merger control is addressed in the Fair Trading Act 2022 (the “Act”), due to the potential of some mergers to restrict competition in certain markets. The approach adopted in the Act is to require notification to and review by the Commission of certain mergers to allow the Commission to regulate those mergers that are likely to result in a substantial lessening of competition. Mergers that are not capable of having a substantial effect on competition are outside the scope of the Fair Trading Act 2022.

These guidelines provide an outline of the broad analytical framework applied by the Commission when assessing whether a merger is likely to substantially lessen competition under the Fair Trading Act 2022. These guidelines have been developed by the Commission in relation to its functions. These guidelines are designed to provide reliable, comprehensive, and detailed information that merger parties, the business community, their advisers, and the public can draw on.

These guidelines are not a substitute of the Fair Trading Act 2022 or any Regulations and should instead be read in conjunction with the relevant legal instruments. The examples used within the guideline are for illustration and do not set a limit on the investigation and enforcement activities of the Commission. Persons in doubt with regards to how their commercial activities may be affected by the Act may wish to seek legal advice. The Commission may, from time to time, review and issue revised versions of its guidelines

2. DEFINITION OF “MERGER” UNDER THE FAIR TRADING ACT 2022

Section 131 (1) of the Fair Trading Act 2022, provides that a merger refers to an acquisition or establishment, direct or indirect, by one or more enterprises, or persons, whether by—

(a) sale or purchase of shares or assets;

(b) sale or purchase of shares or assets in exchange for shares in the merged enterprise;

(c) lease of assets;

(d) amalgamation or combination or otherwise,

of control over the whole or a part of the business of an immediate competitor, supplier, consumer, or another enterprise.

For these purposes, Section 131(2) of the Act provides that a “*..person controls an enterprise, if the person-*

(a) beneficially owns more than one-half of the issued share capital of the enterprise;
(b) is entitled to vote a majority of the votes that may be cast at a general meeting of the enterprise, or has the ability to control the voting of a majority of those votes, either directly or through a controlled entity of that person;
(c) is able to appoint or to veto the appointment of a majority of the directors of the enterprise;
(d) is a parent company, and the enterprise is a subsidiary of that company under the International Business Companies Act (Cap 274) or the Companies Act (Cap 40);
(e) has the ability to materially influence the policy of the enterprise in a manner comparable to a person who, in ordinary commercial practice, can exercise an element of control referred to in paragraphs (a) to (d).”

3. NOTIFIABLE MERGERS

According to Section 132 of the Fair Trading Act 2022;

(1) “For purposes of this Part, a merger or proposed merger shall be determined with a value of combined annual turnover or assets in accordance with subsection (3).
(2) The proposed merger shall have a minimum trading activity in Seychelles.

(3) The Minister, in consultation with the Commission, shall prescribe —

(a) a minimum threshold of combined annual turnover or assets, in Seychelles, in general or in relation to specific industries, for the purposes of determining categories of mergers under subsection (1); and

(b) *a method for the calculation of annual turnover or assets to be applied in relation to each of those thresholds*."

CALCULATION OF TURNOVER AND ASSETS

In order to determine whether a merger is notifiable, Commission will consider the combined annual turnover or combined value of assets, whichever is higher, of all parties to a merger to determine whether it equals to or exceeds SCR 10 million. The annual turnover or value of assets of an enterprise will be calculated by adding together, respectively, the annual turnover and value of;

(a) the enterprises concerned;

(b) its subsidiaries;

(c) its parent companies; and

(d) other subsidiaries of its parent company.

Notwithstanding the above provision, the annual turnover or value of assets of a target enterprise shall not include the annual turnover or value of assets of its parent company and its parent company's other subsidiaries where, after the merger is implemented, such parents are not parents of-

(i) the target enterprise if it remains after the merger; or

(ii) the merged enterprise in the case of an amalgamation or combination

Where a merger consists of the acquisition of parts, whether or not constituted as legal entities, of one or more enterprises, only the turnover relating to the parts, which are the subject of the merger, shall be taken into account.

Annual turnover will comprise turnover in the most recent financial year, and the value of assets will comprise the value of assets at the end of the most recent financial year.

Turnover should be attributed to the place where the customer is located, which is typically the place where the service is actually provided or the product is actually delivered, whether directly to the customer or indirectly through agents or traders.

While the value of assets of an enterprise will not include the value of shares held or interests in another enterprise.

Enterprises may seek guidance from the Commission as to whether a transaction or proposed transaction meets the definition of a merger or proposed merger. This, however, does not preclude the Commission from initiating an investigation as to whether section 132-137 of the Fair Trading Act 2022 applies.

4. APPLICATION TO THE COMMISSION FOR MERGER

Section 133 of the Fair Trading Act 2022 provides that where an enterprise is desirous of effecting a merger, it shall make an application to the Commission. An application made must be in the prescribed form[1], upon payment of the prescribed fee of SCR 1500 and accompanied with the prescribed information and document.

In instances where the application is not in the prescribed form or does not have the prescribed information or document the—

- (a) the Commission may notify the applicant and the other parties of the defect requiring the applicant to complete the application within such period as may permit; and
- (b) the applicant shall within the period permitted under paragraph (a), complete the application and, if required to do so, furnish additional documents or information to the Commission and the parties.

A notification will be deemed complete on the date when all of the information and supporting documents required under the Merger Application Form is received by the Commission.

5. ASSESSMENT OF MERGER

The Commission will assess each merger notified to the Commission to determine whether it is more likely than not to give rise to a Substantial Lessening of Competition ('SLC') and pursuant with Section 133(5) of the Fair Trading Act 2022, the Commission will provide its recommendation to the Tribunal on the merger application submitted within 120 days to the Tribunal.

Where the Commission is unable to provide a decision within the days prescribed in Section 133(5) of the Fair Trading Act 2022, the Commission will need to apply to the Tribunal for consideration.

[1] Merger Application Form

6. FACTORS TO TAKE INTO CONSIDERATION WHEN ASSESSING MERGERS

In determining whether to permit the merger, the Commission will take into consideration the following—

(a) the structure of the market likely to be affected by the proposed merger;
(b) the degree of control exercised by the enterprises concerned in the proposed merger in the market, and particularly the economic and financial power of the enterprises;
(c) the availability of alternatives to the services or goods supplied by the enterprises concerned in the merger;
(d) the likely effect of the proposed merger on consumers and the economy;
(e) the actual or potential competition from other enterprises and the likelihood of detriment to competition;
(f) the actual and potential level of import competition in the market;
(g) the ease of entry into market, including tariff and regulatory requirements;
(h) the level, trend of concentration and history of collusion in the market and the degree of countervailing power in the market;
(i) the likelihood that the acquisition would result in the parties to the merger having market power;
(j) the dynamic characteristics of the market, including growth, innovation and product differentiation;
(k) the nature and extent of vertical integration in the market;
(l) whether the business or part of the business of a party to the merger has failed or likely to fail;
(m) whether the merger will result in the removal of efficient competition.

7. TYPES OF MERGERS

Generally, there are three main types of mergers:

- Horizontal Mergers
- Vertical Mergers
- Conglomerate Mergers

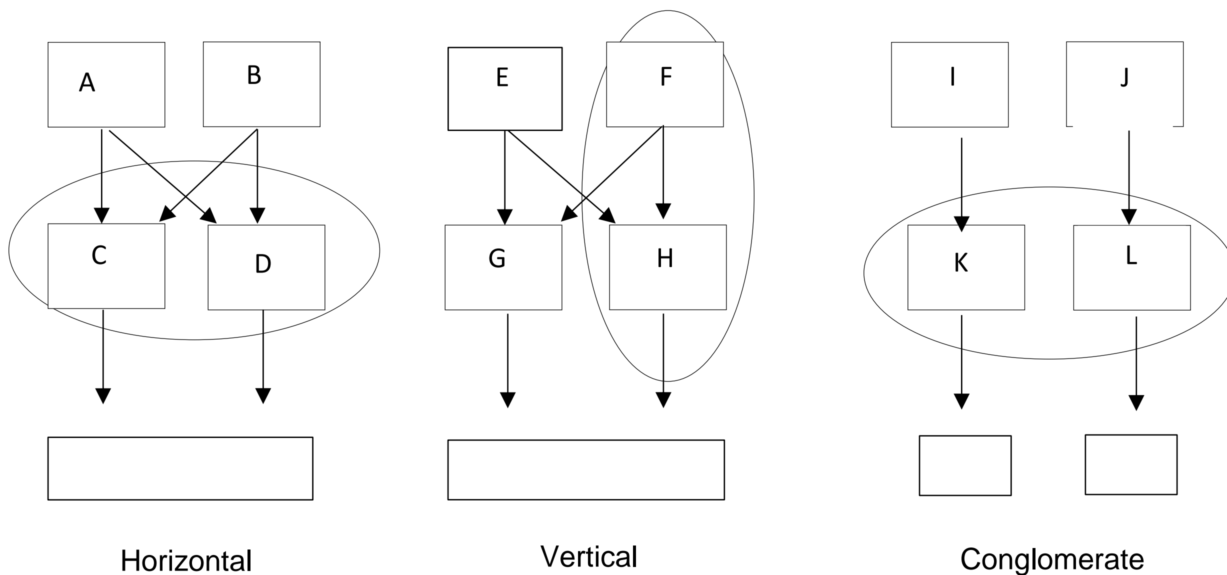

Diagram 1[2]

HORIZONTAL MERGERS

A horizontal merger involves companies that operate at the same level of the supply chain, producing or distributing substitute goods and/or services. Two products are termed substitutes if an increase in the price of one good induces an increase in demand for the other. For example, in the above figure, the left-handed panel illustrates a horizontal merger involving companies C and D. Horizontal mergers bring together enterprises active in the same relevant market. In this type of merger, it is the elimination of rivalry between the overlapping activities of the merging parties that may directly lead to harm to – or loss of – competition.

In evaluating this type of merger, the Commission will focus on evaluating how the competitive incentives of the merging parties and their rivals might change as a result of the merger. The merging parties may realize efficiency gains and, in some circumstances, this may intensify rivalry and be beneficial for consumers. It is the Commission's task to ensure that the merger is not likely to enable enterprises to harm consumers or customers (where products or services are not sold directly to final consumers), e.g., by profitably raising prices, reducing quality, reducing output, or restricting innovation.

VERTICAL MERGER

Vertical mergers, in contrast, involve enterprises that operate at different levels of the supply chain. A common example is a merger between a wholesaler and its retailers,

[2]Bishop, S. and Walker, M. (2010) The Economics of EC Competition Law: Concepts, Application and Measurement. University edn. London: Thomson Reuters (Legal) Limited.

or a manufacturer and its inputs supplier. In terms of the above figure, this can be illustrated as a merger between enterprises F and H. In purely vertical mergers there is no direct loss in competition as in horizontal mergers because the parties' products did not compete in the same relevant market. As such, there is no change in the level of concentration in either relevant market.

Vertical mergers have significant potential to create efficiencies largely because the upstream and downstream products or services complement each other. Even so, vertical integration may sometimes give rise to competition concerns. A key question is whether the vertical merger is expected to force rivals from the market, raise their costs levels or raise barriers to entry in a manner that substantially lessens competition. In some jurisdictions, such effects are usually broadly referred to as ‘market foreclosure effects’.

In addition, vertical mergers could raise competition concerns similar to those predicted in the context of horizontal mergers. As a result of the merger, the merger may increase the ability and incentive of enterprises to coordinate their behaviour in a market in a harmful way for consumers. However, it should be noted that in general vertical merger concerns are likely to arise only if market power already exists in one or more markets along the supply chain.

I. In sum, when assessing vertical mergers, it is fundamental to consider whether or not there is pre-existing market power at one or more levels of the supply chain;
II. which theory of competitive harm is likely to be relevant in a specific case,
III. Whether or not the parties' economic incentives to engage in anticompetitive behaviour materially change as a result of the merger according to the predictions of the underlying theory.

CONGLOMERATE MERGERS

Conglomerate mergers involve enterprises that operate in different product markets, without a vertical relationship. They may be product extension mergers, i.e., mergers between enterprises that produce different but complementary products (e.g. enterprise K and L in the above illustration), or pure conglomerate mergers, i.e. mergers between enterprises operating in entirely different markets. In practice, the focus is on mergers between companies that are active in related or neighbouring markets, e.g., mergers involving suppliers of complementary products or products belonging to a range of products that are generally sold to the same set of customers. Unlike horizontal mergers, conglomerate mergers do not entail the loss of direct competition between the merging enterprises in the same relevant market. A further characteristic of conglomerate mergers is that there is often a potential for efficiency gains when the products of the companies involved are complementary to each other.

It is also possible for a particular merger transaction to have horizontal issues in relation to some activities of the merging parties and non-horizontal issues in respect of others. These different issues will need to be assessed in turn.

Competition concerns raised in mergers can be categorised as *unilateral effects or coordinated effects.* Unilateral effects are said to arise when the merged entity has the ability to increase the price or reduce quality to the detriment of consumers despite the responses of the remaining competitors.

In contrast, the adverse effect associated with coordinated effects depends on one or more competitors to the merged entity choosing to compete less vigorously post-merger. In principle, all categories of mergers can give rise to both concerns, but in practice, coordinated effect concerns arise only rarely in non-horizontal mergers.

8. THE COMPETITION TEST

Competition is a state of ongoing rivalry between enterprises. The rivalry in terms of price, service, technology, and quality. Market participants are mutually constrained in their pricing, output, and related commercial decisions to some extent by the activity of other market participants (or potential market participants). Mergers can alter the level of competition in a market. Some mergers enable the merged enterprise to meet customer demand in a way that facilitates more intense competition. Many mergers do not affect the level of competition at all because there are sufficient substitution possibilities to effectively constrain the merged enterprise.

Other mergers, however, lessen competition by reducing or weakening the competitive constraints or reducing the incentives for competitive rivalry.[3] Mergers that increase the market power of one or more market participants may be detrimental to consumers because they may lead to an increase in price or deterioration in some other aspect of the service offering. The level of market power will be dependent on whether alternative actual or potential supply options are available post-merger to effectively constrain the merged enterprise. If the market structure and circumstances mean that there is limited potential for alternative supply options or substitution possibilities to constrain the merged enterprise, then it will be profitable for the merged enterprise to raise prices despite the potential for lost sales to alternative suppliers.

Further, mergers that increase market power may decrease economic efficiency (because transactions at the margin are deterred) thereby reducing gains from trade and total welfare.

[3] For convenience, the guidelines refer to an increase in market power as accruing to sellers in a relevant market. A merger can also lead to a substantial lessening of competition among buyers in a market. In such a situation, the increased market power of a buyer may enable it to profitably reduce prices or otherwise engage in behaviour that is detrimental to suppliers.

MARKET POWER AND INCREASES IN PRICE

The most obvious and direct manifestation of an increase in market power is the ability of one or more enterprises to profitably raise prices post-merger for a sustained period. Market power can, however, be exercised in other ways. For example, an enterprise with market power may:

- Lower the quality of its products without a compensating reduction in price.
- Reduce the range or variety of its products.
- Lower customer service standards, and/or
- Change any other parameter relevant to how it competes in the market.

While the exact nature of competitive detriment caused by a merged enterprise's increased market power will vary depending on the particular circumstances of the matter, the Commission will often characterize an increase in market power as the ability to raise prices above competitive levels for a sustained period of time. References to 'raising prices' in these guidelines should therefore be read as implicitly incorporating the exercise of market power in other non-price ways.

SUBSTANTIAL LESSENING OF COMPETITION ('SLC")

The term 'substantial' has been variously interpreted as meaning real or of substance not merely discernible but material in a relative sense[4] and meaningful[5].

The precise threshold between a lessening of competition and a substantial lessening of competition is a matter of judgment and will always depend on the particular facts of the merger under investigation. Generally, the Commission takes the view that a lessening of competition is substantial if it confers an increase in market power on the merged enterprise that is significant and sustainable. For example, a merger will substantially lessen competition if it results in the merged enterprise being able to significantly and sustainably increase prices. The level at which an increase in market power is likely to become significant and sustainable will vary from merger to merger. For example, an increase in price that is very small in magnitude might also be significant. The Commission considers that enterprises would generally be deterred from instituting a price increase, or only be able to institute it for a transitory period, where effective competitive constraints exist or where constraints are likely to become effective within a period of one to two years.

In some markets, particular characteristics, such as the prevalence of certain types of long-term contracts between buyers and sellers, may prevent a merged enterprise from exercising any market power it gains through the merger until some point in the

[4] Australia, Senate 1992, Debates, vol. S157, p. 4776.
[5] Rural Press Limited v Australian Competition and Consumer Commission [2003] HCA 75 at 41.

future—for example, at contract renewal. If the exercise of market power is likely to be delayed in this way, the Commission will focus on the period commencing at the point where market power would be exercised (for example, at contract negotiations).

THEORIES OF HARM

The core analysis in most merger cases will be on the effects of the merger in the relevant market or markets. In some cases, this analysis might be unnecessary. If the counterfactual analysis demonstrates that, no matter what the situation post-merger, it would be the same had the merger not happened, then the Commission need not spend significant time and effort on assessing the effects, as no SLC can occur in any event. Similarly, if the entry analysis demonstrates that any anticompetitive effect is likely to quickly be removed by a new entry, then a detailed analysis of those competitive effects might not be necessary. In most cases, however, the Commission's decision will be strongly influenced by its assessment of the merger's effects on competition post-merger.

These fall into three main categories, two of which apply principally to horizontal mergers, one to vertical or conglomerate mergers:

(a) Unilateral effects (horizontal mergers, mainly): the merger creates a supplier with sufficient market power that it faces weaker competitive constraints than before the merger;

(b) Co-ordinated effects (horizontal mergers, mainly, but also vertical mergers): the merger results in a market in which it is more likely that suppliers cooperate, explicitly or implicitly, to raise prices;

(c) Foreclosure (vertical and conglomerate mergers, mainly): the merger creates a supplier whose market position is such that it has a stronger ability or incentive to restrict, prevent, or distort competition, for example by giving it the ability to control inputs to its competitors' production.

Counterfactual

The concept of a substantial lessening of competition implies a reduction, a change compared to something else. This something else is the state of competition if the merger does not take place (nor had the merger not taken place, for a completed merger). If nothing else is changing, the 'counterfactual' can be considered to be the state of competition before the merger. Thus, an SLC would be assessed by considering how competitive the market was/is before the merger, and what is likely to happen after the merger. In practice, this will normally be the Commission's approach.

However, in some cases, other things will be changing so that this comparison does not accurately isolate the effects of a merger. For example, suppose two enterprises (A and B) are merging into one, when it is known that a third enterprise C is about to enter the market, for reasons unrelated to the merger. There were two enterprises in the market before the merger (A & B) and there will be two after (the combined AB and C). This might be held to imply that there is no loss of competition. However, the relevant comparison is the market after the merger (two enterprises: AB and C) compared to a counterfactual in which the merger did not take place (three enterprises: A, B, and C). This may well result in an SLC if the Commission takes the view that there would be more competition with three enterprises in the market.

In assessing the counterfactual, the Commission will consider the most likely course of events had the merger not taken place. However, if the most likely alternative to the merger would be another merger that the Commission would probably seek to prevent, the Commission would discard this possibility as the counterfactual and consider the next most likely outcome.

A special case of the counterfactual: Failing Firms

The counterfactual will be particularly important if one of the enterprises is held to be 'failing'. If a supplier is going out of business anyway, then there might be no loss of competition as a result of it being taken over, even by a close competitor, and even if the resulting market structure is highly uncompetitive. As with any merger, the Commission will clear such a merger, if it believes that there is no loss of competition compared to what would otherwise have happened.

In order to conclude that there is no effect on competition as a result of a merger involving a failing firm, in view of an enterprise is failing, the Commission will need to satisfy itself of the following things:

(a) The competitive constraint represented by the 'failing firm' would certainly be eliminated even without the merger, within the foreseeable future. This normally requires that the enterprise would be unable to carry on profitably, under any ownership. 'Profitability' in this criterion relates to carrying on as opposed to abandoning the market: whether revenues cover short-run avoidable costs. No return on assets is implied. An enterprise that cannot meet the interest payments on its debt may not satisfy this criterion, even if it is going bankrupt (because assets could be bought from the bankrupt enterprise and continue to be used to supply the market, as long as revenues cover the avoidable costs of doing so).

(b) No more competitive outcome is possible than the sale to the acquiring enterprise. This requires, firstly, that purchase by no other potential buyer would provide any more competitive outcome than would exist after the merger. For example, the sale of an enterprise to another in the same market might be expected to create a less competitive outcome than a sale to a company in a completely different business. A sale to a leading enterprise in the market might create a less competitive outcome than a sale to a smaller player. Secondly, the Commission will consider whether competition would be better preserved by allowing the assets to leave the market or be scrapped than to allow them to be taken over by a competitor if that competitor's market power would thereby be enhanced.

9. ANALYTICAL APPROACH AND METHODOLOGIES

In considering the SLC test, the Commission will generally conduct its assessment to consider the following factors-

(a) market definition;
(b) market structure and concentration;
(c) in the case of horizontal mergers, the following theories of harm

   (i) non-coordinated effects (including loss of existing and potential competition and any vertical effects); and
   (ii) coordinated effects;

(d) in the case of non-horizontal mergers, the following theories of harm:
   (i) non-coordinated effects (including input, total input and customer foreclosure, sharing of commercially sensitive information and concerns related to conglomerate and diagonal mergers); and
   (ii) coordinated effects;

(e) Market entry and Market expansion;
(f) assessment of efficiencies;
(g) countervailing buyer power;
(h) removal of a “maverick” enterprise; and
(i) effects from mergers of competing buyers.

9.1.1. **MARKET DEFINITION**

The Commission will determine the relevant markets for each merger being assessed utilising the framework set in the Commission’s Guideline for Relevant Market and Market Power. The Commission will determine the relevant market on a case-by-case basis. The relevant market is comprised of the relevant product market and the

geographical market. When conducting market definition analysis, it is generally practical to describe the relevant product market first and then define the relevant geographic market. It is essential to note that market definition is not an end in itself, but rather a step that helps in the process of determining whether the merged entity possesses, or will, post-merger, possess market power.

In some cases, it may be clear that under any sensible market definition the merged enterprise will not possess any market power or that the merger will not enhance its market power. In either case, it may not be necessary to establish which of the candidate market definitions is correct. Indeed, decisions published by established merger regimes commonly comment that it is not necessary to come to an enterprise conclusion on the scope of the relevant market since the merger does not appear to harm competition under any reasonable definition, including the narrowest possible definition. Alternatively, the competitive harm may be the same in more than one possible market definition. If, for example, two companies have equal market shares of the product A market and product B market (and so do all the other suppliers), then it might make no difference whether the authority considers a market for A and a market for B or a market for A and B. In such circumstances, the Commission may not need to come to an enterprise conclusion on the scope of the relevant market.

Relevant Product Market

The market definition focuses on the empirical question of substitutability of products and services from the point of view of customers/consumers. When assessing the product-market scope, substitutability from both demand- and supply–sides are commonly considered.

Demand-side substitutability assesses the extent to which customers could and would switch among substitute products in response to a change in relative prices or quality or availability or other features. When considering demand-side substitutability, it is generally useful to find out from the competitors which products they see as substitutes – as well as from customers where products are not sold directly to end-consumers.

Supply-side substitutability examines the extent to which suppliers of alternative products could and would switch their existing production facilities to make alternative products in response to a change in relative prices, demand, or other market conditions.

9.1.2. **MARKET STRUCTURE AND CONCENTRATION**

After defining a relevant product and geographic market, the Commission will consider its structure and how it will change as a result of the case under review.

A key aggregation indicator used in assessing market structure and concentration includes market shares, concentration ratios, and the Herfindahl-Hirschman Index

(HHI). Each of these is discussed below. It is essential to note that each of these measures may be used by the Commission as an initial indicator or screen of potential competition concerns, but will not be determinative in itself. An investigation beyond these quantitative indicators, including a detailed analysis of other market features as well as unilateral and/or coordinated effects, is always required before conclusions can be drawn regarding the competitive effects of a merger.

If in the case of a horizontal merger, A and B merge, the market shares of A, B, and each of their rivals can give an initial indication of whether the loss of competition between A and B is important or, conversely, whether the remaining competitors can be expected to constrain the merged entity so much that this 'loss' is not relatively important. Generally, the higher the combined market shares of the merging enterprises, the more likely that the loss of competition will be important. Other concentration data can be an indicator of competitive pressure within the market. Broadly speaking, the fewer the number of enterprises in a market, the more likely the removal of an independent enterprise will present a loss of an important competitive constraint on the remaining enterprises. However, as said, concentration measures are only an initial screen in assessing the competitive effects of a merger.

Measures of concentration: Market shares

Market shares indicate the percentage of total sales (or some other measure) of the product to be held by the merging enterprises and each of their rivals in the relevant market. Thus, they are indicative of the past market success of each enterprise in the relevant market. The Commission will consider mergers that result in substantially larger market shares or increased market concentration as more likely to give rise to an SLC.

When assessing market share information and levels of concentration, the Commission may have regard to the following factors:

a. the degree, if any, of product differentiation;
b. evidence of market share fluctuations over time;
c. how widely the market is drawn; and
d. the level of variable profit margins (e.g., sales revenue minus direct costs of sales), which can serve as an indication of market power when properly benchmarked.

The Commission may use sales revenue, production volume, capacity, or reserves to measure market shares. The measure the Commission will use will depend on the facts of the case and the availability of information.

An important indicator is the combined share of the merging parties, i.e. the sum of their pre-merger shares. The combined share of the merging parties and the increment

in market share resulting from the merger are typically considered as useful screens for possible unilateral effects scenarios. It is also helpful to compare the combined market share with those of other market players. Mergers creating a high market share for the merging enterprises are those that are most likely to raise competition issues. However, it should be noted that enterprises with large market shares may not necessarily possess market power where for instance entry barriers are very low and the threat of entry prevents the exercise of market power.

As previously stated, when establishing the market concentration, the Commission may use Herfindahl-Hirschman Index (HHI)

Herfindahl-Hirschman Index (HHI)

The HHI is calculated by summing the squares of the market shares of all the enterprises active in the market. The HHI potentially reflects both the number of enterprises in the market and their relative size.[6] Both the absolute level of the HHI and the change in the HHI as a result of the merger can indicate whether a merger is likely to raise competition concerns.

9.1.3. **UNILATERAL EFFECTS**

Unilateral effects, also known as 'non-coordinated effects', refer to the situation where the anticompetitive effects of the merger flow from non-coordinated action by market participants. In particular, unilateral effects arise where, as a result of the merger, the merging enterprises can exercise market power, for example, by profitably raising the price, or reducing output or quality or variety (or changing any other competitive parameter) as a result of the elimination of competition between the merging parties themselves.

The most common unilateral effects scenario involves enterprises operating in the same relevant market competing based on price . For instance, an enterprise producing product A merges with an enterprise supplying B. A pre-merger price increase of product A would result in customers diverting their purchasing to product B (and other rival products). Post-merger, profits on sales lost to B will no longer be lost, but be kept or 'internalised' by the merged group producing A and B. It, therefore, has an incentive to raise the price of A. In addition, the enterprise may find it profitable to raise also the price of the acquired products, since it will recapture some of the lost sales through higher sales of its original products (in other words, retain business that pre-merger would have diverted from B to A). In markets involving differentiated products, consideration will be given to the proportion of substitution that would occur.

[6] The HHI index can vary between 0, when the market is entirely fragmented, and 10,000, where there is only one enterprise in the market that has 100 percent of the market share.

Other enterprises in the market may also find it profitable to raise their prices – to continue the same example - because the higher prices of the merged enterprises' products will cause some customers to switch to the rival's products. In other words, even if rival enterprises pursue the same competitive strategies as they did prior to the merger, this can result in their increasing prices following a merger. In such cases, the enterprises in the marketplace are not coordinating their competitive behaviour; they are simply reacting to changes in each other's behaviour.

The central economic question when assessing the foregoing unilateral effects scenario is whether, after the merger, sufficient customers switch to products of the merged enterprises' competitors so that in the event of a price increase the merged enterprise would lose sufficient sales to make a significant price increase unprofitable. Put differently, the critical issue for the investigating authorities is the assessment of the extent to which the merging parties' products are close substitutes (the diversion effects from A to B).

Unilateral effects can also arise in other contexts, including bidding or auction markets, where different enterprises compete to win orders. The specific model used will vary depending upon the circumstances of the market, but should have a common thread of attempting to assess whether there is an increase in market power as a result of the merger, for example, by combining the two lowest-cost bidders and thus allowing the merged enterprise to win with a higher bid.

The anticompetitive effects of a merger may not be limited to price increases. Indeed, when a company faces less competition, it may have less incentive to produce products of such high quality or may reduce the range of products that it offers. Additionally, without competition, enterprises may have less incentives to invest in improving their products and hence innovation may be dampened. All these factors should be considered in assessing unilateral effects.

Assessing in practice the closeness of the merging parties' products can be a very difficult task. Sources of information that the Commission may use include :

- The parties' internal documents – such as (a) business plans, marketing plans, and similar documents which are usually prepared in the ordinary course of business and which will often identify an enterprise's principal competitors; and (b) documents relating to board or other senior management approval to proceed with the merger;
- Customers' views in markets where the products are not sold directly to end consumers.
- Third-party documents such as market intelligence reports, analysts' reports, and so on.
- Documents provided to other competition authorities (assuming confidentiality rules).

Factors in understanding broader competitive constraints

When examining whether there will be non-coordinated effects arising from the merger, the Commission will consider the relevant factors:

- **Low barriers to entry or expansion** – Entry by new competitors or expansion by existing competitors must be sufficient in time, scope, and likelihood to deter or defeat any attempt by the merging parties to exploit the reduction in rivalry following the merger.
- **Buyer power** - The competitive pressure on a supplier is not only exercised by competitors but can also come from its customers. Even enterprises with very high market shares may not be in a position, post-merger, to exercise market power if customers possess countervailing buyer power. In this context, countervailing buyer power means the bargaining strength that the buyer has vis-à-vis the seller in commercial negotiations due to its size, its commercial significance to the seller, and its ability to switch to alternative suppliers. Countervailing power may also exist where a buyer is capable of producing the supplied product itself (through vertically integrating) or directly importing the product.

  The factors to consider in assessing buyer power would be (i) whether or not the customer can credibly threaten to resort, within a reasonable timeframe, to alternative sources of supply; and (ii) whether or not the buyer can refuse to buy products produced by the supplier or (in the case of durable goods) delay purchases. It is more likely that large and sophisticated customers will possess this type of countervailing buyer power than smaller enterprises in a fragmented market.

  Furthermore, buyer power cannot sufficiently offset the adverse effects of a merger if it only applies in relation to certain categories of customers. Finally, it is not sufficient that buyer power exists prior to a merger; it must also exist and remain effective following the merger.

- **The nature of competition within the market** – Sometimes buyers choose their suppliers through a bidding or auction process for example through procurement auctions or tenders. In some circumstances, even if there are only a few suppliers, competition might be intense. This is more likely to be the case where tenders are large and infrequent (so that suppliers are more likely to bid), where suppliers are not subject to capacity constraints (so that all suppliers are likely to place competitive bids), and where suppliers are not significantly differentiated (so that for any particular bid, all suppliers are equally placed to win the contract). Under these circumstances, a merger would not produce

significant unilateral anticompetitive effects even if the merged entity had a high market share.

- **The merging parties may not be close competitors** – In this case, pre-merger market shares may not be a good indicator of levels of rivalry between the merging parties, for example, their products may be differentiated such that they are not close competitors (while still forming part of the same relevant market).

- **Responsiveness of competitors** – In some cases, competitors can react by either increasing output (if spare capacity is available) or repositioning to place a constraint on the parties post-merger.

- **Alternative suppliers exist to whom customers are willing to switch** – If there are several alternative suppliers to whom a significant number of customers are willing to turn, the threat of losing these customers may be enough to place a constraint on the merging parties. However, in product markets differentiated by brand or reputation, this is unlikely to happen even if customers face very low switching costs.

- **Elimination of a potential competitor/new entrant** – Some enterprises have more of an influence on the competitive process than their market shares or similar measures would suggest. A merger involving such an enterprise may change the competitive dynamics in a significant, anti-competitive way, in particular when the market is already concentrated. For instance, an enterprise may be a recent entrant that is expected to exert significant competitive pressure in the future on the other enterprises in the market. In markets where innovation is an important competitive force, an enterprise with a relatively small market share may nevertheless be an important competitive force if it has promising pipeline products[7].

- **Merged entity able to hinder expansion by competitors** – post-merger, the merged entity may be in a position where it would have the ability and incentive to make the expansion of smaller enterprises and potential competitors more difficult. For instance, the merged entity may have such a degree of control, or influence over, the supply of inputs or distribution possibilities so that expansion or entry by rival enterprises may be more costly. Similarly, the merged entity's control over patents or other types of intellectual property (e.g., brands) may make expansion or entry by rivals more difficult. In markets where interoperability between different infrastructures or platforms is important, a merger may give the merged entity the ability and incentive to raise the costs or decrease the quality of service of its rivals.

[7] See OECD, Merger Review in High Innovation Markets (2003). 20 Annex

Note that this is not a checklist of factors or characteristics that must all be present before unilateral anti-competitive effects can be dismissed. These factors are intended simply as a broad indication of the circumstances in which it may be concluded that the risk of such anti-competitive effects is lower or higher. The weight given to factors needs to be considered within the context of the case.

9.1.4. **CO-ORDINATED EFFECTS**

This part of the guideline focuses on the other main way in which the competitive incentives of the merging parties and their rivals might change as a result of the merger. Enterprises, under certain market conditions, may not compete effectively against one another but rather coordinate their behaviour in an anticompetitive way which can take various forms, e.g., coordination on price or output or coordination via customer/market allocation. Such coordination results in a loss of consumer welfare.

Given certain market conditions, enterprises realise that it is in their mutual interest to coordinate or align their market behaviour. However, coordination requires far more than the mere decision of enterprises not to compete.

Coordinated effects may arise where a merger reduces competitive constraints in a market, thus creating or strengthening the conditions that facilitate the ability of competitors to coordinate their competitive behaviour. The main question in analysing coordinated effects should be whether the merger materially increases the likelihood that enterprises in the market will successfully coordinate their behaviour or strengthen existing coordination.

The task is to identify what factors are likely to lead to coordination taking place between enterprises post-merger. This was a controversial area with which competition authorities and courts have struggled to come to terms over the years, but experience has led to the emergence of some agreement on what conditions are most likely to give rise to coordinated effects. These conditions are discussed below and their relevance depends on the type of coordination.

However, it must be borne in mind that these conditions are merely a starting point and that they must not be applied as a 'checklist'. The issue is whether the Commission can develop a coherent theory that takes into account all the evidence available and can explain (i) how the market works currently, and (ii) how the merger will make coordination more likely or stronger still (e.g., more widespread, or longer-lasting).

Assessing the competitive constraints

For coordination to be successful, three conditions must be met in the market or be created by a merger:

- **First,** the participants in the market must be able to identify terms of coordination, for example, the use of posted prices.
- **Second**, it must be costly for enterprises to deviate from coordination; so costly that it will be in each coordinating enterprise's interest to go along with the coordinated behaviour rather than 'cheat', e.g., through its own alternative pricing strategy. For these incentives to hold, participants may need to be able to detect and possibly 'punish' cheating; and
- **Third**, the surrounding competitive constraints must be weak. For example, the threat from players 'outside' the common strategy, including possible market entrants, must be too weak to destabilise any coordinated behaviour.

To determine whether each of these three conditions is present requires an assessment of the structure of the relevant market, its characteristics, and any history of coordination. Where a cartel has been detected in the relevant market in the past, this may serve as strong evidence that all three conditions are fulfilled, provided that market conditions have not changed significantly since.

First condition: Identifying terms of coordination

In order to coordinate, enterprises need to achieve some kind of understanding as to how to do so. This need not involve an explicit agreement on what price to charge, market share quotas, or the quality of products to be attained. Nor is it necessary for the enterprises concerned to coordinate prices around the monopoly price, or for the coordination to involve every single enterprise in the market. However, it is sometimes possible for enterprises to find a 'focal' point around which to coordinate behaviour. Market transparency, product homogeneity, and stability of the relevant enterprises are key elements in giving the enterprises the ability to align in terms of coordination. But the relevant factors are highly dependent on market facts, how competition works in the market and how coordination would work.

Evidence

Examples of the evidence the Commission will be taking into account when determining the extent to which enterprises have the ability to align behaviour in a given market include the following:

- **Market transparency** – the more readily information on enterprises' competitive offerings (in particular, prices or which customers they serve) is available, the easier it will be for enterprises to align behaviour. If coordination takes the form of customer or market allocation, all that is required is to observe who supplies whom, which may be an easy task. Also, the smaller the number of enterprises the easier it will be for them to align with each other.

- **Product homogeneity** – the more homogenous products or services are on a given market – and the smaller the range of products – the easier it will be for enterprises to compare their competitors' offerings and prices accordingly. If products are not homogenous, e.g., where each product/service is provided on an individually customised or 'bespoke' basis, or where many variables are taken into account in determining prices, it will be more difficult for enterprises to arrive at a common understanding. However, product homogeneity is not relevant when cooperative behaviour takes the form of customer allocation.

- **Existence of 'maverick' firms** – if one or more enterprises in the market are 'maverick' firms, coordination may be difficult to sustain. A maverick firm is an enterprise whose strategy is different from the majority of enterprises because of lower costs or other differences but is rational for itself. Alternatively, if the maverick firm is one of the merging parties, then the likelihood of coordinated behaviour may rise because the merger eliminates the differences that led to maverick behaviour. In general, the more symmetrical the cost structures of the enterprises in the market are, the easier it may be for them to coordinate behaviour.

- **Cross-shareholding** – if an enterprise has equity participation in a competitor, the scope for collusion may be enhanced. Links between competitors can make it easier to coordinate pricing and marketing policies, or to exchange information on these matters. Also, incentives to compete might be reduced in such cases given that the financial performance of the enterprise is affected by the profits of the competitor in which the enterprise has participated.

Second condition: Costly for enterprises to deviate from coordinated behaviour.

Though coordination is in the collective interests of the group of coordinating enterprises, it is normally in enterprises' short-term individual interests to 'cheat' on the coordination by cutting prices, increasing market share, or selling outside 'accepted' territories. If coordinated behaviour is to be maintained, any such 'cheating' must be in some way observable directly or indirectly. For coordination to be sustainable the market concerned should therefore be sufficiently transparent that enterprises can monitor the important terms of competition to detect cheating in a timely way and respond to it. Enterprises might have credible ways of 'punishing' any deviation from the coordination, for example, by rapidly cutting prices or expanding output. More generally, it may be sufficient for coordinated behaviour that participating enterprises have a strong incentive not to deviate from the coordinated behaviour (such as the experience of a previous period of strong competition).

A competition authority seeking to assess how incentives are structured within a particular market will have to gain an in-depth understanding of the competitive interaction within the market in question to assess whether coordination would be

sustainable. Often past behaviour and even anecdotal evidence will assist in building up this understanding.

Evidence

Notwithstanding these difficulties, it is possible to identify some evidence useful in assessing the applicability of this second condition concerning the stability of the coordination.

- **Market transparency** - In some forms of coordination, suppliers must obtain details of competitors' offerings. If such data is not readily available to the suppliers, it will be more difficult for enterprises to monitor one another's behaviour and ensure that coordination is maintained.
- **Market stability** - If overall and firm-level demand in a given market is stable and the market is mature, it will be relatively easy for enterprises to detect movements resulting from a change in competitive behaviour by another enterprise and respond accordingly. Information on past trends within a market, such as growth in sales, entry, and exit by enterprises, and relative market shares will often provide a good starting point when assessing the current state of a market and its likely future development. Also, demand stability depends on the regularity and frequency of orders. An unexpected large order may give an incentive to enterprises to break the coordination while the high frequency of orders helps enterprises to bring their behaviour into line because it will be easier for enterprises to detect changes in each other's behaviour.

- **Cross-shareholding** – if an enterprise has equity participation in a competitor, or if they operate a joint venture, not only may the scope for collusion be enhanced as already seen for the first condition, but it may be more costly for an enterprise to deviate given that the financial performance of the enterprise is affected by the profits of the competitor in which the enterprise has participation.

- **Multi-market contacts and symmetry** – If the coordinating enterprises compete with each other in various markets, the potential to 'punish' deviation might increase. The more symmetric the enterprises are, with regard to their market shares, cost structures, etc., the more symmetric their incentives and their mutual sanction potential are. Also, the threat of punishment may be credible in certain situations; for instance, where enterprises not only supply to the same customers but also deal with each other by way of sub-contracts, the termination of such contracts might present a threat to 'punish' deviation from the coordinated behaviour.

Third condition: weak competitive constraints

Overall, the conditions of competition in the market need to be conducive to coordination to sustain such behaviour. Typically, this means that the market should be sufficiently stable and with such limited competition (both actual and potential) that the coordination is not likely to be disrupted. For example, a strong fringe of smaller competitors with the capacity to take sales from the coordinating enterprises (or perhaps a single maverick firm) or a strong buyer (with buyer power) might be enough to render coordination impossible or unsustainable. Low barriers to entry may also render coordination unsustainable.

Evidence

In order to determine whether coordinated behaviour in a given market would be sustainable, the following information is likely to be relevant:

- **Market shares of the participants**. Is there a fringe of smaller competitors with sufficient spare capacity or a possible maverick competitor (not part of the merger)?
- **Details of new entry**, including evidence of past entry and likely ease of entry in the future. Could new entrants upset any coordination aimed at reducing overall capacity in the market?
- **Details of buyers.** Are there any powerful buyers? By concentrating its orders, a powerful buyer might be able to break coordinated behaviour.[8]

It should be remembered that the analysis must not stop once the competition authority has concluded that a market has conditions that may facilitate coordination.

This in itself will not tell the Commission that a merger will make coordination easier or more likely. A focus on the track record of each competitor in the market may help to determine what dynamic they bring to the market. The merger might be 'swallowing up' a maverick firm, making coordination more stable or durable, or it could even be creating a lower-cost enterprise whose incentive is to deviate from – and thereby frustrate –coordination. Perhaps third parties are the most important actors in the market and the merger itself makes no real difference.

Demonstrating an increased probability of coordination as a result of a merger may be a difficult task. If pre-merger conditions appear to facilitate coordination, then the effect of the merger may be to make coordination more likely, more effective, and more durable. Investigation of coordinated effects, like that of unilateral effects, should also focus on the specific effect of the merger itself rather than only the state of pre-merger competition.

[8] However, there are instances where coordination may be sustainable even in the presence of large buyers: for example, if the coordinating enterprises – in case of output coordination - are able to subcontract their orders out to each other to maintain the stability of coordination.

9.1.5. **MARKET ENTRY AND EXPANSION**

A merger that materially increases market concentration would not give rise to sustained anticompetitive effects if new enterprises would enter the market (or existing enterprises expand) and deter the merging parties (and others) from exploiting their position in the market. Entry into the market by new enterprises may prevent or counteract any attempt by the merging parties or their competitors to profit from the potential reduction in competition brought about by the merger.[9]

For this part of the merger assessment, the Commission considers entry by new enterprises or expansion by existing enterprises as a result of the merger, i.e., entry or expansion involving significant sunk costs of entry and occurring within the foreseeable future (often called 'committed entry'). Entry by way of supply-side substitutability can be seen as a special case of entry since it must occur quickly and without any significant sunk investment. Also, where there is evidence of entry from new enterprises outside the relevant market (or exit from existing enterprises in the relevant market) or committed expansion plans by existing competitors that would occur absent the merger, this evidence will be reflected in the counterfactual assessment as the competitive situation without the merger would be altered because of this entry, exit or expansion.

New entry or expansion by competitors sometimes can effectively discipline the behaviour of the current market participants. When determining the likelihood of new entry, the Commission will consider that entry/expansion is a real competitive constraint on the merging parties where three conditions are met:

- The entry or expansion is likely to occur;
- The anticipated entry or expansion is of a nature, scale, and scope to prevent or reverse the anticompetitive effects the merger otherwise would have; and
- The entry or expansion is likely to occur within a reasonable period of time (i.e., it should be timely).

Likelihood of entry

Entry is likely to occur if it would be profitable. Thus, when reviewing a merger, a competition authority faces several critical issues:

- Would the merger itself trigger entry into the market? Indeed, this might happen because of the effect of the merger on the profitability of entry.
- Would the proposed merger itself create a significant opportunity for entry?

To assess the probability of entry, the Commission will consider the barriers to entry, as well as any history of entry or exit. A barrier to entry can be described as an

[9] As noted in the market definition, it is also possible to assess shorter-term supply-side responses in the context of market definition.

advantage enjoyed by an incumbent enterprise over potential entrants which prevent new enterprises from entering the market.[10]

It should be noted that the mere need to invest to enter is not in itself a barrier to entry. Rather, when assessing barriers to entry, the Commission will assess the expected profitability of entry to see whether they may be considered low or high. Examples of possible barriers to entry are as follows:

- **Absolute barriers**, such as where government regulations, e.g., licensing and intellectual property rights, limit market participation or impose substantial regulatory approval costs (e.g., environmental restrictions). Regulations can also make it more difficult for consumers to switch suppliers.

- **Structural barriers**, arising from basic market conditions such as cost, demand, and technology. Examples include situations where the existing incumbents control assets necessary for the production or supply of the relevant products (e.g., natural resources); where existing enterprises have access to superior technology; where network effects are strong; and where economies of scale and sunk costs are important. A merger would not attract entry if the anticipated reward was not commensurate with the risk from being unable to recover sunk costs (e.g., expenditures not recoverable upon exit, associated with acquiring or constructing specialized facilities, recruiting, training, product development, and other requirements for successful entry).

- **Economies of scale** can limit the incentive to enter.[11]Even when investment costs are not sunk, scale economies tend to deter entry in the sense that only large-scale entry would be profitable. In this connection, information on the minimum viable scale needed to enter the market can indicate the scale that a new entrant would need to make to compete profitably.

- **Strategic advantages**, where the existing established position of the incumbent gives it an advantage over new entrants (also known as 'first mover advantage') or where the incumbent responds to new entry with aggressive tactics such as by significantly lowering prices or by investing in excess capacity to deter entry. Two important aspects of this are sunk costs (e.g., expenditure in advertising and R&D) and reputation. Where demonstrated reliability is very important to the buyer, this can favour current suppliers. Other factors might include product differentiation, tying and bundling, and exclusive dealer agreements.

[10] See also OECD Roundtable on 'Barriers to Entry', 2005.

[11] Economies of scale enjoyed by incumbent enterprises arise where average costs fall as the level of output rises. Typically, this occurs when there are high fixed costs for the initial investment – say, a sizeable plant – which has relatively low running costs (i.e., variable or marginal costs). See also the OECD Glossary of Industrial Organization Economics and Competition Law (1993).

Furthermore, by comparing the costs of entry with the expected sales income (net of the operating costs) and how long it will take to recover incurred costs, the Commission will be able to gauge whether potential entrants will consider it profitable to enter the market. In determining the likelihood of entry, the Commission may also ask customers whether they would be willing to switch to a new supplier as this will have an impact on how effectively new entry can be expected to constrain the merging parties' behaviour. The Commission in this regard may also ask the merging parties to provide data on customer gains and losses to determine the level of customer switching in the market.

In determining the likelihood of entry, Commission will assess whether there is a **history of entry** to (and exit from) this market. If it is possible to establish a record of enterprises entering and exiting the market, the Commission will use this as evidence that entry into the market is possible and may continue post-merger. In assessing the history of entry, the Commission will consider;

- The experiences of enterprises in recent years as they entered or exited from the market. If there is no evidence of any new enterprise having entered in recent years, the Commission will not necessarily rely on evidence about possible new entry as there might be barriers of a less obvious nature. The Commission may also use evidence from similar markets in other countries that may be useful.

- As a complement, the Commission will look for information about past and expected market growth of a market as this could be an indicator of the likelihood of entry. Generally, new entry is more expected in a market that has experienced recent growth and is further expected to grow. In contrast, a shrinking market where suppliers face increasingly reduced margins can be expected to attract fewer new entries.

It should be noted that a lack of entry does not necessarily mean that entry barriers are high. In fact, the cost to enter the market may be low but the market concerned is so competitive that entry is not attractive. Similarly, the mere need to invest to enter a market may not in itself be a barrier to entry. Also, the fact that past entry has occurred does not automatically mean entry barriers are low: entry may have been on a small scale or into a specific market niche.

Additionally, in assessing the merger, the Commission will look for evidence of any enterprises currently contemplating entry but only if circumstances change. In this case, the merger may or may not be the sort of change necessary to cause enterprises to enter.

Another factor that is taken into consideration is whether there are large buyers that have in the past or might in the future 'sponsor' new entry as this would also likely act as a constraint.

Furthermore, the Commission will look at the duration, termination, and renewal provisions of clauses in existing sale contracts. If, for example, buyers are tied into a five-year contract, it could take a long time for an entrant to capture market share. This may reduce the profitability and consequently the likelihood of entry.

Sufficiency of entry

This condition generally requires that entry by new enterprises successfully prevents incumbents from raising prices post-merger or makes them promptly reverse price increases, by capturing a sufficient amount of their sales. Even profitable entry therefore may not be sufficient if it fails to win enough business from existing enterprises which could still extract increased profits through price rises. Small-scale entry into a niche market might not be of sufficient scale to act as a constraint, although each case
should be considered on its own facts. When analysing the sufficiency of new entries, the Commission will consider the following question:

- Is the new entry likely to be so small or isolated that incumbents can nevertheless still raise prices to a significant section of the market? It may be that the new entry is of insufficient scope to compete effectively with the merging parties.
- In a merger between sellers of differentiated products would the new entrant provide a product that competes directly with those of the merging parties such that a sufficient number of customers would switch to the entrant product in response to an attempt by the merging enterprises to raise prices by switching away?
- Is the new entry able to counteract the specific anticompetitive concern brought about by the merger?
- Is the new entry able to counteract any localised anticompetitive effects? In some cases, the anticompetitive effect(s) of the merger might only occur in a distinct location and any new entrants would have to target their business in the adversely affected area to prevent such effects.

Timeliness of entry

Profitable entry will only be considered to act as a competitive constraint if it is sufficiently timely and sustainable. The Commission, like many other jurisdictions, will consider any entry that occurs within two years to have a disciplining effect.

Expansion

Expansion refers to the ability of existing market participants to expand their capacity quickly, or utilize existing spare capacity, in response to a price rise by the merging parties can act as a competitive constraint. This is assessed in conjunction with the assessment of the likelihood of market entry as they have similar factors. Rival enterprises are asked;

- whether they have expansion plans,
- whether they face any barriers to expansion; and
- the level of costs to be incurred versus increased revenues to be gained.

9.1.6. **EFFICIENCIES**

A merger may deliver efficiencies. It could increase production efficiency, and hence, benefits could be passed on to consumers, for example, in lower prices or increased innovation.

Efficiency gains are often claimed for horizontal mergers. However, efficiencies are not frequently supported with convincing evidence and consequently, the Commission will generally tend to be sceptical about such claims. There are very few cases where a horizontal merger enforcement decision has turned explicitly on the efficiency-enhancing attributes of the transaction.

The quantification of merger-specific efficiencies is often the most speculative single element of merger review. Efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are small and when the degree of post-market power is not too high.

Mergers can generate significant efficiencies by permitting a better utilisation of existing assets, enabling the combined enterprise to achieve lower costs than either enterprise could have achieved alone. Efficiencies may increase rivalry in the market so that no adverse competitive effects would result from a merger. For example, this could happen in stances where two of the smaller enterprises in a market gain such efficiencies through a merger that they can exert greater competitive pressure on larger competitors.

Efficiencies include cost savings, more intensive use of existing capacity, economies of scale or scope, or demand-side efficiencies such as increased network size or product quality. They might also encompass pro-competitive changes in the merged entity’s incentives, for example by capturing complementarities in R&D activity, which in turn might increase incentives to invest in product development in innovation markets.

In a unilateral effects context, marginal cost reductions may offset the merged enterprise's incentive to elevate the price. While efficiencies are typically more relevant for the assessment of unilateral effects, there are some situations where they might

also play a role in the assessment of coordinated effects. In this context, marginal cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by engendering disharmony among competitors through increasing cost asymmetry.

Which efficiencies should be considered in the merger review?

Efficiencies tend to have an impact on short-term pricing behaviour incentives (in terms of lower prices for customers) if they lower the marginal or variable costs and there is sufficient competitive pressure remaining. Conversely, savings in fixed costs generally will not often impact short-term pricing behaviour incentives, so that fixed cost savings will normally not be passed on to consumers. It is often challenging to make a clear distinction between variable and fixed cost savings as this distinction will depend on the time horizon used. Also, fixed costs may be important in short-run price formation where, for example, competition takes place via auctions and bids that reflect both the fixed and variable costs of the tendered service.

How to incorporate efficiencies in merger review

Another fundamental question is how efficiencies are incorporated into the assessment of individual cases. Efficiency evidence may be taken into account as part of the competitive effects analysis by showing that the economic incentives to compete of the merged enterprise may be increased so that the merger would not harm consumer welfare (e.g., will result in lower prices, improved quality, or new products). This ‘integrated’ approach looks at the net effect of a merger on prices (and other indicia of competitive performance) and is the approach favoured by the Commission.

Assessment

Merger-specific efficiency gains are difficult to assess both for merging parties and for competition authorities. The merging parties typically have the best knowledge about the likely efficiencies that a merger may create for them. However, this self-assessment might be too optimistic and has proven wrong for many mergers. Also, merging parties have a clear incentive to overstate the likely efficiencies when presenting them to the competition authority or courts. Claimed efficiency gains, therefore, have to satisfy a high evidentiary standard which the merging parties have to meet.

The evidence of the claimed efficiencies is normally solely in the possession of the merging parties. Such evidence may include internal documents that were used by the management to decide on the merger, statements from the management to the owners and financial markets about the expected efficiencies, historical examples of efficiencies, and pre-merger external experts' studies on the type and size of efficiency gains. Where reasonably possible, efficiencies and resulting benefits should be

quantified. In general, jurisdictions require that only those efficiencies which have a high probability of realization within a reasonably short period post-merger will be taken into account. Assessing efficiencies is very difficult in practice.[12]

FAILING FIRM

Where one of the parties to a merger is genuinely failing, pre-merger conditions of competition might not prevail even if the merger was prohibited. In these circumstances, the counterfactual would need to reflect the expected failure of one of the parties and any resulting loss of rivalry. But, the 'failing firm defence' may be claimed by merger parties even where an enterprise is not truly failing. Hence, claims that an enterprise is failing need to satisfy a high evidentiary standard.[13]

A merger is not likely to create or enhance market power or to facilitate its exercise, if the imminent failure of one of the merging enterprises would cause the assets of that enterprise to exit the relevant market. In such circumstances, the competitive structure after the merger may be no worse than the competitive structure had the merger been blocked. It should be noted that the counterfactual – with which the post-merger situation should be compared - is not the pre-merger situation, but the situation occurring after the failing firm would have exited the industry. The treatment should be the same in the highly unusual case where the failing firm is actually the acquiring enterprise.

Normally, economically viable assets are unlikely to exit the relevant market, while the acquisition of assets that are not economically viable would not be expected to remain in the market. The acquisition of a failing firm's assets, however, can cause its assets to become economically viable, and thus remain in the market if the acquisition generates significant efficiencies.

Conditions

In order to satisfy the failing firm defence against a finding that a merger would be anticompetitive, conditions along the following lines should be met:

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[12]In most jurisdictions, the second requirement is that some share of the benefits expected to be realised from post-merger efficiencies is likely to be passed on to consumers (or customers), usually in the form of lower prices or increased output, if they are to be taken into account in the merger review. The third requirement in most jurisdictions is that the efficiency gains are merger specific, or, in other words, not likely to be produced or available absent the merger. The verification of this requirement entails the specification and possible quantification of alternative scenarios, i.e., different forms of non-merger cooperation between the companies such as joint ventures. However, only practical business alternatives likely to be pursued absent the merger should be considered.

[13] See also OECD Roundtable on 'Failing Firm Defence', 1996.

- **First,** in order to rely on a failing firm's defence, it must be clear that the enterprise is in such a deteriorated financial situation that without the merger it and its assets would exit the market and this would occur in the near future.

- **Second**, there must be no serious prospect of re-organising the business. This could include re-organising the underlying business or the financial structure. Identifying the appropriate counterfactual in these types of situations is often very difficult. Even companies in severe financial difficulties often survive and recover and, as explained, the test is whether, in the absence of a merger, the assets of the failing firm would inevitably exit the market.

- **Third,** there should be no less anti-competitive alternative to the merger. Even if the company is failing and a sale of the company or its relevant assets is inevitable, the failing firm argument only applies where there are no competitively preferable acquirers of the assets. If an alternative enterprise is willing to acquire the assets, then it is unlikely that the assets would exit the relevant market without the proposed acquisition. An acquisition by such an alternative enterprise may be less anticompetitive than the proposed merger. It may also be better for competition that the firm fails and the remaining players compete for its share of the market and assets than the failing firm's share and assets being transferred wholesale to a single purchaser.

In most cases, the acquisition of the failing firm can prevent its assets from exiting the market only if there are merger-specific efficiencies. Indeed, it is part of the competitive process that enterprises will fail, either because of internal problems or due to external changes in market demand and resultant excess capacity. In such circumstances, mergers can be an effective means of putting resources to alternative uses and/or improving efficiency through rationalisation.

When conducting the merger review the Commission will also assess whether the acquisition of a failing firm, which initially raises competition concerns, can result in customer benefits. The competitive outcome with the merger may be better than the competitive outcome without the merger (the counterfactual).

In most instances, the acquisition of a failing firm does not even raise competition issues because there are sufficient competitive constraints on the merged entity remaining in the market, even if the assets of the failing firm would still exit the market.

Evidence

Information to establish a failing firm defence may include the following evidence:

Deteriorated financial situation

- The Commission may request the assistance of a financial and/or accounting expert to provide the necessary information necessary to examine the condition of the failing firm and to assess the merits of the claim.

- The Commission will request the past and recent financial information, ideally, profit and loss and cash flow data, of the business that it is claimed is 'failing',

- The Commission may request for the prospective/forecast financial information for the current year. More weight is likely to be given to forecasts produced either in advance of the transaction or for another purpose and not produced solely for the competition authority. In considering the financial situation of a division, the Commission will ensure that the correct revenues and costs are considered. The respective division of the enterprise will be required to provide the negative cash flow as evidence on an operating basis.

- To establish that trading conditions and hence financial performance are unlikely to improve, the Commission will also assess whether the business is in an industry where cyclical losses are normal or whether the failure of the business may be the result of technological change.

Unable to re-organise successfully

In assessing the failing firm defense, the Commission will look for;

- Evidence to establish whether the enterprise that is irredeemably failing has considered various ways to improve its situation. E.g., board papers or other strategy documents produced by the company.
- Evidence on whether all re-financing options have been explored and exhausted.

No less anticompetitive alternative to the merger:

The Commission will also look for evidence that the failing firm has unsuccessfully sought out less anticompetitive alternatives to the proposed transaction. In this regard, it must be shown that there are no other credible bidders in the market and that all possible options have been explored. For example, if there was an auction or similar process in which all logical potential acquirers were given an opportunity to participate, it may be possible to demonstrate that the vendor explored all options. Alternatively, if such a process was not carried out, the Commission may undertake an assessment of whether such enterprises are interested in acquiring the enterprise or its relevant assets.

9.2. **NON-HORIZONTAL MERGERS ASSESSMENT**

VERTICAL MERGERS

As explained in previous parts, vertical mergers are those transactions between enterprises that operate at different but complementary levels in the chain of production and/or distribution of the same final product. Vertical mergers can potentially generate substantial efficiencies and should rarely be a cause for concern. In some cases, however, vertical mergers may give rise to competition issues. The vertically integrated merged entity may be able to constrain the ability of rivals to compete by excluding them from a market or by raising their costs; when such actions harm consumer welfare, they are anticompetitive. Furthermore, as a result of the vertical merger, the potential for price or output coordination may increase.

In view that a vertical merger is between parties that do not currently compete in the same relevant market, a vertical merger will not have the direct anticompetitive effect of reducing the number of horizontal competitors. Moreover, vertical mergers have significant potential to create efficiencies and are rarely anti-competitive. Transaction costs associated with performing complementary activities may be best minimized by internalizing those activities as technology changes over time. The realization of the efficiencies from vertical mergers may be expected over time to reduce production and internal organizational costs and thereby allow more and higher quality products to be produced at a lower cost to society.

In some situations, however, a detailed factual analysis may show that a proposed vertical merger is likely to have an anticompetitive effect in a particular market. If that is the case – and assuming that merger-specific efficiencies will not offset the harm to competition – the Commission will seek to enjoin the transaction. In deciding whether to challenge a proposed vertical merger, the Commission will rely on a detailed, credible, and substantial factual evidence supporting the conclusion that the merger will harm competition in a particular market.

Taking these caveats into account, there are situations under which a vertical merger may prove to have anticompetitive effects by enhancing the market power of the merged entity or increasing the potential for price or output coordination.[14]These situations are analysed below.

9.2.1. **UNILATERAL ANTICOMPETITIVE EFFECTS**

[14] In addition, a regulated enterprise may vertically integrate with a non-regulated (upstream or downstream) enterprise in the hope of subsequently “evading” price regulation by “leveraging” its monopoly from the regulated to the unregulated stage of commerce. (It may also reassign costs between stages of commerce.)

A vertical merger can have anticompetitive effects if it enables the vertically integrated merged entity to constrain a rival's ability to compete either by foreclosing it from an upstream or downstream market or by raising its costs in a way that permits the merged entity to exercise market power. The anticompetitive behaviour of the merged entity can increase rivals' costs and eventually this will lead the rivals to raise their prices to consumers, thereby enabling the merged entity responsible for the rivals' cost increase to raise its prices as well.

For example, in certain limited market conditions, if the merged entity gains control, post-merger, of a critical means of competitive distribution to a downstream market, it might be able to reduce competition from its rivals by refusing to give them access to that means of distribution, or by granting access only at discriminatory prices that favour the merged entity's own business, thus placing rivals at a disadvantage. Or, if a merged entity gains control of a large proportion of a critical input to a downstream process where it also competes, it may be able to dampen competition from its rivals in the downstream market by, for instance, diverting all its production of the input to its own downstream process. If the merged entity thus refuses to supply a product to its downstream rivals or only sells the input to its rivals at a price that makes them uncompetitive, this might also foreclose competition or allow it to increase prices to consumers.[15]

Assessment Of Unilateral Anticompetitive Effects

In assessing the possible anticompetitive effects of a vertical merger, the Commission will consider the following:

- **First**, whether the integrated merging enterprise would have the ability to exercise market power in the upstream and/or downstream market to foreclose rivals or raise their costs in a way that harms consumer welfare.

  Evidence with regard to the upstream market could include, for example, the demand elasticity for the input (i.e., whether the inputs sold by the other upstream enterprises are close substitutes?); the Commission may also assess whether upstream rivals have excess capacity (could they expand their supplies, for instance, in the case where the integrated merging enterprise refuses to supply the independent downstream enterprises?); and the existence of potential entry. These factors might reduce the ability of the merged enterprise to exercise market power in the upstream market. This is a similar analysis as for a horizontal merger situation to see whether the merging enterprise is able to sell at higher prices (or cease to supply) the input to the

[15] In particular, there is the possibility that a vertical merger might alter incentives so as to make refusal to supply – or worsening the terms of supply – more credible than pre-merger, to the detriment of competition and ultimately of consumers.

downstream enterprise in a non-transitory and profitable way. At the downstream level, a similar analysis should also be carried out.

- **Second**, even if the merged entity has the ability to foreclose rivals or to raise their costs, the Commission is of the opinion that it is also important to consider the incentives of the merged enterprise to engage in this conduct in any market. Thus, evidence will also focus on whether and to what extent the merger would actually enhance the incentives to act in a way that is detrimental to consumers. In certain cases, the merged enterprise may have the ability to engage in anticompetitive practices in some way but lack the incentive to do so as such a strategy would not be profitable. A merger should be challenged where there is sufficient evidence supporting all elements of the theory of competitive harm.

- **Finally**, a merger analysis would take into account the potential harm to the consumer as a result of the transaction. In particular, any efficiency claims of the vertical merger should be taken into account.

9.2.2. **ASSESSMENT OF COORDINATED EFFECTS**

Under certain circumstances, a vertical merger can increase the likelihood of successful price or output coordination by altering incentives and abilities to collude within either the relevant upstream market or the relevant downstream market, or both. Such concerns may arise, for example, where vertical integration increases market transparency, cross-ownership, or multi-market contacts between enterprises in one or more key dimensions of competition (e.g., price, output, capacity, or quality) or decreases the likelihood of market entry. For example, if vertical integration affords the merged entity better knowledge of selling prices in another market together with other factors, anticompetitive coordination in that market might be facilitated.

A vertical merger will not facilitate price or output coordination in any relevant upstream or downstream market implicated by the merger – and, thus, will not be anticompetitive – unless, post-merger incumbents are able to

(i) reach terms of coordination on some competitive dimension (e.g., price, output, capacity, or quality), and
(ii) detect deviations from the coordination, and
(iii) punish enterprises that deviate[16].

A merger may make coordinated conduct substantially more likely to occur by making it easier for enterprises to meet one or more of these necessary conditions. Even assuming those conditions are satisfied; enforcement action will only proceed if the evidence indicates that anticompetitive coordination would likely occur.

[16] For example, a vertical merger taking place in the presence of an already vertically integrated incumbent might increase cost transparency between the new integrated enterprise and the integrated incumbent. Similarly, to the extent that a vertical merger would increase transparency in any of the key dimensions of competition (e.g. better enabling a seller to know that it lost a sale to a competitor because of a lower price), the ability and incentive to achieve successful anticompetitive coordination may be enhanced.

In assessing the above-mentioned, the Commission will evaluate whether the merger will affect the scope for alignment, market transparency, monitoring of adherence to the coordinated strategy, incentives not to deviate from that strategy, and competitive conditions conducive to coordination. The analysis, moreover, will not only focus on the potential for coordination (which may exist even pre-merger) but also on whether the merger increases the likelihood of coordination in any of the post-merger relevant markets. In the absence of proper evidence showing an increased likelihood of coordination, the Commission will not consider it appropriate to recommend the Tribunal to take enforcement action.

9.2.3. **ASSESSMENT OF COUNTERVAILING FACTORS**

As with horizontal mergers, a vertical merger that enables an enterprise to achieve or enhance market power may nonetheless produce substantial efficiencies. When these efficiencies are properly accounted for in the competitive effects analysis, the merger may be competitively neutral, if not pro-competitive, in so far as consumer welfare is concerned.

9.3. CONGLOMERATE MERGERS

Conglomerate mergers also involve enterprises that operate in different product markets but without a vertical relationship. In practice, the focus is on mergers between companies that are active in related or neighbouring markets, e.g., mergers involving suppliers of complementary products or products belonging to a range of products that are generally sold to the same set of customers.

Unlike horizontal mergers, conglomerate mergers do not entail the loss of direct competition between the merging enterprises in the same relevant market. A further characteristic of conglomerate mergers is that there is often a potential for efficiency gains when the products of the companies involved are complementary to each other. Therefore, conglomerate mergers normally do not harm consumers. However, in rare circumstances, such mergers may raise competition concerns of foreclosure, or possibly, facilitate collusion.

In conglomerate mergers, as well as horizontal or vertical mergers, intervention requires the Commission to make predictions about future developments of the markets concerned and of behaviours of the merging parties. These predictions are typically much more difficult with respect to conglomerate mergers than with respect to horizontal or vertical mergers. For this reason, some enforcement agencies prefer to use their ex-post powers to constrain abusive practices, instead of ex-ante merger

powers, for any competitive concerns associated with a conglomerate merger. In their view, the risk that challenging a merger could result in consumer harm is significantly greater for conglomerates than for horizontal mergers and even vertical mergers. However, some other competition agencies believe it might be more efficient to prevent possible anticompetitive concerns under merger control powers in order to avoid the need for ongoing ex-post intervention and the use of monopoly powers.

In terms of unilateral conglomerate theories of competitive harm, those agencies who believe ex-ante control is warranted argue that in settings where the merger brings together strong market positions in individual markets, the new enterprise may be able to strengthen its market positions by means of tying or bundling. The main competitive concern in this context is foreclosure: as a result of tying or bundling, demand for competing rivals' products may be curtailed, as a result of which these rivals become less effective competitors in the longer run.[17] Foreclosure may be inspired by the desire to gain market power in the tied goods market, to protect market power in the tying goods market, or a combination of the two.

However, such conduct is likely to result in adverse effects on competition only if it would be difficult for rivals or new entrants to provide competing bundles and if they would therefore be unable to constrain the behaviour of the merged entity which could then engage in profitable price increases, output reductions or other strategies.

Nonetheless, as with assessing vertical mergers, the Commission will consider first the ability and second the incentives of the merged enterprise to foreclose competition in any market. Finally, a careful analysis will be undertaken which among other things to consider any efficiency claims and determine whether consumers are likely to be harmed as a result of the transaction.

As far as coordinated effects are concerned, conglomerate mergers may facilitate coordination especially if the merged enterprise's rivals in one market are also rivals in at least one of its other markets and if other factors facilitating collusion are also present in these markets. The theory of competitive harm to consumer welfare in non-horizontal mergers needs to be substantiated by convincing evidence particularly given the fact that there is no loss of direct competition between the merging parties in the same relevant market.

[17] See also the OECD Roundtable on 'Portfolio Effects in Conglomerate Mergers' (2002).