ICN RECOMMENDED PRACTICES FOR MERGER ANALYSIS

These recommendations on substantive merger analysis are derived from the ICN Merger Guidelines Workbook and common practices across member jurisdictions. They are intended to complement the detailed descriptions of merger analysis in the Workbook. For a description of effective investigative techniques to develop evidence to account for particular facts presented in merger investigations, see the ICN Investigative Techniques Handbook for Merger Review.

The ICN Recommended Practices for Merger Notification and Review Procedures address the procedural aspects of notification and review. Several topics covered in those recommended practices relate to the legal framework for substantive merger analysis. In particular, the practices that address transparency, agency powers, confidentiality, and the conduct of a merger investigation are relevant to the legal framework for substantive merger review.

I. The Legal Framework for Competition Merger Analysis

A. The purpose of competition law merger analysis is to identify and prevent or remedy only those mergers that are likely to harm competition significantly.

WORKING GROUP COMMENTS
Original Comments (April 2008)

Comment 1: The legal framework for competition law merger review ("merger review law") should focus exclusively on identifying and preventing or remedying anticompetitive mergers. A merger review law should not be used to pursue other goals.

Comment 2: Most mergers do not harm competition. Many mergers enable the merged firm to reduce costs and become more efficient, leading to lower prices, higher quality products, or increased investments in innovation. Some mergers, however, may harm competition by creating or enhancing the merged firm's ability or incentives to exercise market power – either unilaterally or through coordination with rivals – resulting in price increases above competitive levels for a significant period of time, reductions in quality or a slowing of innovation.

Comment 3: Merger review laws and policies should provide competition agencies with the ability to differentiate mergers that are unlikely to have significant anticompetitive effects from those that require more analysis. The identification of those mergers that potentially threaten to harm competition and expeditious clearance of non-problematic mergers can lead to more efficient use of agency resources and more effective analysis of critical legal and economic issues.

Comment 4: A competition authority's decision to take enforcement action against a merger should not be based on expected anticompetitive effects that are insignificant or transient in duration.

Comment 5: Agencies should only intervene to prohibit or remedy a merger when it is necessary to prevent anticompetitive effects that may be caused by that merger. The appropriate goal of agency intervention to prohibit or remedy a merger is to restore or maintain competition affected by the merger, not to enhance premerger competition.

B. A jurisdiction's merger review law and policy should provide a comprehensive framework for effectively addressing mergers that are likely to harm competition significantly.

WORKING GROUP COMMENTS
Original Comments (April 2008)

Comment 1: A jurisdiction's merger law and policies should enable the competition agency to perform its competition analysis and to take appropriate and effective enforcement action.

Comment 2: A merger review law should have broad application to transactions[1] that may raise significant competitive concerns, regardless of how the transaction is structured. The legal authority to analyze a merger should not be based on the form or technicalities of a merger agreement.

Comment 3: Specific sector exceptions or exemptions to generally applicable merger review provisions, if any, should be narrowly drawn, clearly delineated, and reviewed periodically.

Comment 4: The substantive legal standard for mergers and any analytical guidelines should be based on sound and robust economic principles. Merger review laws and policies should establish a framework for analysis that can address the likely anticompetitive effects of a merger while retaining sufficient flexibility to adapt to developments in economic learning. Clear, comprehensive, and transparent legal and analytical standards, that include identifying the range of mergers subject to the law and the substantive standard for assessing whether a merger is likely to be harm competition significantly, improve the predictability of enforcement actions.

Comment 5: A determination of whether a merger is likely to harm competition significantly should take place within established legal procedures, including an appropriate and transparent standard of proof.

[1] A detailed discussion of the types of transactions that merger review laws cover is contained in the 2007 ICN report, "Defining 'Merger' Transactions for Purposes of Merger Review."

C. An agency's merger analysis should be comprehensive in its assessment of factors affecting the determination of whether a merger is likely to harm competition significantly.

WORKING GROUP COMMENTS
Original Comments (April 2008)

Comment 1: An agency's merger analysis should not be a mechanical application of a legal standard based on rigid presumptions, structural criteria, or formulaic concentration numbers. An agency should apply its merger analysis reasonably and flexibly on a case-by-case basis, recognizing the broad range of possible factual contexts and the specific competitive effects that may arise in different transactions.

Comment 2: The substantive legal standard in a merger review law should permit intervention only where it can be established to the requisite standard of proof that any likely future anticompetitive effects are attributable to the merger itself and not to any other factor. Central to the analysis, therefore, should be a comparison of competition in the relevant market with and without the merger. In most cases, the starting point for such analysis will be an assessment of the competitive conditions existing before the merger, but account should also be taken of any changes in those conditions likely to take place irrespective of the merger.

Comment 3: Merger analysis requires an agency to predict a merger's competitive impact to prevent any competitive problems before they materialize. Agencies should recognize that the further in the future the predicted effects (both harmful and beneficial) are projected to occur, the more difficult it is to predict confidently that they will occur.

Comment 4: The objective application of competition law standards in merger analysis promotes consistency and predictability. An agency's merger analysis practice should also include a commitment to transparency (subject to appropriate confidentiality protections) in order to achieve consistency and predictability and allow merging parties and the public to understand better how the merger laws are enforced. An agency should clearly articulate the analytical factors it uses for merger analysis.

II. Market Definition

A. Agencies generally should assess the competitive effects of a merger within economically meaningful markets. A relevant market consists of a product or group of products and a geographic area in which it is produced or sold that could be subject to an exercise of market power.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: The purpose of market definition in merger analysis is to identify an appropriate frame of reference for assessing whether a merger may create or enhance market power. Market definition is not an end in itself, but is rather an exercise designed to inform the analysis of competitive effects of a merger by identifying which goods or services (collectively referred to herein as "products") in which geographic locations significantly constrain the competitive behavior of the merging firms. Where available, rigorous empirical proof of effects on competition may not only directly inform the analysis of competitive effects, but may also be useful in determining the relevant market.

Comment 2: The term "market" in merger analysis has a distinct, precise meaning that may differ from the use of the term "markets" in other contexts. An economically meaningful market is one that could be subject to an exercise of market power that likely would result in significant harm to competition, rather than anticompetitive effects that are insignificant or transient in nature. While reference to "markets" in business documents and other contexts may provide important insights that may be highly relevant to market definition, businesses and customers often do not use the term "market" in the same sense used in merger analysis. Therefore, agencies should be careful to distinguish between the technical term "market" used in merger analysis and how the term "market" may be used in other contexts.

Comment 3: Mergers may have potential effects in more than one relevant product market or geographic market[2] and require an independent competitive assessment for each market of potential competitive concern. Agencies should examine the relevant markets potentially impacted by a merger to determine whether significant harm to competition in their jurisdiction is likely to occur in any of them.

Comment 4: Agencies should assess market definition within the context of the particular facts and circumstances of the merger at issue. Competitive conditions change over time and may vary in different geographic areas. While relevant markets identified in past investigations in the same industry, or in investigations by agencies in other jurisdictions, may be informative, they may not be applicable to an agency's assessment of the merger in question when, for example, market conditions differ (or have evolved) over time or across geographic areas.

[2] Some agencies refer to a relevant "product market" and a relevant "geographic market," while others consider a relevant market to consist of a product and geographic "dimension." The same analysis applies under either framework.

Comment 5: Market definition provides the basis for market share calculations and concentration levels, and more generally a framework for the analysis of competitive effects.[3] Market shares and concentration levels are meaningful in merger analysis only when they are based on properly defined markets. Therefore, agencies should exercise particular care in defining markets where the choice among possible market definitions may have a significant impact on market shares. In such cases, agencies may seek to develop more direct evidence regarding likely competitive effects. In other cases, it may be clear that a merger will not create or enhance market power under any plausible market definition, or that competitive harm would be predicted under all plausible market definitions. In such circumstances, agencies may not need to reach a firm conclusion on the scope of the relevant market.

B. The "hypothetical monopolist" or "SSNIP" test is an appropriate test to determine the relevant market(s) in which to analyze the competitive effects of a merger.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: An exercise of market power is feasible only when customers would not sufficiently reduce their demand for the relevant product(s), or divert sufficient demand to other products or to other locations, so as to make a price increase (or other lessening of competition) unprofitable. Market definition depends primarily upon demand-side substitution, which focuses on the extent to which customers likely would switch from one product to another, or from a supplier in one geographic area to a supplier in another area, in response to changes in prices, quality, availability, or other features. In addition, supply considerations also are relevant to understanding the competitive constraints on the merging firms. The identification of the relevant product market and relevant geographic market are interrelated. Thus, for example, the extent to which buyers would shift to other products must be evaluated in the context of the relevant geographic market.

Comment 2: The hypothetical monopolist or "SSNIP" test generally identifies an area in product and geographic space within which a hypothetical monopolist would profitably exercise market power. Under this test, agencies generally identify the relevant market as a product or group of products and a geographic area in which it is produced or sold for which a hypothetical, profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of the product(s) in that area, would impose at least a "small but significant and nontransitory increase in price" (commonly referred to as a "SSNIP"), assuming the terms of sale for all other products remain constant.[4] In practice, there often may not be sufficient data available to apply the SSNIP test quantitatively. Nevertheless, the conceptual framework of the test in most cases provides a useful

[3] Merger Analysis RP III addresses the use of market shares. Merger Analysis RPs IV, V, and VI address the analysis of competitive effects.
[4] Agencies may characterize the test in different terms as to whether a hypothetical, profit-maximizing monopolist "would," "likely would," or "could" profitably impose a SSNIP. The analysis is very similar under any of these formulations, and each generally will lead to the same results in the substantive assessment.

methodological tool for gathering and analyzing available evidence relevant to market definition.

Comment 3: In most cases, agencies use the prevailing prices of the products of the merging firms and possible substitutes as a starting point for application of the SSNIP test. However, agencies may use likely future prices, absent the merger, when changes in the prevailing prices can be predicted with reasonable reliability. Furthermore, where pre-merger circumstances strongly suggest coordinated interaction or other evidence strongly indicates that current prices are above competitive levels, agencies may consider using a price more reflective of the competitive price. What constitutes a "small but significant and nontransitory increase in price" will depend on the nature of the industry, but a common benchmark is a price increase of between 5 and 10 percent lasting for the foreseeable future (*e.g.*, one year). In some cases, the SSNIP test is applied to the value added by suppliers in the market rather than the final price.

Comment 4: Agencies generally apply the "smallest market principle" to identify a relevant product and geographic market that is no bigger than necessary to satisfy the SSNIP test. At times, however, it may be appropriate to define broader markets. In some cases, applying the smallest market principle may fail to detect a horizontal overlap of concern between the merging parties. In other cases, where the competitive effects analysis is the same for a broader market, it may be unnecessary to define the smallest market. Similarly, it may be appropriate as a matter of convenience to aggregate markets where the competitive effects analysis is the same across a group of products or geographic areas, each of which could be defined as a separate relevant market.

Comment 5: Evidence regarding the likely demand responses of customers to a SSNIP may be derived from several sources, such as customers, the merging firms, competitors, industry or trade associations, and intermediate sellers. In some cases, adequate reliable price, cost, and quantity data may exist that allow empirical analysis, such as estimation of the relevant elasticities of demand or estimates of sales that would be lost in response to a SSNIP. In addition, evidence directly related to a merger's actual or likely competitive effects, such as evidence derived from prior market events such as entry and exit or a prior merger (sometimes called "natural experiments"), is also relevant to market definition. Such evidence may identify potential relevant markets and reinforce or undermine other evidence relating to market definition.

C. In applying the SSNIP test to identify a relevant product market, agencies generally should identify a product or group of products for which a hypothetical, profit-maximizing monopolist would impose profitably at least a SSNIP, assuming the terms of sale of all other products were held constant.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: In determining the appropriate product market(s) in which to assess the competitive effects of a merger, agencies should assess the extent to which products are substitutable from the point of view of customers. Agencies should consider not only whether products are functional substitutes, but also whether they are good economic substitutes for sufficient numbers of customers so as to make a SSNIP unprofitable. Own price or cross price elasticities of demand, and diversion ratios, where they can be reliably calculated, are highly relevant in assessing whether products are close substitutes for one another and part of the same relevant market. In practice, the data necessary to calculate reliable demand elasticities often are not available.

Comment 2: A single firm may participate in a number of product markets. Agencies generally should begin the process of product market definition by applying the SSNIP test to a candidate market of each product produced or sold by each of the merging firms, assessing what would happen if a hypothetical monopolist of that product imposed at least a SSNIP on that product, while the terms of sale of all other products remained constant. If the hypothetical monopolist would not profitably impose such a price increase because of substitution by customers to other products, the candidate market is not a relevant product market by itself. Agencies then should add to the product group the product that is the next-best substitute for the merging firm's product, and apply the SSNIP test to a candidate market of the expanded product group. This process continues until a group of products is identified such that a hypothetical monopolist supplying the product(s) would be able to exercise market power, and profitably impose a SSNIP in the candidate market. The relevant product market generally will be the smallest group of products that satisfies this test. In practice, sufficient data are usually not available to implement this sequential process as described. Nevertheless, the conceptual framework of the test in most cases provides a useful methodological tool for gathering and analyzing available evidence relevant to market definition.

Comment 3: The boundaries of relevant product markets may not be precise, particularly in differentiated products where substitutes may exist along a continuum. In such cases, some products may be in the same market yet may be much closer substitutes for each other than they are for other products that are also in the market. The degree of product differentiation and customer substitutability may vary over time and across geographic areas. Agencies should recognize that the simple dichotomy of classifying products as either "in the market," and therefore a close substitute for other products within the product market, or "out of the market," and therefore offering little or no competitive constraint on products in the market, does not adequately capture the competitive interaction either of particularly close substitutes or of relatively distant substitutes. In some cases, it may be appropriate to draw a market boundary around a subset of possible substitutes that is narrower than the full range of functional substitutes from which customers choose, to the extent that a hypothetical monopolist over such a segment of the possible substitutes profitably would raise prices significantly.

Comment 4: In considering the likely reaction of customers to a price increase, agencies should consider the available evidence relevant to the likelihood of product substitution by customers in response to a SSNIP. Relevant evidence often includes, but is not limited to:

- the characteristics, prices, functions, and customer usage of the product(s) in question;
- evidence that customers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables. In some instances, agencies may be able to derive such evidence from empirical analysis of quantitative data, such as through calculation of own price or cross price elasticities of demand;
- the margins between price and marginal or incremental cost, as higher margins as a fraction of price may imply that consumers are less price sensitive;
- evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables;
- evidence regarding the strength and nature of customer preferences among products (*e.g.*, brand loyalty, preferences for certain product performance or compatibility standards, etc.);
- relative price levels and price movements of the products compared to costs and to potential substitutes;
- legal or regulatory requirements (*e.g.*, product certification standards, regulatory compliance standards, etc.) that may impact the substitutability of products from the standpoint of customers; and
- the time and costs required to switch products, as high switching costs relative to the value of a product tend to make substitution less likely.

D. In applying the SSNIP test to identify a relevant geographic market, agencies generally should identify an area in which a hypothetical profit-maximizing monopolist would impose profitably at least a SSNIP, assuming the terms of sale of all products at all other locations were held constant.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: In determining for each product market the appropriate geographic market, absent price discrimination, agencies should consider the extent to which customers, in response to a SSNIP by a hypothetical monopolist within a geographic area, would shift to products produced or sold outside the geographic area. Agencies should consider not only whether customers could shift to suppliers in other geographic areas, but also whether sufficient numbers of customers would shift so as to make a SSNIP unprofitable.

Comment 2: A single firm may operate in a number of geographic markets. Agencies should typically begin the process of geographic market definition by applying the SSNIP test to a candidate market of each location in which each merging firm produces or sells the relevant product, assessing what would happen if a hypothetical monopolist in that location imposed at least a SSNIP on sales of the product in that location, while the terms of sale at all other locations remained constant. If the hypothetical monopolist would not profitably impose such a price increase because of substitution by customers to products from other geographic areas, the candidate market is not a relevant geographic market by itself. Agencies then should add the location that is the next-best substitute for the merging firm's location, and apply the SSNIP test to a candidate market of the expanded area. This process will continue until an area is identified such that a hypothetical monopolist would achieve market power, and profitably impose at least a SSNIP in the candidate market. The relevant geographic market generally will be the smallest area that satisfies this test.

Comment 3: A relevant geographic market may be local, regional, national, multinational, or global in nature, and may not correspond to political or jurisdictional boundaries. In considering whether a market may be multinational or global in nature, agencies should assess the extent to which imports, or the potential for imports, would constrain the ability of a hypothetical domestic monopolist to impose a SSNIP by constituting a competitive threat that would make such a price increase unprofitable. As part of this assessment, agencies should consider evidence regarding the extent to which customers currently view imported products as acceptable substitutes, the potential and likelihood for substitution to imports to increase in response to a SSNIP imposed by a hypothetical domestic monopolist, and whether imports would occur on a sufficient scale, and sufficiently quickly, to constrain an exercise of market power by a hypothetical domestic monopolist.

Comment 4: In considering the likely reaction of customers to a price increase, agencies should consider the available evidence relevant to the likelihood of substitution by customers to suppliers outside the geographic area in response to a SSNIP. Relevant evidence often includes, but is not limited to:

- the cost and difficulty of transporting the product in relation to the value of the product (the higher the value of a product relative to its transportation costs, the more likely customers are to seek suppliers in more distant locations and the more likely suppliers located in other areas are willing to supply customers in that area);
- product characteristics (*e.g.*, product perishability or fragility, the nature and requirements of offered services, etc.), geographic features, or other circumstances impacting the ability of customers to obtain products from sellers outside the geographic area;
- evidence that customers have shifted or have considered shifting purchases between different geographic locations in response to relative changes in price or other competitive variables. In some instances, agencies may be able to derive such evidence from empirical analysis of quantitative data;

- evidence that sellers base business decisions on the prospect of buyer substitution between geographic locations in response to relative changes in price or other competitive variables;
- relative price levels and price movements of products in different geographic areas;
- the willingness of customers to obtain the relevant product or service from suppliers in other geographic locations, including customer preferences for obtaining the product from a supplier with a local presence or with the ability to communicate in the local language;
- constraints on the ability of outside sellers to expand their sales into the geographic area (*e.g.,* production capacity, committed capacity, the need to establish brand recognition and acceptance; distribution and after-sales service capabilities, etc.);
- legal or regulatory requirements (*e.g.,* import duties, tariffs, quotas, licensing requirements, required regulatory authorizations or approvals, etc.) that may raise the costs of suppliers from outside the geographic area or impact the ability of customers to obtain the product or service from suppliers located outside the geographic area; and
- the timing and costs of switching suppliers from one region to another, as high switching costs relative to the value of the product will make substitution less likely.

E. Where a hypothetical monopolist would profitably discriminate in prices charged to particular groups of customers or in particular geographic areas, agencies should consider whether a narrower relevant market, consisting of a product or group of products sold to certain groups of customers or in particular geographic areas, is appropriate.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: Existing customers may differ in their ability and willingness to switch to other products, or to suppliers in other areas, in response to a SSNIP. If a hypothetical monopolist would price differently to different groups of customers or to customers in different locations, agencies should evaluate the likely demand responses of each such buyer group. If a hypothetical monopolist would exercise market power only, or especially, in sales to a targeted group of customers or customers in particular locations, agencies may delineate a relevant product market consisting of a particular use or uses by groups of customers of the product, or a relevant geographic market consisting of particular locations of customers, for which a hypothetical monopolist would profitably and separately impose at least a SSNIP.

Comment 2: In assessing whether a hypothetical monopolist would price discriminate to impose a SSNIP profitably on particular groups of customers or customers in particular locations, relevant factors include, but are not limited to:

- whether price discrimination is feasible in the market at issue;
- whether a hypothetical monopolist could successfully identify transactions subject to successful price discrimination;
- whether customers or third parties could undermine price discrimination through some form of arbitrage in which a product sold at lower prices to some customer groups is resold to customer groups intended by the firms to pay higher prices; and
- whether price discrimination would permit or enhance the successful exercise of market power against particular buyer groups or customers in particular locations.

F. Agencies should consider the potential for supply-side substitution, and whether to include as participants in the relevant market not only all firms that currently produce or sell in the relevant market, but also firms that likely would, in response to a SSNIP in the relevant market, produce or sell in the relevant market within a short time frame and without incurring significant sunk costs.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: Supply-side substitutability focuses on the extent to which, in response to a SSNIP, suppliers that do not currently produce or sell the relevant product likely would profitably switch their existing production facilities, in whole or in part, to produce or sell the relevant product in the relevant geographic market within a short time frame (*e.g.,* within one year), and without incurring significant sunk costs of entry or exit. Firms that meet these conditions are capable of making such quick supply responses that they likely influenced the market pre-merger, would influence it post-merger, and accordingly are appropriately considered as market participants at both times. Some agencies consider supply-side substitution as part of market definition, while other agencies consider it in identifying market participants. The same analytical results should apply regardless of the particular method used.

Comment 2: If a firm has existing assets that could be shifted or extended quickly into production or sale of the relevant product in the relevant geographic market, it does not necessarily mean that (a) the firm would have the incentive to produce or sell the relevant product, (b) the firm would entirely switch or extend its production or sales of the relevant product, and (c) all firms producing the other product would do so. The relevant question for analysis is not whether a firm has the capability to produce or sell the relevant product, but whether it would likely make such sales profitably in response to a SSNIP.

Comment 3: In determining the extent to which supply-side substitution is likely, relevant factors include, but are not limited to:

- the extent to which obtaining new tangible or intangible assets, or switching or extending existing assets, to enter into production or sale in the relevant market is technically feasible;
- the extent to which customers would be willing to switch to products offered by the firm in the relevant market;
- the time it would take to enter into production or sale, including the time necessary to comply with any applicable legal or regulatory requirements;
- the costs of shifting or entering into production or sale relative to the profitability of sales at the elevated price; and
- whether the firm's capacity is elsewhere committed or elsewhere so profitably employed that such capacity likely would not be made available to respond to an increase in price in the relevant market.

Comment 4: Agencies should assess the competitive significance of probable supply responses that will not meet the requirements for quick supply-side substitution in their analysis of entry.[5]

[5] Merger Analysis RP VII addresses the analysis of entry and expansion.

III. Use of Market Shares: Thresholds & Presumptions

A. Market shares and measures of market concentration play an important role in merger analysis but are not determinative of possible competition concerns. Agencies should give careful consideration to market definition and the calculation of market shares and market concentration.

WORKING GROUP COMMENTS
Original Comments (April 2008)

Comment 1: Market shares are an indication of the competitive significance of each merging firm in the relevant market. They provide an indication of a firm's incentives to coordinate its actions with rivals and its ability unilaterally to exercise market power. The significance of market shares and measures of market concentration is specific to the analytical context presented in each investigation. They are not determinative of possible competition concerns in themselves, as they may, for instance, either underestimate or overestimate the future competitive significance of a firm or the impact of a merger.

Comment 2: In general, agencies should pay greater attention to a merger that significantly increases market concentration than to one that does not, or does so only marginally. Whatever the existing level of concentration, the change in concentration caused by a merger is a useful, although imperfect, indicator of the loss of direct competition between the parties and of the potential for competitive harm.

Comment 3: Market shares and measures of concentration are useful in merger analysis only when they are based on properly defined product and geographic markets. Particular caution is needed in markets involving differentiated products, as market definition itself is more complex in these cases. Market share calculations should be based on reliable data and sources and sound assumptions.

Comment 4: Market shares should be based on a measure of economic strength (*e.g.*, sales, production, or capacity) that is appropriate to the circumstances of the market. Market share and concentration estimates used for a merger analysis should reflect the best available indication of the firms' future competitive significance. Market characteristics and changes in market conditions should be considered in interpreting market shares and market concentration data. Before drawing any conclusions from market share and concentration data, agencies should consider imminent or reasonably certain changes to the market, such as the entry or exit of a firm or the introduction of additional capacity. To gain a better insight into the competitive dynamics of some markets, it may also be relevant to analyze changes in market shares and concentration over time.

B. Market shares and measures of market concentration can provide useful initial guidance to help identify mergers that may raise competitive concerns requiring further analysis.

WORKING GROUP COMMENTS
Original Comments (April 2008)

Comment 1: The purpose of initial guidance based upon market shares or measures of concentration is to help differentiate mergers that are unlikely to have anticompetitive consequences from those that require more detailed analysis. Such guidance can enhance predictability and allow for a better allocation of agency resources.

Comment 2: The absence of high market shares or post-merger concentration ordinarily supports a conclusion that a given transaction requires no further analysis. Similarly, a transaction that does not significantly increase post-merger market shares or concentration ordinarily requires no further analysis, as the premerger competitive conditions are unlikely to be significantly altered by the merger. However, there may be exceptions. For example, when at least one party to the merger has substantial market power, even small increases in market share may be indicative of possible competition concerns. Evidence that the merged firm would have a high market share or that the market is highly concentrated can be significant to a decision to initiate an in-depth investigation.

Comment 3: Many agencies identify thresholds based on market shares and levels of concentration to give initial guidance as to the likely need for an in-depth investigation. An agency can set threshold levels of market shares and measures of concentration under which it commits itself not to, or is generally unlikely to, challenge a merger or over which it is likely to continue an in-depth analysis of the merger's effects on competition.

C. High market concentration and significant increases in market shares brought about by a merger are useful, but generally are not conclusive indicators that a merger is likely to harm competition significantly. Jurisdictions that use market concentration and/or market shares to presume competitive harm should ensure that any such presumption may be overcome or confirmed by a detailed review of market conditions.

WORKING GROUP COMMENTS
Original Comments (April 2008)

Comment 1: Mergers that lead to high market share for the merging firms and that result in significant increases to concentration levels are in general the mergers most likely to raise competition concerns.

Comment 2: In some jurisdictions, high market share or market concentration gives rise to a presumption of competitive harm, whereas in others they do not. When agencies use presumptions of competitive harm based on market shares or market concentration, the investigatory process should take into account evidence that may overcome or confirm the presumption. Agencies should be transparent about the meaning and use of any presumptions, including any quantitative standards used to evaluate market shares or concentration.

Comment 3: Agencies should not make enforcement decisions to prevent or remedy a merger solely on the basis of market shares and concentration. Thus, agencies should not automatically reach a final conclusion that a merger is likely to be anticompetitive because the merger increases concentration above a certain level or reduces the number of remaining firms below a certain level. A detailed analysis of other market factors and of theories of unilateral and/or coordinated effects should always be required before definitive conclusions are drawn regarding the likely competitive effects of a merger.

IV. Competitive Effects Analysis in Horizontal Merger Review: Overview

A. The goal of competitive effects analysis in the review of horizontal mergers is to assess whether a merger is likely to harm competition significantly by creating or enhancing the merged firm's ability or incentives to exercise market power, either unilaterally or in coordination with rivals.

WORKING GROUP COMMENTS
Original Comments (June 2009)

Comment 1: Agencies should conduct competitive effects analysis in merger review to identify those mergers likely to harm competition significantly by creating or enhancing market power. When exercised by sellers, market power is the ability profitably to raise price above competitive levels for a significant period of time, and/or to lessen competition on parameters other than price, such as quality, service, or innovation. In some cases, market power may be exercised by buyers. In such cases, market power is the ability profitably to reduce the price paid to suppliers below competitive levels for a significant period of time, which may in some cases lead to an anticompetitive reduction in supplier output.

Comment 2: Agencies generally should conduct competitive effects analysis within the context of properly defined product and geographic markets. However, market definition is not an end in itself but is a tool to assist in determining whether a merger will create or enhance market power. In some cases, evidence of competitive effects, such as price effects following a consummated merger under investigation or a prior merger in the industry, may inform the analysis of the appropriate relevant markets.

Comment 3: Agencies engaged in competitive effects analysis should conduct a forward-looking inquiry focusing on a comparison of the anticipated state of competition in the relevant market(s) with and without the merger. An agency's assessment of competition without the merger (sometimes called the "counterfactual") should be informed not only by the existing conditions of competition, but also by any significant changes in the state of competition likely to occur without the merger.

Comment 4: While changes in market share or market concentration are useful indicators of potential competitive concerns, competitive effects analysis involves a comprehensive assessment of market conditions, and provides agencies with a more reliable means to assess potential harm to competition than changes in market share or market concentration alone.

B. In conducting competitive effects analysis, agencies should consider whether a merger likely will result in anticompetitive unilateral or coordinated effects. These two theories of competitive harm provide the analytical frameworks for determining whether a horizontal merger may be expected to harm competition significantly.

WORKING GROUP COMMENTS
Original Comments (June 2009)

Comment 1: Unilateral effects, also known as non-coordinated effects, arise when, as a result of a merger, it is likely that the merged firm, without any coordination with non-merger rivals, will be able profitably to exercise market power to a materially greater degree than would have been possible for either of the merged firms before the merger.

Comment 2: Coordinated effects arise when, as a result of a merger, it is likely that firms remaining in the market after the merger will be able to coordinate (either tacitly or explicitly) their behavior or strengthen existing coordination in order to exercise market power.

Comment 3: Unilateral effects and coordinated effects are broad analytical frameworks designed to encompass the full range of anticompetitive effects that may result from horizontal mergers. While anticompetitive effects of a merger within a particular market are often best characterized as either unilateral or coordinated, a merger may result in both unilateral and coordinated effects.

C. The analysis of competitive effects under either the unilateral or coordinated effects framework should be clearly grounded in both sound economics and the facts of the particular case.

WORKING GROUP COMMENTS
Original Comments (June 2009)

Comment 1: Economic theories and models are useful in analyzing competitive effects under both unilateral and coordinated effects frameworks, but only to the extent that the theory or model used to assess the likely competitive effects of a merger is based on sound and robust economic principles and fits the factual conditions of the market to which it is applied.

Comment 2: Competitive effects analysis depends heavily on the specific facts of each case. In conducting competitive effects analysis, agencies should refine their theories or models of likely competitive harm in light of the available qualitative and quantitative evidence. Qualitative evidence often comes from documents or first-hand observations of the industry by customers or other market participants. Quantitative evidence is often derived from statistical analysis of price, quantity, or other data related to, among other things, prior market events (sometimes called "natural experiments") involving incumbent responses to prior events such as entry or exit by rivals. Competitive effects analysis should be flexible enough to adapt over time to evolving markets, business practices, and economic learning.

V. Unilateral Effects

A. In analyzing the potential for a horizontal merger to result in anticompetitive unilateral effects, agencies should assess whether the merger is likely to harm competition significantly by creating or enhancing the merged firm's ability or incentives to exercise market power independently.

WORKING GROUP COMMENTS
Original Comments (June 2009)

Comment 1: Horizontal mergers eliminate any competitive constraint that the merging parties formerly exerted upon one another. In the majority of mergers, this has no significant adverse effect on competition because there are other sufficient competitive constraints on the merged entity. In some cases, however, the elimination of competition between the merging parties in itself may create or enhance the ability of the merged firm independently to exercise market power, depending on market conditions, including the existence and effectiveness of other competitive constraints.

Comment 2: Agencies conducting unilateral effects analysis should look not only at market shares and market concentration, but should also examine the specific features of the market that affect the merged firm's ability to exercise market power. While market shares are a useful indicator of the potential for the merged firm to exercise unilateral market power, market shares alone may overstate or understate the potential for a merger to result in anticompetitive unilateral effects. Competitive constraints may preclude the exercise of market power even by firms with high market shares. On the other hand, even small changes in market share in some circumstances may increase the ability or incentives of a firm to exercise market power.

B. In conducting unilateral effects analysis, agencies should apply the economic theory or model that best fits the characteristics of the market(s) at issue.

WORKING GROUP COMMENTS
Original Comments (June 2009)

Comment 1: Mergers may increase the likelihood of the exercise of unilateral market power in a variety of settings. There are a number of unilateral effects theories and models in the economic literature that address competitive effects in specific factual settings. While the specific model or theory used will vary depending on the characteristics of the market, all are designed to assess whether there is any material increase in unilateral market power as a result of the merger. Common theories and models include, but are not limited to:

- *Merger to monopoly*: A merger that would combine the only two rivals in a properly defined market raises a high risk of significant anticompetitive unilateral effects. In examining a merger combining the only two rivals in a relevant market, agencies should assess whether any competitive constraints exist, such as ease of entry, that would preclude the unilateral exercise of market power by the merged firm.

- *Merger of competitors in differentiated product markets:* A merger that would combine competing suppliers of differentiated products may raise the potential for significant anticompetitive unilateral effects if a sufficient proportion of consumers view the products combined by the merger as their first and second choices (or closest substitutes). Commonly used sources of evidence on the degree of substitutability among differentiated products include marketing surveys, analysis of purchasing patterns, cross-price elasticities, and information contained in normal course of business documents from market participants. Agencies should assess whether the merger would allow the merged firm profitably to increase price on one or more products after the merger, or whether sufficient customers would switch to products of other competitors so as to render such a price increase unprofitable for the merged firm. Agencies should also consider whether rival sellers likely would replace any loss of competition by repositioning or extending their product lines to compete more closely with the merged firm.

- *Merger of competitors in undifferentiated product markets:* In examining a merger that would combine competing suppliers of undifferentiated products in markets in which firms are distinguished primarily by capacity, agencies should consider whether the merged firm would find it profitable to raise price by reducing output below the level that would have prevailed absent the merger. The exercise of market power in such markets is likely only if competitors of the merged firm likely would not respond to the price increase and output reduction by the merged firm with increases in their own outputs sufficient in the aggregate to make the unilateral action of the merged firm unprofitable. This may occur if non-merging firms face binding capacity constraints that could not be economically relaxed in a timely manner, or if existing excess capacity is significantly more costly to operate than capacity currently in use. In such cases, competitors may find it more profitable to raise price than expand output, resulting in additional anticompetitive unilateral effects.

- *Merger of rivals in bidding or auction markets:* A merger that would combine rival bidders in bidding or auction markets may raise the potential for significant anticompetitive unilateral effects. There are a variety of models in the economic literature addressing a wide array of bidding and auction formats involving both differentiated and undifferentiated products. For example, some models focus on whether the merger would combine the two lowest-cost or otherwise closest competitors. Other models focus on whether the merger would result in a competitively significant reduction in the number of bidders. Agencies should determine the appropriate model depending upon the circumstances of the market, and each bid or auction market should be analyzed on its own facts.

Comment 2: Merger simulation and other formal economic modeling can be useful tools in unilateral effects analysis. In order to be useful, the particular model used should be based on sound and robust economic principles, fit the facts of the market, and suitable data must exist to calibrate the model. The fit of a model should be based on the totality of the evidence.

C. In conducting unilateral effects analysis, agencies should assess the competitive constraints and other factors relevant to the ability of the merged firm to exercise market power in the relevant market(s).

WORKING GROUP COMMENTS
Original Comments (June 2009)

Comment 1: In assessing the impact of a merger on the merged firm's ability to exercise market power, agencies should draw on all available evidence, especially evidence created in the ordinary course of business. Common sources of evidence include documents, information, quantitative evidence, and economic analyses from the merging parties, customers, competitors, and other third parties; statements, representations, and testimony from representatives of the merging parties and other industry participants; and generally available industry studies, reports, and market data.

Comment 2: Agencies should assess whether competitive constraints or other market conditions that will remain in the market following the merger are adequate to prevent the creation or enhancement of unilateral market power. Factors that are often relevant in assessing the likelihood of a unilateral exercise of market power as a result of a merger include, but are not limited to:

- *Availability and Responsiveness of Alternative Suppliers:* If alternative suppliers (offering adequate substitutes and with sufficient available capacity) will remain post-merger, and a significant number of customers are willing and able to turn to these alternative suppliers in the event of an anticompetitive increase in price, the threat of losing such customers may be enough to deter the exercise of market power by the merged firm.

- *Entry, Repositioning, or Expansion:* The prospect of entry by new competitors, or expansion or repositioning by existing competitors, may be sufficient in time, scope, and likelihood to deter or defeat any attempt by the merged firm to exercise market power.[6] In some cases, however, a merger may lessen the potential for entry, expansion or repositioning to act as a competitive constraint against the exercise of market power.

[6] Merger Analysis RP VII addresses the analysis of entry and expansion.

- *Buyer Power:* In some circumstances, customers may have the incentive and ability to defeat the exercise of market power through their bargaining strength against the seller because of their size, commercial significance to the seller, or ability to switch to alternative sources of supply. Customers also may have the ability to encourage or sponsor competitive entry or expansion, or to produce the relevant product themselves. In such cases, even firms with very high market share may not be in a position to exercise market power post-merger. To prevent significant anticompetitive effects, however, buyer power must constrain the exercise of market power in the market and not merely protect certain individual customers.

- *Efficiencies:* Agencies should carefully assess any substantiated claims by the merging parties that a merger will generate efficiencies sufficient to prevent or mitigate anticompetitive unilateral effects from the merger. For instance, cost reductions may reduce a merged firm's incentive to raise price. Efficiencies may also result in benefits in the form of new or improved products, even when price is not immediately and directly affected. Agencies should consider the impact of substantiated efficiencies that are unlikely to be achieved in the absence of the merger on the merged firm's ability and incentives to compete, and whether such efficiencies may preserve or intensify competition, thereby benefiting consumers.

VI. Coordinated Effects

A. In analyzing the potential for a horizontal merger to result in coordinated effects, agencies should assess whether the merger increases the likelihood that firms in the market will successfully coordinate their behaviour or strengthen existing coordination in a manner that harms competition significantly.

WORKING GROUP COMMENTS
Original Comments (June 2009)

Comment 1: To identify those mergers that materially enhance the likelihood of coordination or strengthen existing coordination, agencies should: (a) assess whether market conditions are conducive to coordination in the relevant market(s) affected by the merger; and (b) analyse specifically whether and how the merger would affect market conditions and firms' ability or incentives that would make coordination more likely post merger.

Comment 2: The fact that a market has conditions that are conducive to coordination in itself is not sufficient to conclude that a merger is likely to further or enhance coordination. Agencies should also be able to determine whether the merger will make coordination easier or more likely, considering the specific features of the market that affect the merged firm's ability and incentives to exercise market power in coordination with rivals.

Comment 3: Changes in market concentration and market share are relevant, but not determinative, factors in assessing whether a merger is likely to further or enhance coordinated interaction. Agencies should focus on whether the merger will materially alter firms' ability or incentives to achieve and sustain coordination. An examination of the role each competitor plays in the competitive dynamics of the market may help to determine how the merger is likely to impact the likelihood of coordination post-merger.

B. In conducting coordinated effects analysis, agencies should assess whether the conditions that are generally necessary for successful coordination are present: (a) the ability to identify terms of coordination, (b) the ability to detect deviations from the terms of coordination, and (c) the ability to punish deviations that would undermine the coordinated interaction.

WORKING GROUP COMMENTS
Original Comments (June 2009)

Comment 1: Coordinated behaviour can take many forms: it may be tacit or explicit and may or may not be lawful in itself. In some markets, firms may coordinate their behaviour on prices in order to keep them above the competitive level. In other markets, firms' coordination may aim at limiting production or the amount of new capacity brought to the market. Firms may also coordinate by dividing the market, for instance by geographic area or other customer characteristics, or by allocating contracts in bidding markets.

Comment 2: In order to coordinate, firms need to achieve an understanding as to how to do so. This need not involve explicit agreements among competitors, or any communication between them, nor need it involve all firms or perfect coordination between firms. Agencies should assess whether it is likely that participants could achieve terms of coordination that would be sufficiently successful to result in significant harm to competition. When assessing market conditions conducive to reaching terms of coordination, important factors include, but are not limited to:

- The number of firms in a market, since it is easier to coordinate among a few players than among many;
- The existence of frequent and regular orders, which make it easier to coordinate and to detect deviations from the terms of coordination;
- The homogeneity of the products, since it is easier to coordinate on terms such as price when competing products are substantially the same;
- The homogeneity of the firms, especially in terms of symmetry of market shares, similarity of cost structures, levels of vertical integration, and the impact that such homogeneity may have on their ability or incentives to coordinate;
- The degree of transparency of important information that could provide a focal point for coordination, such as information concerning prices, output, capacity, customers served, territories served, discounts, new product introductions, etc.;
- Cross-shareholdings and other links that may make it easier for competitors to exchange information on terms of coordination, and may reduce their incentives to compete; and,
- Other market conditions: for instance, it is easier to coordinate on price when demand and supply conditions are relatively stable than when they are frequently changing (*e.g.*, because of the ease of entry by new firms or rapid, significant product innovations).

Comment 3: Firms may be able to identify terms of coordination even in markets with complex product characteristics or terms of trade. For instance, in a market with many differentiated products, firms may still be able to coordinate on prices by establishing simple pricing rules that reduce the complexity of coordinating on a large number of prices or to coordinate on terms other than prices. Moreover, coordination may not necessarily be achieved on all dimensions of competition.

Comment 4: Although coordination may be in the collective interest of participants, it is often in a firm’s individual interest to deviate from the terms of coordination in order to take advantage of the profit opportunity created when other firms raise their prices or otherwise coordinate their behaviour. For coordination to be maintained, participants must have the ability to detect and respond to deviations from the terms of coordination. Agencies should assess the extent to which firms would have the ability to monitor the important terms of coordination and to detect deviations from the terms of coordination in a timely manner. When assessing the likelihood and timeliness of detection of deviations from the coordinated behaviour, important factors include, but are not limited to:

- The degree of transparency of important information necessary to verify compliance by other firms with the terms of coordination, such as information concerning other firms' pricing, output levels, or individual transactions. For instance, if orders for the relevant products are regular both in terms of frequency and size, it may be difficult for a firm to deviate (by expanding its output) without being detected. Also, if there is little fluctuation in demand or costs, deviations may be easier to detect. On the other hand, if orders for the relevant products are infrequent and large, firms may have a greater incentive to deviate to secure orders and the threat of later punishment may not serve as an effective deterrent.
- The extent to which the homogeneity or heterogeneity of the products and firms may make monitoring of compliance with the terms of coordination and detection of deviations more or less difficult.

Comment 5: In order to deter deviations from the terms of coordination, firms must have the ability to punish deviations in a manner that will ensure that coordinating firms find it more profitable to adhere to the terms of coordination than to deviate, given the cost of reprisal. Punishment may take many forms, including temporary abandonment of the terms of coordination by other firms in the market. In assessing whether there will be a sufficiently credible and severe punishment when a deviation by one of the firms is detected, important factors include, but are not limited to:

- The effectiveness of the deterrent mechanism itself: *e.g.*, the threat of expanding output to punish a deviating firm may not be credible or effective if coordinating firms have no or little excess capacity;
- The speed with which the deterrent mechanism can be implemented, given that reprisal that manifests itself after some significant time lag is less likely to be sufficient to offset the benefits from deviating; and,
- The costs of implementing the deterrent mechanism compared to the long-term benefits of coordination.

Other factors, such as the presence of the same firms in several markets (sometimes called "multi-market contacts"), may also be of relevance in determining the likelihood of sufficiently credible and severe punishment.

C. In conducting coordinated effects analysis, agencies should assess the extent to which existing competitive constraints and other factors would likely deter or disrupt effective coordination. In making this assessment, agencies should consider all available evidence, including the pre-merger market conditions that may constrain or facilitate successful coordination, and the impact of the merger on these conditions.

WORKING GROUP COMMENTS
Original Comments (June 2009)

Comment 1: Agencies should assess whether competitive constraints or other market conditions that will remain in the market following the merger are adequate to prevent the creation or enhancement of coordinated interaction. Factors that are often relevant in making this assessment include, but are not limited to:

- *Past Coordination/Behaviour of Firms*: In assessing the likelihood of coordinated effects, agencies should take into account information on the pre-merger characteristics of the markets concerned, including the past behaviour of firms. Evidence of past coordination is important and may serve as strong evidence that all three conditions for successful coordination are present if the relevant market characteristics have not changed appreciably or are not likely to do so in the near future.

- *Entry or Expansion*: Agencies should also consider the actions of competitors not expected to participate in the coordination ("non-coordinating competitors") and potential competitors, which may be sufficient in time, scope, and likelihood to jeopardise the outcome expected from coordination.[7] For instance, the existence of non-coordinating competitors with the ability to expand capacity to take sales from coordinating firms may deter or disrupt coordination. Agencies should therefore consider the existence and significance of barriers to entry and expansion into the relevant market(s) since low barriers to entry and expansion may render successful coordination unlikely or impossible.

- *Maverick Firm*: Coordination may also be difficult to sustain in the presence of a maverick firm – a firm with a different competitive strategy and a greater economic incentive than its rivals to deviate from the terms of coordination. Particular care is needed in mergers involving the acquisition of a maverick firm because in some circumstances those mergers may eliminate a significant constraint to effective coordination and make coordinated interaction more likely, more successful, or more complete.

- *Buyer Power*: Agencies should consider whether the actions or characteristics of customers affect the likelihood of successful coordination. In some circumstances, buyers may be able to undermine coordinated behaviour, for example by sponsoring entry or expansion. Where large buyers likely would engage in long-term contracting, so that sales covered by such contracts would be large relative to a firm's total output, firms may have a greater incentive to deviate from the terms of coordination.

- *Efficiencies*: Agencies should carefully assess any substantiated claims by the merging parties that a merger will generate efficiencies sufficient to prevent or mitigate coordinated effects from the merger. For instance, cost reductions may enhance a merged firm's incentives to lower prices, thus reducing incentives to coordinate. Efficiencies may also result in benefits in the form of a new or improved product that could undermine coordination. Agencies should consider the impact of

[7] Merger Analysis RP VII addresses the analysis of entry and expansion.

substantiated efficiencies that are unlikely to be achieved in the absence of the merger on the merged firm's incentives to coordinate.

Comment 2: In assessing market conditions conducive to coordination, competition authorities should bear in mind that no single factor or group of factors is always determinative.

VII. <u>Entry & Expansion</u>

A. The assessment of firm entry and/or expansion by existing competitors should be an integral part of the analysis of whether a merger is likely to harm competition significantly (*e.g.*, the merged firm could raise prices or reduce output, quality, or innovation).

WORKING GROUP COMMENTS
Original Comments (April 2008)

Comment 1: Entry, or the threat of entry from potential competitors or from customers turning to in-house supply, can be an important competitive constraint on the conduct of the merged firm. If the merged firm is subject to competitive constraints from the threat of market entry (*e.g.*, if barriers to entry are low and entry is likely to be profitable at premerger prices), the merger is unlikely to have anticompetitive effects.

Comment 2: The ability of rival firms to expand capacity in a timely manner, or use existing spare capacity or switch capacity from one use to another, can also constitute an important competitive constraint on the merged firm's conduct (these shorter term supply-side responses can also be assessed in the context of market definition). Many of the factors that are used to assess entry are relevant to the analysis of expansion, including competitor expansion plans, barriers to expansion, and the profitability of expansion.

Comment 3: Competition agencies should consider whether entry and/or expansion would deter or offset the likely anticompetitive effects of a merger. Competition agencies should focus on entry and/or expansion that would occur as a result of the post-merger competitive situation as well as entry and expansion that is likely to take place independent of the merger.

B. In assessing whether entry and/or expansion would effectively constrain the merged entity, competition agencies should consider whether entry and/or expansion would be: (a) likely; (b) timely; and, (c) sufficient in nature, scale and scope.

WORKING GROUP COMMENTS
Original Comments (April 2008)

Comment 1: For entry and/or expansion to be *likely*, it should be profitable for competitors of the merged entity to expand output and/or for potential entrants to enter the market in response to an attempt by the merged entity to profit from the potential reduction in competition brought about by the merger (*e.g.*, a post-merger price increase). In assessing the *likelihood* of entry, competition agencies should also consider establishing, if possible, the history of entry into and/or exit from the relevant market by using available evidence including information on firms that have recently entered or exited the market, information about past and expected market growth, evidence of planned entry and/or expansion, direct observation of the costs, risks and benefits associated with entry and information from firms identified as potential entrants.

Comment 2: In assessing the *likelihood* of entry and/or expansion, competition agencies should consider the existence and significance of barriers to entry and expansion to the relevant market (*i.e.*, the advantages enjoyed by incumbent firms over the potential entrants that may prevent or delay new firms from entering the market). When assessing ease of entry, agencies should focus on whether potential entrants would consider entry to be profitable in light of factors including but not limited to:

- economies of scope and/or scale, the availability of a scarce resource that is an essential input, technical capability or intellectual property rights;
- the reputation of incumbent firms, incumbent firms' investment in excessive capacity, or the duration, termination and renewal provisions in existing contracts;
- government regulations that might, for example, limit the number of market participants or impose substantial regulatory approval costs; and,
- sunk costs that could not be recovered if the entrant left the market including machinery that might be site specific or R&D that has not yet resulted in any marketable invention or innovation.

Comment 3: In assessing whether entry and/or expansion is *timely*, competition agencies should consider whether entry and/or expansion would take place within a reasonable period of time after the merger (many jurisdictions consider that entry must have a competitive impact within two years to have a sufficiently disciplining effect). The appropriate time horizon may vary according to the characteristics of the relevant market.

Comment 4: For entry and/or expansion to be *sufficient*, competition agencies should consider whether entry and/or expansion would be:

- sufficient in scale to compete effectively with the merged entity;
- able to counteract any specific anti-competitive effects resulting from the merger; and,
- able to counteract any localized effects of the merger (*e.g.*, in markets differentiated by geographic areas or customer categories).

VIII. Efficiencies

A. The assessment of potential efficiencies should be part of a competition agency's overall analytical framework for merger review. In specific cases where the merging parties assert that a merger is unlikely to harm competition significantly because of expected efficiencies, agencies should carefully assess appropriate efficiency claims.

WORKING GROUP COMMENTS
Original Comments (May 2017)

Comment 1: Mergers can produce significant efficiencies for the merged firm and such efficiencies can be important business motivation for a merger. Merger efficiencies can include cost savings in production or distribution, economies of scale or scope, increased innovation leading to new or improved products, increased network size or product quality, among others. Some of these efficiencies (innovation, combination of complementary assets, etc.) may bring synergies on a potentially continuous basis, thus enhancing the potential performance of the merged entity and the potential benefit to competition and consumers.

Comment 2: Mergers can produce efficiencies that may counteract the potential for anti-competitive effects. The benefits of some merger efficiencies can be passed on to consumers, for example, in lower prices or gains in innovation that lead to new or improved products. To counteract likely anticompetitive harm, efficiencies need to increase rivalry by enhancing the ability and economic incentive of the merged firm to compete. Efficiencies can have such impact if they lower costs or increase output, innovation, or quality and there is sufficient competitive pressure remaining such that the merger is unlikely to harm consumers in the relevant market(s).

Comment 3: In order to determine the impact of a merger that potentially harms competition, agencies should take into account substantiated, likely, and merger-specific efficiencies put forward by the parties. Efficiency claims should be assessed in light of all other evidence. Agencies should not challenge a proposed merger if it is likely that the demonstrated efficiencies would be passed through to consumers and would counteract the anticompetitive effects in the relevant market(s). Efficiencies are most likely to impact merger analysis when the likely adverse competitive effects, absent the efficiencies, are not large. The evaluation of efficiencies commonly is part of an agency's competitive assessment, focusing on whether the claimed efficiencies counteract the harm in the market in which the lessening of competition occurs. In a few jurisdictions, efficiencies also are considered after a merger is determined to be anticompetitive, as a separate assessment of the offsetting relevant consumer benefits of a merger.

Comment 4: The assessment of efficiencies is not necessary in those cases in which a merger does not raise competition concerns because there are sufficient competitive constraints in the market to prevent significant harm regardless of whether the merger will enable efficiencies.

Comment 5: Efficiencies can be important to merger remedy design. When feasible, merger remedies should eliminate the likely anti-competitive effects of a merger in the relevant market without unnecessarily sacrificing substantiated efficiencies in the same or other markets or aspects of the transaction.

Comment 6: Agencies should provide transparency with respect to their approach to evaluating potential efficiencies in merger control, including the weight the agency is likely to place on efficiency claims, the types of efficiencies that are likely to be taken into account, and any evidentiary requirements for substantiating efficiencies, including identifying the party that bears the burden of demonstrating efficiencies. Such guidance may be provided, for example, through public merger guidelines and other statements explaining merger analysis, as well as through decisions in specific cases in which parties have raised efficiency claims.

B. In assessing claims that a merger will not harm competition significantly because it will produce efficiencies, agencies should carefully review information provided by the merging parties on whether the claimed efficiencies are (a) merger specific, (b) sufficient enough to counteract the potential harm of the proposed merger, and (c) properly substantiated.

WORKING GROUP COMMENTS
Original Comments (May 2017)

Merger Specificity

Comment 1: Agencies should credit only those efficiencies that are merger specific. Merger-specific efficiencies are those that are of direct consequence of the merger and unlikely to be accomplished either in the absence of the merger or by alternatives with similar or less anticompetitive effects. In many cases, efficiencies can be achieved without the proposed merger. Efficiencies that are achievable, for instance, via internal growth, modernizing equipment, or adoption of industry best practices are not merger specific. In assessing whether efficiencies can be achieved by alternatives other than the merger, only realistic and practical business alternatives should be considered. Timing and cost can be important factors to consider in the evaluation of alternatives.

Sufficiency

Comment 2: Agencies should evaluate whether the claimed efficiencies are sufficient to counteract the merger’s potential anticompetitive harm in the relevant market(s), e.g., by likely enhancing the merged firm’s ability and incentive to lower prices, increase quality, or otherwise compete in a way that is beneficial to consumers.

Comment 3: In many jurisdictions, this sufficiency requirement includes a showing that a significant share of the benefits expected to be realised from the efficiencies is likely to be passed on to consumers (or customers), usually in the form of lower prices or increased output, innovation, or quality. Efficiencies that reduce variable or marginal costs are more likely to be passed on to consumers in the form of lower prices and thus more likely to be relevant to the assessment than those that reduce fixed costs. Cost savings due to anticompetitive decisions to reduce input prices, innovation, output, or service should not be considered. For dynamic efficiencies, it can be important not only to consider benefits from lower prices or increased output, but also from innovation and quality improvements such as new products stemming from higher R&D investment or new combinations of know-how, experience, or technologies.

Comment 4: When reasonably possible, efficiencies and resulting benefits should be quantified. Efficiency claims should be assessed net of the costs to achieve the expected efficiencies. While the quantification of claimed efficiencies is often complex and speculative, quantification can better inform the scope of possible benefits to consumers and facilitate a comparison of the efficiencies with the likely harm to competition.

Substantiation

Comment 5: Merger-specific efficiency gains are difficult to assess and verify both for merging parties and for competition agencies. Agencies should advise merging parties to submit efficiency claims very early in the process because verification by reasonable means typically requires significant time and resources. Crucial information about the claimed efficiencies is normally solely in the merging parties' possession. Therefore, the merging parties should be required to present evidence regarding the type, likelihood, size, and timing of any claimed efficiencies, including how they would be achieved, how they would enhance the firm's ability and incentive to compete, and why they are merger specific. Merging parties often claim efficiency gains but frequently fail to substantiate them with adequate evidence.

Comment 6: To verify efficiency claims, agencies typically review internal data and documents from the merging firms to determine how realistic the claims are. Evidence that agencies consider in evaluating efficiency claims typically includes internal documents that management used to decide on the merger, company statements about the expected efficiencies, business plans on how the company plans to achieve the efficiencies, examples of past efficiencies, and any studies on the type and size of expected efficiency gains. Proof that similar efficiencies were achieved in the past from similar actions can be among the most convincing evidence in evaluating efficiency claims. In evaluating the information submitted to substantiate efficiency claims and any conclusions, agencies should assess the accuracy of the parties' data and information, as well as the analytical methods and assumptions used.

Comment 7: The greater the likely adverse effects on competition, the greater the need to demonstrate clear, significant, and verifiable efficiencies and their likely impact on competition and consumers. When the potential adverse competitive effects of a merger are likely to be substantial, significant verifiable efficiencies likely to benefit consumers are necessary to prevent the merger from being anticompetitive. Likewise, the more uncertain and modest the likely harm to competition, the greater potential role for claimed efficiencies to outweigh the harm.

Comment 8: The stronger the evidence to substantiate the efficiency claims, the more confidence an agency is likely to have in relying on efficiencies as part of its analysis. Efficiency claims that are vague, speculative, and cannot be verified by reasonable means should not be credited.

Comment 9: The time horizon for claimed efficiencies can be an important consideration in evaluating efficiencies in light of potential anti-competitive harm. Efficiencies should have a timely impact on the merged firm's ability and incentives to compete. The more time projected for the efficiencies to be realised, the more uncertainty and difficulty predicting their effects.

IX. Failing Firm/Exiting Assets

A. A merger is not likely to create or enhance market power if one of the merging parties is likely to fail and its assets are likely to exit the market in the imminent future. In cases where the merging parties assert that a merger is unlikely to harm competition because one of the merging firms is failing, agencies should carefully assess the appropriate counterfactual in which to analyse the competitive effects of the merger.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: Agencies should carefully review claims by the merging parties that a merger will not harm competition because the acquired firm and its assets would have exited the market absent the merger in any event. In such cases, the basis for concluding that the merger will not harm competition is that the competition provided by a failing firm would be lost even without the merger and, consequently, the competitive situation post-merger may be no worse than the counterfactual, *i.e.*, the competitive situation absent the merger. In cases where one of the merging parties is an allegedly failing firm, agencies should carefully assess whether there is a causal link between the merger and any worsening of competitive conditions, or whether the competitive structure of the market would deteriorate at least to the same extent even without the merger.

Comment 2: Agencies should carefully consider the implications of an allegedly failing firm in the context of the counterfactual analysis. In this regard, agencies should be mindful that there might be more than one relevant counterfactual scenario (*e.g.*, the failing firm's assets exit the market or are bought by a less competitively significant incumbent or a potential new entrant). Consequently, the choice of the appropriate counterfactual could be a complex exercise. In addition, much of the evidence of exit of the allegedly failing firm is in the hands of the merging parties who may advance failing firm claims even when the productive assets would not leave the relevant market, in which case the failure and exit of the firm is not the appropriate counterfactual.

Comment 3: In many cases, a merger involving a failing firm will not in fact raise competition concerns because there are sufficient competitive constraints remaining in the market to prevent significant harm to competition regardless of whether the firm will fail and its assets exit the market in the imminent future. When there are no competition concerns, agencies need not consider whether the conditions of a failing firm have been established.

B. In assessing claims that a merger will not harm competition because one of the merging parties is failing, agencies should determine whether: (a) the firm is unable to meet its financial obligations in the imminent future; (b) there would be no serious prospect of reorganizing the business; (c) there would be no credible less anticompetitive alternative outcome than the merger in question; and, (d) the firm and its assets would exit the market in the imminent future absent the merger.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: In some jurisdictions, consideration of whether a firm is failing is included as part of the competitive effects analysis (for example as part of the counterfactual), while in other jurisdictions the imminent failure of the firm is a formal defence to an otherwise anticompetitive merger. Furthermore, some agencies may require a more exacting standard of proof and some may place the burden on the merging parties to establish the conditions for a failing firm, but a similar substantive analysis applies regardless of the particular method used.

Comment 2: Where a failing firm claim is raised, agencies should carefully review whether the firm in question is truly failing. Many firms, despite temporary difficulties, are able to survive and continue competing. The fact that a firm has not been profitable does not necessarily mean that it is a "failing firm" since accounting losses do not necessarily reflect the true economic losses from ongoing operations, *i.e.*, its fundamental ability to compete effectively in the future. For instance, a firm with a substantial debt may be able to emerge from its financial trouble as an effective competitor through a new business strategy or new management because it possesses valuable assets.

Comment 3: To assess whether the firm is unable to meet its financial obligations, agencies should require merging parties to provide current and historic financial information about the business that is claimed to be failing. This information may include profit and loss and cash flow information, recent balance sheets and analysis of the most recent statutory accounts, the timing and nature of the firm's financial obligations, the relationship between the company's costs and its revenues, the likely ability of the firm to obtain new revenues or new customers, and the current and future availability of key inputs. Agencies should consider whether ordinary course of business documents indicate an imminent financial failure, or whether the claims of failure appear overstated to justify the merger. Prospective financial information should also be requested including forecast information for the current year, ideally forecasts produced either in advance of the proposed transaction or for another purpose and not produced solely for the agency. In most cases, agencies should seek the (in-house or outsourced) assistance of financial and accounting expertise.

Comment 4: To assess whether the failing firm is unable to re-organize itself successfully, agencies should require the merging firms to demonstrate that they have no reasonable corporate restructuring or re-financing options, since even firms in administration[8] often survive and recover. Such evidence might come from board papers or other strategy documents produced by the firm when considering various ways to improve its situation. If the firm is in administration, agencies should consider investigating with the administrator whether there was any serious prospect that the firm could emerge from administration, potentially in a re-organised form.

Comment 5: In assessing whether there is no credible less anticompetitive alternative to the merger, agencies should assess whether the failing firm has unsuccessfully sought in good faith any credible alternative offers of acquisition of the firm or its assets that would both retain the assets in the relevant market and pose less harm to competition than the merger in question. In this regard, agencies should require evidence that there is sufficient awareness regarding the sale of the firm or its assets to attract the attention of likely prospective purchasers. Agencies should consider any offer to purchase the assets of the failing firm above the liquidation value of those assets (net of the costs associated with the liquidation process). The fact that an alternative purchaser's offer is not commercially preferable to that of the merging parties should not lead agencies to disregard the alternative purchaser's offer so long as it is above the asset liquidation value. In addition, some jurisdictions consider whether the failure of the firm and the liquidation of its assets could be a less anticompetitive alternative to the merger since the remaining firms in the market would compete for the failing firm's market share and assets that otherwise would have been transferred wholesale to a single purchaser.

Comment 6: In considering a failing firm claim, agencies also should assess whether the failing firm's assets would exit the market in the imminent future but for the merger in question. If the firm owns important assets whose value is greatest in their current use, these assets are unlikely to exit the market, even if the firm cannot meet its financial obligations in the imminent future. On the other hand, assets that are not economically viable would not be expected to remain in the market unless the acquirer expects the acquisition to generate significant efficiencies that will make the assets economically viable. In such cases, the acquiring firm would acquire the failing firm to benefit from the resulting efficiencies, arising from the merger, rather than from a reduction in competition since the failing firm would leave the market in any event. Such a merger is likely to result in consumer benefits since the competitive outcome with the merger may be better than without the merger.

Comment 7: It may be that there will be more merger cases involving financially troubled firms and, as a result, more failing firm claims in difficult economic times. However, agencies should assess whether the conditions for a failing firm are met in the same way during difficult economic times as during a less challenging economic environment.

[8] The term "administration" is used here as shorthand for the various bankruptcy procedures in place in ICN jurisdictions whereby a company in financial distress is judged insolvent and its property sold or liquidated, or is restructured. These procedures typically involve the appointment of a person to oversee the company's estate on behalf of creditors during the liquidation or the restructuring process, indicated here by the term "administrator." While it is not necessary for a firm to go into administration to qualify as a failing firm, the fact that a firm is in administration is relevant to whether to the firm is unable to meet its financial obligations in the imminent future. Laws governing administration vary across jurisdictions and may consequently restrict the options available to potential acquirers of all or part of a failing firm.

Comment 8: Merging parties may advance claims that a merger will not harm competition on the grounds that one of the merging parties is "flailing", *i.e.*, is in financial distress but does not meet the conditions of a failing firm. If the criteria to establish a failing firm are not met, agencies should appropriately consider these claims in the analysis of competitive effects since the financial weakness of the firm may still be a relevant factor in determining whether the merger is anticompetitive. In such cases, a firm's weakened financial condition may indicate that it is likely to compete less effectively in the future, such that the merger will not substantially lessen competition.

C. In assessing claims that a merger will not harm competition because a division of a firm is failing, agencies may assess whether the following conditions are met: (a) the division has a negative cash flow on an operating basis; (b) the division and its assets would exit the market in the imminent future absent the merger; and, (c) there is no reasonable less anticompetitive alternative outcome than the merger in question.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: In some instances, a merger may involve the acquisition of a failing division (or group of related assets) of an otherwise financially viable company. In such cases, in some jurisdictions the merging parties may claim that the merger will not harm competition significantly because the failing division and its assets will exit the market absent the merger. Such claims may be considered as part of the competitive effects analysis, or as a formal defence to an otherwise anticompetitive merger.

Comment 2: In jurisdictions that consider failing division claims, agencies should apply similar conditions to determining whether a division is failing as would be applied to failing firm claims. However, given factual differences between a failing division and a failing firm, agencies should also be aware that the conditions may need to be applied differently. In assessing failing division claims agencies should be aware of the possibility that, in some cases, the accounting practices of the parent company may create the appearance of a failing division when the division is not in fact failing. The fact that a business division is not currently profitable does not necessarily mean that the division is failing or necessarily that it will exit the market in the imminent future. A division may operate with temporary losses but be able to recover, and even an unprofitable division may be unlikely to exit if it serves an important purpose in the company, such as supporting or developing an important brand or other business line. In addition, it may be difficult to assess the amount of money that the parent company could be expected to invest in the division absent the merger. Therefore, agencies should seek from the merging parties clear evidence demonstrating that, absent the merger, the division is likely to fail and its assets are likely to exit the market in the imminent future.

Comment 3: In assessing whether the failing division has a negative cash flow on an operating basis, agencies should ensure that the correct revenues and costs are considered.

Given the ability of the larger firm to allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, agencies should require supporting evidence not based solely on documents that have been prepared by the merging parties for the purpose of demonstrating negative cash flow or the prospect of exit.