



**THE COMMON MARKET FOR EASTERN AND SOUTHERN
AFRICA, COMESA**



COMESA MERGER ASSESSMENT GUIDELINES

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**PREPARED IN ACCORDANCE WITH THE
COMESA COMPETITION REGULATIONS, 2004**

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DEFINITIONS

Unless otherwise noted herein, the terms used in these Guidelines will have the definitions provided in Article 1 of the Regulations.

“Acquiring undertaking” means an undertaking that as a result of a merger:

- (a) would directly or indirectly acquire, or establish direct or indirect control over the whole or part of the business of another undertaking; or
- (b) has direct or indirect control over the whole or part of the business of the undertaking contemplated in (a).

For purposes of these Guidelines, in the case of a merger resulting in a joint venture, amalgamation or combination, each undertaking which controls the joint venture, or is amalgamated or combined will be considered an acquiring undertaking.

“Commission” means the COMESA Competition Commission.

“Committee” means the committee responsible for initial determinations, under Article 13(4) of the Regulations.

“Competition Rules” means the COMESA Competition Rules.

“Day” means a calendar day. In accordance with rule 3(2) of the Competition Rules, where a period of time prescribed under these Guidelines expires on a Saturday, Sunday or a public holiday in Malawi, such period will be extended to the next day that is not a Saturday, Sunday or a public holiday in Malawi. Delivery of documents to the Commission will only be considered delivered on a given day if delivery is made during the Commission’s business hours.

“Director” means the Director of the Commission appointed by the Council under Article 9 of the Regulations.

“Merged undertaking” means the undertaking(s) that result from the merger of the acquiring undertaking(s) and the target undertaking(s).

“Merging party” means any acquiring undertaking or target undertaking.

“Notifying party” means the party that makes or the parties that jointly make a notification to the Commission. For purposes of these Guidelines, the notifying party must comprise at least one acquiring undertaking and any actions to be taken by or communications made to the notifying party must be taken by or made to all parties that comprise the notifying party.

“Party” means any merging party and, if a merger has been implemented, any merged undertaking.

“Phase 1” means the initial phase of the Commission’s assessment of a merger.

“Phase 2” means the second phase of the Commission’s assessment of a merger.

“Regulations” means the COMESA Competition Regulations.

“Rules on Notification Threshold” means the COMESA Rules on the Determination of Merger Notification Threshold, 2012.

“SPLC” means a substantial prevention or lessening of competition in the Common Market, taking into account any merger-specific efficiencies, or other pro-competitive effects of a merger.

“Target undertaking” means, an undertaking that as a result of a merger:

- (a) the whole or part of whose business would be directly or indirectly controlled by an acquiring undertaking; or
- (b) would directly or indirectly transfer control of the whole or part of its business to an acquiring undertaking.

For purposes of these Guidelines, in the case of a merger resulting in a joint venture, amalgamation or combination, each undertaking which controls the joint venture, or is amalgamated or combined will be considered a target undertaking.

“Treaty” means the Treaty Establishing the Common Market for Eastern and Southern Africa.

“Undertaking” means an undertaking as defined in Article 1 of the Regulations to include “any person, public or private, involved in the production of, or the trade in, goods, or the provision of services.” For purposes of these Guidelines, a person who holds an interest in or in which an undertaking holds an interest will be considered “involved in the production of, or the trade in, goods, or the provision of services,” and hence an undertaking. The Regulations, Competition Rules and the Rules on Notification Threshold also make reference to “firms,” and, for purposes of these Guidelines, such references are considered interchangeable with the term “undertakings.”

OVERVIEW

The purpose of these Guidelines is to provide guidance to parties contemplating or in the process of merging within the Common Market. These Guidelines set out mechanisms for determining whether a transaction is a notifiable merger under the Regulations, the procedural obligations of parties to such a merger, and substantive and procedural elements of a merger assessment.

DISCLAIMER

The information in this publication is for general guidance only. It does not constitute legal advice and should not be relied on as a statement of law. Parties should obtain legal advice if there is doubt about whether any conduct may breach the Regulations. This publication reflects the views of the Commission at the time of publication. As economic theory, legal thinking and best practice develop, the Commission may hence revise the Guidelines from time to time to reflect developments.

CITATION

These Guidelines may be cited as: “The COMESA Merger Assessment Guidelines of 2014.”

SECTION 1

INTRODUCTION

- 1.1 Article 55 of the Treaty provides for the prohibition of any agreement or concerted practice between undertakings, which has as its objective or effect, the prevention, restriction or distortion of competition within the Common Market. It further authorises the Council to: *“make regulations to regulate competition within the Member States.”*
- 1.2 The Regulations made under the Treaty, establish the Commission and empower it to regulate competition in the Common Market. The purpose of the Regulations as stated in Article 2 thereof is: *“to promote and encourage competition by preventing restrictive business practices and other restrictions that deter the efficient operation of markets, thereby enhancing the welfare of the consumers in the Common Market, and to protect consumers against offensive conduct by market actors.”*
- 1.3 The scope of the Regulations’ application is set forth in Article 3. They apply to economic activities *“within, or having an effect within, the Common Market.”* In relation to anticompetitive practices, merger control and consumer protection, the scope of the Regulations extends, under Article 3(2), to conduct having *“an appreciable effect on trade between Member States and which restrict competition in the Common Market.”* However, Article 4 excludes application of the Regulations to certain arrangements for collective bargaining, certain activities of trade unions and professional associations and the direct enjoyment of the privileges and protections conferred by other laws protecting intellectual property provided that the same are not used in a manner that causes anti-competitive effects prohibited by the Regulations.
- 1.4 Merger control is addressed in the Regulations due to the potential of some mergers to affect trade between Member States and restrict competition in the Common Market. The approach is to require notification to and review by the Commission of certain mergers in order to allow the Commission to regulate those that are likely to result in a substantial lessening of competition. Conduct not capable of having an appreciable effect on trade between Member States or restricting competition in the Common Market is outside the scope of the Regulations, including merger control.

SECTION 2

WHAT CONSTITUTES A “MERGER” UNDER THE REGULATIONS

- 2.1 Article 23 of the Regulations defines what a “merger” is and when it is notifiable or non-notifiable. Article 24(1) requires “notifiable mergers,” which are those that have a “regional dimension” and are above a specified “threshold” (as discussed in Section 3), to be notified to the Commission.

DEFINITION OF “MERGER” UNDER THE REGULATIONS

- 2.2 Article 23(1) of the Regulations defines a “merger” as the direct or indirect acquisition or establishment of a controlling interest by one or more persons in the whole or part of the business of a competitor, supplier, customer or other person whether that controlling interest is achieved as a result of:
- (a) the purchase or lease of the shares or assets of a competitor, supplier, customer or other person;
 - (b) the amalgamation or combination with a competitor, supplier, customer or other person; or
 - (c) any means other than as specified in sub-section (a) or (b).
- 2.3 For these purposes, “controlling interest” is defined in Article 23(2) of the Regulations as:
- (a) in relation to any undertaking, any interest which enables the holder thereof to exercise, directly or indirectly, any control whatsoever over the activities or assets of the undertaking; and
 - (b) in relation to any asset, any interest which enables the holder thereof to exercise, directly or indirectly, any control whatsoever over the asset.
- 2.4 As indicated by the phrases “any interest” and “any control whatsoever” in Article 23(2), control can take many forms. These include various types of rights (e.g., property and contract), which may be acquired in one transaction or over the course of several transactions, may be exercised directly or indirectly (e.g., through an undertaking acting as a vehicle), and may be exercised by various means (e.g., voting of securities, management of an undertaking or its assets, or other means).
- 2.5 However, the variety of potential forms of control does not dilute the substantive quality of control itself. The Commission regards “control” as being constituted by rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on the undertaking or asset concerned. Whether or not a person has the possibility of exercising decisive influence on an undertaking or asset concerned should be assessed on a case

by case basis. Regard should be had to the overall relationship between the person and undertaking or asset concerned in light of the commercial context, in particular in relation to the competitive conduct of the relevant business, including its strategic direction and its ability to define and achieve its commercial objectives.

- 2.6 Notwithstanding the generality of Section 2.5, when determining whether a person has the possibility of exercising decisive influence over an undertaking, the Commission will take into account, among other factors, whether the person directly or indirectly:
- (a) has the ability to determine a majority of the votes that may be cast at a general meeting of the undertaking;
 - (b) is able to appoint or to veto the appointment of a majority of the directors of the undertaking;
 - (c) has the ability to determine the appointment of senior management, strategic commercial policy, the budget or the business plan of the undertaking; or
 - (d) has a controlling interest in an intermediary undertaking that in turn has a controlling interest in the undertaking.
- 2.7 Notwithstanding Sections 2.5 and 2.6, the Commission considers that acquisition of non-voting securities does not alone confer the possibility of exercising decisive influence over an undertaking. The Commission will also deem the mere acquisition of a minority interest below 15% of the voting securities of an undertaking, held solely for the purpose of passive investment and without exercising influence over the affairs of the undertaking, as being incapable of conferring the possibility of exercising decisive influence on an undertaking. The Commission will regard these as not constituting a “controlling interest” and as a result not being a “merger.”
- 2.8 In some cases, a minority interest in an undertaking may include certain rights, such as the ability to veto decisions which are essential to determining the strategic commercial behaviour of the undertaking. Any such rights must be considered as a whole to assess whether they amount to a “controlling interest” or not. Such rights will typically not be considered to confer the possibility of exercising decisive influence unless they relate to decisions over the appointment of senior management, strategic commercial policy, the budget or the business plan. Whenever a minority interest in an undertaking is changed, the parties should consider whether the new minority interest amounts to a “controlling interest.” Where the new minority interest amounts to a “controlling interest” a merger is construed.

OTHER MEANS OF CONTROL

- 2.9 Where control over an undertaking or an asset is not established by purchase or lease of shares or assets or by amalgamation or combination but by other means as provided for under Article 23(1)(c) of the Regulations (e.g., upon exit of a shareholder, on a contractual basis or otherwise), such means must confer the possibility of exercising decisive influence similar to that in the case of a purchase or lease of shares or assets for the arrangement to be viewed as a “merger.”
- 2.10 The Commission considers that purely contractual means of control, such as operation under a management services contract, are only capable of conferring the possibility of decisive influence (and so can only be regarded as mergers) if the contracts are of a long duration. Outsourcing contracts will not confer the possibility of exercising decisive influence unless the assets and personnel associated with the service constituting the whole or part of a business (i.e., a business with access to the market, including customers other than the outsourcing customer) are transferred to the outsourcing supplier for a long duration. For purposes of Section 2.10, a long duration is typically five or more years, although the overall package of rights, including those relating to early termination and renewal, should be taken into account. The considerations under Section 2.10 are without prejudice to the application of Part 3 of the Regulations to agreements among undertakings.

JOINT VENTURES

- 2.11 Some joint ventures involve the integration of parts of the business activities of the undertakings to the joint venture, including a contribution of productive assets to the new joint venture. This can result in a reduction or elimination of competition between the undertakings to the joint venture in the joint venture’s field of activity. Whether it does so depends on the relative permanence of the joint venture and the degree of autonomy it enjoys from its parent companies.
- 2.12 For a joint venture to constitute a “merger” within the meaning of Article 23(1) of the Regulations, it must be a “full-function” joint venture. This means that it must perform, for a long duration (for purposes of Section 2.12, is typically 5 or more years) all the functions of an autonomous economic entity, including:
- (a) operating on a market and performing the functions normally carried out by undertakings operating on the same market; and
 - (b) having a management dedicated to its day-to-day operations and access to sufficient resources including finance, staff and assets (tangible and intangible) in order to conduct for a long duration its business activities within the area provided for in the joint-venture agreement.

A joint venture established for a purposefully finite period (e.g., for a major construction project) will not be viewed as having a long duration.

- 2.13 The Commission will consider a joint venture not to be “full-functional” if it only takes over one specific function within the parent companies’ business activities without access to the market. This is the case, for example, for joint ventures limited to research and development or production. Such joint ventures are auxiliary to their parent companies’ business activities. This is also the case where a joint venture is essentially limited to the distribution or sales of its parent companies’ products or services and therefore acts principally as a sales agency. However, the fact that a joint venture makes use of the distribution network or outlet of one or more of its parent companies normally will not disqualify it as full-functional as long as the parent companies are acting only as agents of the joint venture, distributing the products or services of the joint venture itself.
- 2.14 The strong presence of the parent companies in upstream or downstream markets is a factor to be taken into consideration in assessing the full-functional character of a joint venture where this presence leads to substantial sales or purchases between the parent companies and the joint venture. The fact that the joint venture relies almost entirely on sales to its parent companies or purchases from them only for an initial start-up period (e.g., three years) does not normally affect the full-functional character of the joint venture. Such a start-up period may be necessary in order to establish the joint venture on a market. The start-up period depends on the dynamics of the market in question.
- 2.15 If the joint venture sells or is expected to sell more than half of its output to persons other than its parent companies, it will typically be considered to be “full-functional.”

RESTRUCTURING, LIQUIDATION AND OTHER MATTERS

- 2.16 The Commission regards an internal restructuring within a group of undertakings (where one undertaking already controls the other undertaking or the undertakings concerned are ultimately controlled by the same undertaking) as not constituting an acquisition or establishment of a “controlling interest” and so as not being a “merger” for the purposes of the Regulations.
- 2.17 The acquisition of control by a liquidator according to the law of a Member State relating to liquidation, winding up and similar matters will not be treated as a “merger.”
- 2.18 The Commission will not view ownership of an undertaking acquired by an interim buyer with a view to onward sale to an ultimate acquirer within less than one year in the ordinary course of business (e.g., an underwriter of shares in a public offering) as being the acquisition of a “controlling interest” unless the interim owner directly or indirectly exercises decisive influence over the undertaking.
- 2.19 The Commission will consider other transactions entered into solely for financing purposes on a case-by-case basis. Parties may seek pre-notification consultations with the Commission under Section 4 in that regard.

ACQUISITION OF ASSETS

- 2.20 While the object of control may include assets as opposed to shares in an undertaking, the acquisition of control over assets can only be considered a merger in the terms of Article 23(1) if those assets constitute the whole or part of a business. Accordingly, the assets must comprise a business with a market presence to which a market turnover can be clearly attributed.

SECTION 3

TERRITORIAL NEXUS

REGIONAL DIMENSION, APPRECIABLE EFFECT ON TRADE, RESTRICTION OF COMPETITION

- 3.1 Article 24(1) of the Regulations requires “notifiable mergers” to be notified to the Commission. Article 23 of the Regulations sets forth a framework for identifying “notifiable mergers.”
- 3.2 Article 23(5) defines a “notifiable merger” as a merger or proposed merger with a “regional dimension” and that has “a value at or above the threshold” of turnover or assets prescribed by the Commission’s Board under Article 23(4). According to Article 23(3), Article 23 will apply where:
- (a) both the acquiring undertaking and the target undertaking or either the acquiring undertaking or target undertaking operate in two or more Member States; and
 - (b) the threshold of combined annual turnover or assets prescribed by the Board under Article 23(4) is exceeded.
- 3.3 Article 23(4)(a) provides for the Board, subject to approval of Council, to prescribe a threshold of combined annual turnover or assets “in the region” at or above which Article 23 will apply to mergers that have a “regional dimension.”
- 3.4 The Commission’s Board prescribed such threshold with Council approval in the Rules on Notification Threshold, the scope of which is also limited to mergers having a “regional dimension” (Rule 3). According to the Rules on Notification Threshold currently in force, the threshold of combined annual turnover or assets for the purposes of Article 23(4) is exceeded if:
- (a) the combined worldwide aggregate annual turnover or the combined worldwide aggregate value of assets, whichever is higher, of all undertakings to the merger in the Common Market equals or exceeds US \$ zero; and
 - (b) the aggregate annual turnover or the aggregate value of assets, whichever is higher, of each or at least two undertakings to the merger in the Common Market equals or exceeds US \$ zero.
- 3.5 The Commission recalls the Treaty basis for competition regulation in Article 55, which concerns “the prevention, restriction or distortion of competition within the Common Market.” It recalls further that the scope of the Regulations themselves, as also mentioned above, is limited to economic activities “within, or having an effect within, the Common Market” (Article 2(1)) and, in relation to merger control, to conduct having “an appreciable effect on trade between Member States and which restrict competition in the Common Market” (Article 3(2)).

- 3.6 The Commission thus considers that merger control must concern mergers capable of having a “regional dimension” and be carried out with a view to regulating only those capable of having an “appreciable effect on trade between Member States and which restrict competition.”
- 3.7 This implies a dimension which can be appraised by the scale of operations of the merging parties and the number of Member States involved. It is reasonable to limit the Commission’s review to conduct capable of having effects of a certain magnitude within the COMESA region. Conduct falls outside the scope of application of the Regulations, and so is not subject to merger control review, when it affects the market only insignificantly having regard to the weak position of the undertakings concerned on the market for the products or services in question. Sections 3.8 through 3.12 explain the application of this scope limitation to the “regional dimension” of a merger.
- 3.8 As noted above, Article 23(3)(a) of the Regulations requires both the acquiring undertaking and target undertaking or either of them to “operate” in two or more Member States for Article 23 to apply.
- 3.9 The Commission considers that an undertaking only “operates” in a Member State for purposes of Article 23(3)(a) of the Regulations if its operations in that Member State are substantial enough that a merger involving it can contribute to an appreciable effect on trade between Member States and restriction on competition in the Common Market. For these purposes, the Commission considers that an undertaking “operates” in a Member State if its annual turnover or value of assets in that Member State exceeds US \$5 million.
- 3.10 The Commission regards Article 23(3)(a) as reflecting the supra-national nature of the Commission’s jurisdiction so that to justify resorting to the jurisdiction of the Commission (rather than of a competent national authority), at least one merging party must operate in at least two Member States. The Commission thus views Article 23(3)(a) as setting out affirmative conditions that are necessary but alone not sufficient for a merger to be notifiable. In particular, the Commission considers that where no target undertaking operates in any Member State in the Common Market, a merger between them does not have sufficient regional dimension or effect on trade between Member States or restriction on competition in the Common Market to establish a territorial nexus at the supra-national level, and is therefore not a “notifiable merger.”
- 3.11 The Commission also considers that there will not be an appreciable effect on trade between Member States and restriction on competition within the Common Market, and a merger will not be a notifiable merger, if more than 2/3 of the annual turnover or value of assets in the Common Market of each of the merging parties is achieved within one and the same Member State.
- 3.12 To summarize the preceding sections, a merger will be notifiable to the Commission only if:

- (a) at least one merging party operates in two or more Member States (an undertaking “operates” in a Member State if it has annual turnover or value of assets in that Member State exceeding US \$5 million);
- (b) a target undertaking operates in a Member State;
- (c) it is not the case that more than 2/3 of the annual turnover or value of assets in the Common Market of each of the merging parties is achieved or held within one and the same Member State.

3.13 The merging parties should note that when a merger is not notifiable to the Commission, the merging parties may be subject to notification requirements of national competition authorities of Member States under national competition laws.

CALCULATION OF TURNOVER AND ASSETS

3.14 The Commission considers that the scale of a merger in terms of turnover or assets of the merging parties is a useful indicator of the importance of the merger for the purposes of determining whether it should be subject to review or not. As undertakings involved in larger scale mergers that are likely to have an appreciable effect on trade or restrict competition are often part of groups of companies involved in the same business, and such groups act on the market as a whole under common control, the Commission considers it appropriate to have regard to the group as opposed to merely the individual undertakings concerned when considering the scale of a merger. This is particularly relevant given the extensive use of special purpose vehicles and holding entities within groups, as well as intercompany transfers and asset ownership structures serving financial purposes. The Commission also considers there to be advantages in providing for a reasonably straightforward method of identifying the undertakings whose turnover and assets should be counted for the purposes of these Guidelines. It therefore applies a more “bright line” approach to identifying these undertakings than is used in Section 2 when defining “controlling interest” for the purposes of determining whether or not a transaction constitutes a merger.

3.15 For the purpose of these Guidelines, annual turnover and value of assets of an undertaking will be calculated by adding together, respectively, the annual turnover and value of assets in the Common Market of the following:

- (a) the undertaking concerned;
- (b) its subsidiaries, meaning those undertakings in which the undertaking concerned has, solely or jointly with one or more persons, the rights or powers set forth in Section 2.6(a), (b) or (c), together with the subsidiaries of those subsidiaries, and so on;
- (c) its parents, meaning those undertakings of which the undertaking concerned is a subsidiary (as such term is used in (b)), together with the parents of those parents, and so on; and

(d) other subsidiaries of its parents not included in (b).

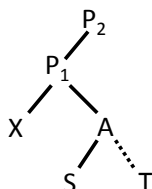
3.16 Notwithstanding Section 3.15, the annual turnover and value of assets of a target undertaking will not, for the purposes of these Guidelines, include the annual turnover or value of assets of its parents (under Section 3.15(c)) and its parents other subsidiaries (under Section 3.15(d)) where, after the merger is implemented, such parents are not parents of (i) the target undertaking if it remains after the merger, or (ii) the merged undertaking in the case of an amalgamation or combination.

3.17 Where an undertaking has a Member State or a state-owned enterprise of a Member State as its parent, the annual turnover and value of assets of the Member State will not be included for purposes of Section 3.15(c). To the extent, but only to the extent, that the undertaking concerned or any of its parents are subject to co-ordination, and controlled under the same independent centre of decision-making, with other subsidiaries of the Member State, the annual turnover and value of assets of such subsidiaries will be included for purposes of Section 3.15(d).

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

3.19 Various illustrative examples of which turnover and assets to count are set out below:

Example 1

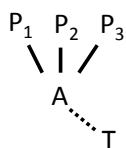


Acquirer A acquires target T. A is wholly owned by parent P₁, which is wholly owned by its parent P₂. P₁ also owns the majority of X. A owns the majority of subsidiary S.

Turnover to be taken into account is: A and T as the undertakings concerned; P₁ as parent of A and P₂ as parent of P₁; X as subsidiary of P₁; and S as subsidiary of A.

The selling parent of T and any subsidiaries of such parent are disregarded because A is acquiring T only.

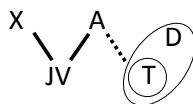
Example 2



A acquires T. A is jointly held by parents P₁, P₂ and P₃, in that they all have to agree on appointment of directors.

Turnover to be taken into account is: A and T as the undertakings concerned; and P₁, P₂ and P₃ as parents of A.

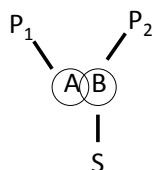
Example 3



A acquires T, a division (i.e., assets comprising a market facing business) of seller D. A jointly controls JV on a 50/50 basis with X.

Turnover to be taken into account is: A and turnover attributable to T as the undertakings concerned (disregard the turnover of D that is not attributable to T); and JV as subsidiary of A.

Example 4



A and B merge to form a single surviving entity. A is wholly owned by P₁ which will hold 90% of surviving entity after the merger. B is wholly owned by P₂ which will hold 10% of surviving entity. S is wholly owned by B, and will be wholly owned by surviving entity.

Turnover to be taken into account is: A and B as the undertakings concerned; S as subsidiary of surviving entity; and P₁ as parent of surviving entity. P₂ is disregarded because it will not qualify as a parent of the surviving entity.

- 3.20 Annual turnover will comprise turnover in the most recent financial year, and the value of assets will comprise the value of assets as at the end of the most recent financial year.
- 3.21 Annual turnover will not include amounts derived from the sale of products or the provision of services between any of the undertakings referred to in Section 3.15.
- 3.22 Geographically, turnover should be attributed to the place where the customer is located, which is typically the place where the service is actually provided or product is actually delivered, whether directly to the customer or indirectly through agents or traders.
- 3.23 While the value of assets of an undertaking will include the value of assets of its subsidiaries under Section 3.15(b), it will not include the value of shares held or interests in another undertaking.
- 3.24 Where an undertaking prepares its financial statements in a currency that is not the United States Dollar, its turnover for a financial year and value of assets at the end of a financial year should be converted to United States Dollars according to the average, over the twelve months of that financial year, of the foreign exchange rate reported by the Central Bank where such currency is issued.
- 3.25 Subject to Sections 3.15 through 3.24, annual turnover and the value of assets will be calculated for the purposes of these Guidelines pursuant to Generally Accepted Accounting Principles.
- 3.26 The Commission may, in the calculation of turnover or value of assets of the merging parties, approach the Revenue Authorities of the Member States concerned.

SECTION 4

PRE-NOTIFICATION CONSULTATION AND COMFORT LETTERS

PRE-NOTIFICATION CONSULTATION

- 4.1 To ensure that it completes its merger assessment in the quickest possible manner and to avoid unnecessary notifications, the Commission will allow for pre-merger notification consultations with the parties. Such consultations may take place in person, by phone, or by any other means the Commission determines to be appropriate to enable the parties and the Commission to clarify matters such as:
- (a) whether or not a transaction is a merger;
 - (b) whether or not a merger is required to be notified;
 - (c) the calculation of annual turnover, value of assets, market shares, the merger notification filing fee and other matters;
 - (d) information to be supplied in a comfort letter request;
 - (e) the requirements of Form 12 and unavailability of required information; and
 - (f) requests for confidential treatment of information or documents.

COMFORT LETTERS

- 4.2 An acquiring party may, alone or jointly with other parties, request a comfort letter determining that a merger is not a notifiable merger because it would not have an appreciable effect on trade between Member States or restrict competition in the Common Market.
- 4.3 Such party or parties may submit to the Commission a reasoned request for such a comfort letter. The request should include any information and supporting documents that the parties believe is necessary for the Commission to evaluate the request and parties are encouraged to consult with the Commission on its form and contents. The request must be received no later than 30 days after the merging parties' decision to merge as such date is interpreted in Section 5.1. Sections 5.7 through 5.12 relating to requests for confidential treatment of notifications apply also to comfort letter requests. The Commission will, if requested, keep confidential the fact that a comfort letter request has been made, unless such comfort letter request is deemed a notification in accordance with Section 4.8(a).
- 4.4 In evaluating a comfort letter request, the Commission will take into account the facts and circumstances of the merger, including without limitation the combined annual turnover or value of assets in the Common Market of the merging parties.

- 4.5 As described in Section 3.11, the Commission will regard a merger as not being capable of having an appreciable effect on trade between Member States or restricting competition in the Common Market (and so not requiring notification) if more than 2/3 of the annual turnover or value of assets in the Common Market of each of the merging parties is achieved within one and the same Member State.
- 4.6 Within 21 days after receipt of the comfort letter request, the Commission will:
- (a) provide the requesting party or parties with a comfort letter stating that no merger notification to the Commission is required (which will not prejudice whether or not notification to any Member State authorities may be required);
 - (b) advise the requesting party or parties of any further information or documents reasonably required, and fix a period for submission of such information or documents; or
 - (c) inform the requesting party or parties that a merger notification to the Commission is required.
- 4.7 Within 14 days after receiving the information or documents requested in Section 4.6(b), the Commission will respond to the requesting party or parties in accordance with 4.6(a) or (c). If at the end of the period fixed in Section 4.6(b) the information and documents requested are not provided to its satisfaction, the Commission will not be obligated to further respond.
- 4.8 If the Commission informs the requesting party or parties that a merger is required to be notified under Section 4.6(c), then
- (a) Unless the parties that submitted the comfort letter request notify the Commission within 14 days that they do not wish to submit a notification, the submission of the comfort letter request to the Commission will be deemed submission of a notification under Section 5.4 as of the date on which the comfort letter request was submitted;
 - (b) the party or parties that submitted the comfort letter request will be considered the notifying party for purposes of these Guidelines; and
 - (c) the notifying party will be required within 30 days to supplement the comfort letter request by submitting a completed Form 12 and all supporting documents in accordance with the requirements of Section 5.4 or be deemed to have failed to make a timely notification.
- 4.9 If the Commission provides a comfort letter in reliance on a material misstatement or omission in information or documents provided with a comfort letter request, it may take such actions as are within its powers, including where appropriate by:
- (a) revoking the comfort letter;

- (b) finding the parties to have failed to notify the Commission of a notifiable merger;
- (c) finding the parties to have carried out a merger in contravention of Part 4 of the Regulations; or
- (d) exercising the Commission's powers under such Part, including but not limited to Article 24 of the Regulations.

SECTION 5

NOTIFICATION PROCESS

TIMING OF NOTIFICATION

- 5.1 Article 24(1) of the Regulations requires notification of notifiable mergers no later than 30 days after the merging parties' "decision to merge." The Commission considers that a decision to merge must either be (i) a joint decision taken by the merging parties and so comprise the conclusion of a definitive, legally binding agreement to carry out the merger (which may or may not be subject to conditions precedent), or (ii) the announcement of a public bid in the case of publicly traded securities.
- 5.2 For the purposes of compliance with the 30-day deadline in Article 24(1), a notification will be deemed to have been made when it has been submitted in accordance with Section 5.4 (including any deemed submission under Section 4.8(a)) so long as payment of the notification fee is subsequently received in accordance with Sections 5.16 and 5.18.

FORM OF NOTIFICATION AND PROCEDURE FOR SUBMISSION

- 5.3 A merger notification must be made by the notifying party on the prescribed Form 12, and include the information and all supporting documents requested therein.
- 5.4 Notifications must be made either by email to the Commission's prescribed email address attaching or otherwise providing effective electronic access to Form 12 and all supporting documents in PDF format and including the email addresses of each party comprising the notifying party or submitting an electronic version of the Form 12 and all supporting documents in PDF form on CD or DVD-ROM format. The notification will be deemed submitted upon receipt of such email or CD or DVD by the Commission. *One hard copy of the Form 12 and all supporting documents should be sent to the Commission within seven (7) days thereafter.* If there are any discrepancies between the two formats of the notification, the version received by email or CD/DVD will control.
- 5.5 No later than 7 days after a notification is deemed submitted (or in the case of a comfort letter request that is deemed submission of a notification under Section 4.8(a), after the date the notifying party submits Form 12 in accordance with Section 4.8(c)), the Commission will:
- (a) publish on its website the fact of the notification, indicating the parties, their country of origin, the nature of the merger and the economic sectors involved; and
 - (b) send to each Member State in which any of the merging parties operates a summary of the merger including relevant information provided in the notification.

- 5.6 The notifying party may request in writing that the Commission accept a notification omitting certain information required by Form 12 if such information is not reasonably available (e.g., because of the unavailability of information on a target undertaking during a contested bid), so long as the notifying party provides reasons for the unavailability of the information and provides the estimated date when it expects to have access to such information, and its best estimates with respect to the content of such information (to the extent such estimates are possible) together with the sources for such estimates.

CONFIDENTIAL INFORMATION

- 5.7 The notifying party may request that any documents or information submitted be treated as confidential by submitting a reasoned request for confidentiality in Form 2. Parties may consult with the Commission prior to notification regarding such a request.
- 5.8 If the Commission determines that disclosure of such information or documents or parts thereof would likely result in disclosure of business secrets, destruction or appreciable diminution of the commercial value of any information or cause serious injury, it will confirm within a reasonable time to the notifying party that the Commission will treat such information or documents as confidential and not disclose them publicly. To the extent that the Commission refers to confidential information in its decisions, it will respect the confidential nature of such information by redacting it.
- 5.9 The notifying party should not make blanket requests for confidential treatment, as these will be rejected. The notifying party should make requests relating to specific documents or information and provide the related reasons for the request. Such reasons should be detailed, in particular showing the nature and materiality of the harm that will result from public disclosure in order to convince the Commission of the importance of confidential treatment.
- 5.10 If a notifying party requests confidential treatment of information or documents submitted with but not required by Form 12, the Commission will, prior to publishing such information, allow it the opportunity to withdraw such information from its submissions. If the notifying party elects to do so, the Commission will not rely on or disclose such information.
- 5.11 Examples of business secrets include strategies for pricing, marketing and product differentiation, cost structures and other factors conferring a competitive advantage. Examples of the appreciable diminution of commercial value of information include disclosure of computer algorithms, scientific formulas, and trade secrets generally.
- 5.12 The Commission will only disclose information or documents designated as confidential pursuant to Section 5.8 to a Member State or authority of a Member State or any other nation where such Member State or authority is obligated to respect the confidentiality of such information or documents.

NOTIFICATION FEE

- 5.13 As set forth in rule 55 of the Competition Rules, as amended, the fee for notification of a merger is currently set at 0.5% or US \$500,000 or whichever is lower of the combined annual turnover or combined value of assets in the Common Market, whichever is higher.
- 5.14 The Commission will calculate the fee under rule 55 as follows:
- (a) The Commission will first calculate 0.5% of the higher of the combined annual turnover and the combined value of assets of the merging parties.
 - (b) The fee will be the lower of US \$500,000 and the amount calculated in (a).
- 5.15 The Commission will calculate the notification fee and issue an invoice to the notifying party no later than seven (7) days after a notification is deemed submitted under Section 5.4. In the case of a comfort letter request that is deemed submission of a notification under Section 4.8(a), the Commission will calculate the fee and issue the invoice no later than seven (7) days after the date the notifying party submits Form 12 in accordance with Section 4.8(c). Even if issued earlier, an invoice will not be effective until after a notification is deemed submitted or, in the case of a comfort letter request that is deemed submission of a notification under Section 4.8(a), after the date the notifying party submits Form 12 in accordance with Section 4.8(c).
- 5.16 Notwithstanding Section 5.15, if the Commission requires additional information from the parties to calculate the notification fee, it will request such information from the notifying party, fix a time limit for submission of such information and calculate the notification fee and issue an invoice to the notifying party no later than seven (7) days after the information is received. If a notification has already been submitted, or in the case of a comfort letter request that is deemed submission of a notification under Section 4.8(a), Form 12 has already been submitted in accordance with Section 4.8(c), failure of the notifying party to submit such information within such period may be deemed a failure to make a timely notification.
- 5.17 Fee payment must be received within seven (7) days after the date on which the invoice is issued, or if later, seven (7) days after the invoice becomes effective.
- 5.18 Under rule 55 of the Competition Rules, a fee payment will be deemed to be received by the Commission on:
- (a) the date that a cheque or money order in payment of that fee is delivered to the Commission (provided that the payment clears within 14 days after presentation); or
 - (b) the date that a direct deposit or an electronic transfer of funds in the amount of that fee is credited to the account of the Commission.

COMPLETION OF NOTIFICATION

- 5.19 A notification will be deemed complete on the date when all of the information and supporting documents required under Form 12 are received by the Commission, subject to any omissions permitted under Section 5.6. Within 14 days after a notification is deemed submitted (or in the case of a comfort letter request that is deemed submission of a notification under Section 4.8(a), after the date the notifying party submits Form 12 in accordance with Section 4.8(c)) and the merger notification fee is received, the Commission will examine the merger notification for completeness and either:
- (a) issue a certificate of receipt to the notifying party confirming that the Commission has received a complete notification and Phase 1 has commenced as of the date the Commission received a complete notification; or
 - (b) advise the notifying party that the notification is incomplete, identify any omitted information or documents and fix a time limit for submission of such information or documents.

Within 14 days after receipt of the further information and documents requested in (b), the Commission will issue the certificate described in (a) or make additional requests as described in (b). Confirmation to the notifying party under (a) will not prejudice the Commission's power to request additional information or documents during its review of the merger.

- 5.20 So long as the notifying party complies with the time limits set forth under 4.8 and 5.19(b), as applicable, in providing information and documents, then the fact that such information or documents are provided later than 30 days after the merging parties' decision to merge will not constitute late submission of the notification for purposes of Article 24(1) of the Regulations. The Commission will not consider a notification to have been submitted if the notifying party fails to provide such information or documents requested.
- 5.21 If a merger is notified to the Commission and the Commission subsequently determines that notification was not required under the Regulations, it will inform the notifying party and arrange for the return of any notification fee paid no later than 30 days thereafter. Such improper notification will not relieve the parties of any obligation under applicable national laws to submit notifications to any Member State authorities.

ABANDONMENT OF MERGER

- 5.22 Under rule 56 of the Competition Rules, after a merger is notified but prior to implementation, the notifying party may notify the Commission in writing that it has abandoned the merger and has no intention to implement it. Upon receipt of such notification:

- (a) the merging parties will remain in the same position as if the merger had never been notified; and
- (b) any merger notification fee paid to the Commission will not be refunded.

REFERRAL TO MEMBER STATE AUTHORITIES

- 5.23 Pursuant to Articles 24(8) and 24(9) of the Regulations, a Member State may request the Commission to refer a merger to a competent authority of the Member State for consideration under the Member State's national competition law if such Member State is satisfied that the merger, if carried out, is likely to disproportionately reduce competition to a material extent in such Member State or any part of such Member State.
- 5.24 In order to ensure orderly administration of referral requests and to allow the Commission to make referral determinations before it expends substantial resources on its own review (which is also subject to a time limit), Member States should make referral requests within 14 days after receiving the information from the Commission pursuant to Section 5.5(b).
- 5.25 Within seven (7) days after receiving a referral request from a Member State, the Commission will publish on its website the fact that it has received such referral request, including which part of the merger is requested to be referred and the reasons provided for the request. Interested parties may make reasoned submissions to the Commission within seven (7) days after such publication regarding whether or not it should refer the whole or any part of the merger to the Member State authority.
- 5.26 Within 21 days after receiving a referral request from a Member State, the Commission will, pursuant to Article 24(9) of the Regulations, make a decision and inform the Member State as to whether it will:
- (a) deal with the case itself in order to maintain or restore effective competition in the market concerned and the region as a whole; or
 - (b) refer the case in whole or in part to the competent authority (or authorities) of the Member State with a view to the application of such Member State's national law.
- 5.27 In making its decision on a referral request, the Commission will consider whether the Member State authority to which the Commission is considering referring the merger is the most appropriate authority for dealing with it, taking into account, without limitation:
- (a) the disproportionality and materiality of any potential reduction of competition within that and other Member States (provided that such consideration at this stage will not prejudice any assessment, whether by

the Commission or a Member State's competent authority, of the effect of the merger on competition);

- (b) the sufficiency of the Member State's merger control system, including legal powers and expertise, in that Member State to assess and regulate mergers with a view to preventing an SPLC or its equivalent; and
- (c) the administrative implications of the requested referral, including the risk of delay, fragmentation, duplication and incoherent treatment by multiple authorities.

5.28 The Regulations do not prevent the merging parties from implementing mergers before notification or the completion of an assessment (as discussed further in Sections 5.31 through 5.32). The Commission considers that the parties to an implemented merger notified in accordance with the Regulations and these Guidelines should not, upon referral to a Member State authority, be penalised for having implemented the merger or not previously notifying such authority. The Commission will therefore only refer a merger to a Member State authority that requires notification and assessment of a merger prior to implementation if such authority undertakes in its referral request not to impose penalties on the parties or prejudice its review of the merger due to the implementation of the merger prior to the publication under Section 5.25.

5.29 The Commission will publish its decisions on referral requests on its website within seven (7) days after issuing the decision to the Member State.

5.30 If a merger is wholly or partly referred to a Member State authority, the merger will be subject to that Member State's Competition Law. As regards the notification fee, the concerned Member State shall receive its portion of the filing fee in accordance with rule 8 on Revenue Sharing of Merger Filing Fees under Part 4 of the Regulations.

EFFECT OF FAILURE TO NOTIFY AND IMPLEMENTATION OF MERGERS

5.31 Article 24 of the Regulations provides that any notifiable merger that is carried out in contravention of the merger control part of the Regulations will have no legal effect and no rights or obligations imposed on the parties by any agreement in respect of the merger will be legally enforceable in the Common Market. The same Article empowers the Commission to impose penalties for non-compliance.

5.32 The Regulations do not prohibit the parties from implementing a notifiable merger before making a notification or before the Commission issues a decision declaring that it does not object to the merger. However, parties should be cautious when implementing a notifiable merger before receiving such a decision. If upon review the Commission determines that such a merger is unlawful under Article 26(7) of the Regulations, the parties may be required to dissolve the merger or take steps as may be determined by the Commission under the Regulations to make the merger lawful.

5.33 The Commission hereby provides a grace period for parties who failed to notify the Commission of a notifiable merger in accordance with the Regulations after the Commission became operational on 14 January 2013. The Commission will not take disciplinary or enforcement action against such parties on the basis of the lateness of the notification if they submit a notification in respect of the merger in accordance with these Guidelines within 90 days after their date of publication. Parties seeking guidance in relation to such matters should contact the Commission and may do so initially on an anonymous basis.

SECTION 6

ASSESSMENT OF THE MERGER

GENERAL

- 6.1 The Commission will assess each merger notified to the Commission to determine whether it is more likely than not to give rise to an SPLC. At the end of its assessment, the Commission will issue a decision declaring either that it does not object to the merger, which may be subject to certain conditions, or that it objects to the merger.
- 6.2 As required under Article 25(1) of the Regulations, the Commission will make a decision on a merger within 120 days after receiving the notification. Such period will commence on the date on which a complete notification has been received by the Commission.
- 6.3 Pursuant to Article 25(2) of the Regulations, the Commission may extend the periods of Phase 1 and Phase 2 with the approval of the Board so long as all such extensions do not cumulatively exceed 30 days. The Commission will provide prior notice of an extension to the notifying party.
- 6.4 At any time during an assessment, the Commission may request information, documents or other evidence from any party and fix a reasonable period for such information or documents to be delivered to the Commission. If the information, documents or other evidence is not received within such period, the Commission may, with approval of the Board and notice to the notifying party, take any of the following actions:
- (a) suspend the period of the applicable assessment phase until such information or documents are received; or
 - (b) assess the merger in light of such submissions and proposals received but draw an adverse inference in light of the failure to provide such information, documents or other evidence.
- 6.5 When submitting evidence of a technical nature to the Commission, including survey evidence or econometric estimates, parties will include any necessary data, descriptions of methodology and algorithms to enable the Commission to assess and replicate their analysis. The Commission may undertake its own econometric analysis (either in the light of analysis produced by the parties or of its own accord) at any time, but is more likely to do so in Phase 2.
- 6.6 As part of its assessment of a merger, the Commission will consider submissions of interested parties that are received:
- (a) in the case of Phase 1, within 21 days after the publication referred to in Section 5.5; and

- (b) in the case of Phase 2, within 30 days after the publication of its decision under Section 6.11.

6.7 In each phase of its assessment of a merger, the Commission will:

- (a) inform the parties of its concerns regarding the merger;
- (b) permit the parties a reasonable opportunity to propose modifications to the merger or any prohibitions, restrictions or other conditions to be placed on the merger to address the Commission's concerns; and
- (c) assess the merger in light of such proposals received.

PHASE 1

6.8 Phase 1 will commence on the first day of the 120-day review period set forth in Section 6.2 and will expire no later than 45 days thereafter (subject to any extensions under Section 6.3 and suspensions under Section 6.4).

6.9 If during Phase 1, the Director determines that on the balance of probabilities:

- (a) the notifiable merger is not more likely than not to give rise to an SPLC, and
- (b) there are no reasonable grounds for believing that additional evidence could be obtained or further assessment made in Phase 2 which could lead the Director to reverse or significantly improve the Director's confidence in his/her determination,

then, before the expiration of Phase 1, the Commission will issue to the notifying party and publish on its website a decision declaring that it does not object to the merger.

6.10 A decision under Sections 6.9 not to object to a merger may be conditioned upon one or more parties implementing modifications to the merger or observing prohibitions, restrictions or other conditions specified in the decision. Such conditions may only address competition issues raised by the merger. If the Commission subsequently determines that one or more parties failed to comply with any such conditions, it may issue a decision declaring that it objects to the merger and including any of the orders under Section 6.18.

6.11 If during Phase 1, the Director determines that on the balance of probabilities:

- (a) the merger is more likely than not to give rise to an SPLC, or
- (b) there are reasonable grounds for believing that additional evidence could be obtained or further assessment made in Phase 2 which could lead the Director to reverse or significantly improve the Director's confidence in his/her determination,

then before the expiration of Phase 1, the Commission will issue to the notifying party and publish on its website a decision to proceed to Phase 2, whereupon Phase 1 will immediately expire and Phase 2 will commence the following day.

6.12 If upon the expiration of Phase 1 the Commission has failed to:

- (a) issue a decision under Sections 6.9; or
- (b) notify the notifying party that the notification was improper under Section 5.21;

and the merger has not been wholly referred to a Member State authority under Article 24(9) of the Regulations, then the Commission will be deemed to have issued a decision under Section 6.9 declaring that it does not object to the merger, or any part of it that has not been referred to a Member State authority under Article 24(9) of the Regulations.

PHASE 2

6.13 Phase 2 will commence as provided in Section 6.11 and will continue until the end of the 120-day review period set forth in Section 6.2 (subject to any extensions under Section 6.3 or suspensions under Section 6.4.).

6.14 During Phase 2, the Director will submit a report to the Committee setting out the economic and legal arguments as to whether the merger is more likely than not to give rise to an SPLC.

6.15 Prior to the end of Phase 2, the Commission will issue to the notifying party and publish on its website a decision as follows:

- (a) Where in light of the report of the Director in Phase 2 the Committee determines that on the balance of probabilities the merger is not more likely than not to give rise to an SPLC, the Commission's decision will declare that it does not object to the merger; or
- (b) Where in light of the report of the Director in Phase 2 the Committee determines that on the balance of probabilities the merger is more likely than not to give rise to an SPLC, the Commission's decision will declare that it objects to the notifiable merger and may include any of the orders set forth in Section 6.18.

6.16 A decision under 6.15(a) not to object to a merger may be conditioned upon one or more parties implementing modifications to the merger or observing prohibitions, restrictions or other conditions specified in the decision. Such conditions may only address competition issues raised by the merger. If the Commission subsequently determines that one or more parties failed to comply with any such conditions, it may issue a decision declaring that it objects to the merger and including any of the orders under Section 6.18.

- 6.17 If on the expiration of Phase 2 the Commission has failed to issue a decision to the notifying party under Section 6.15, then the Committee will be deemed to have issued a decision declaring that it does not object to the merger under Section 6.15(a).

ORDERS OF THE COMMISSION

- 6.18 As contemplated in Article 26(7) of the Regulations, if the Commission issues a decision declaring that it objects to the merger, it may, as part of such decision or subsequently, issue an order:
- (i) declaring the merger unlawful, except to such extent and in such circumstance as may be provided by or under the order;
 - (ii) prohibiting or restricting the acquisition by any person named in the decision of the whole or part of an undertaking or the assets of an undertaking, or the doing by that person of anything which will or may result in such an acquisition if the acquisition is likely, in the Commission's opinion, to lead to a merger;
 - (iii) requiring any person to take steps to secure the dissolution of any organization, whether corporate or unincorporated, or the termination of any association where the Commission is satisfied that the person is concerned in or is a party to a merger;
 - (iv) requiring that if any merger takes place, any party thereto who is named in the order will observe such prohibitions or restrictions in regard to the manner in which it carries on business as are specified in the order; or
 - (v) generally making such provisions as, in the opinion of the Commission, are reasonably necessary to terminate or prevent the merger or alleviate its effects.

APPEALS

- 6.19 Under Article 26(12) of the Regulations, any person aggrieved by the decision of the Commission will have the right to appeal to the Board.
- 6.20 An appeal to the Board must be submitted to the Commission within 30 days after the publication of the decision. An appeal may not rely on or include any document or information that was not already before the Commission in its review of the merger unless such document or information was not reasonably available during the merger review.
- 6.21 Within 14 days after receipt of an appeal to the Board, the Commission will publish on its website:
- (a) the names of the parties to the appeal;

- (b) a reference to the decision which is being appealed; and
 - (c) a copy of the appeal to the Board, as submitted.
- 6.22 Interested parties and the Commission may make reasoned submissions relating to the appeal within 30 days after the date of publication under Section 6.21.
- 6.23 In evaluating an appeal, the Board will have all necessary powers granted to the Commission in the Competition Rules to request information or documents, conduct investigations, hold hearings or take any other reasonable action to enable it to evaluate the appeal.
- 6.24 The Commissioners forming the Committee that made the decision will not participate in the deliberations or decision making of the Board when considering such an appeal.
- 6.25 The Board will issue a decision on the appeal within 90 days after the date of publication under Section 6.21. The Commission will publish such decision on its website within 7 days after its issuance. The decision will also subsequently be published in the Board's official publication in accordance with Rule 28 of the Competition Rules.
- 6.26 If the Board annuls the whole or part of a Commission decision, subject to the conditions of any annulment, the Commission will re-examine the merger in light of then-prevailing market conditions. It may require the notifying party to amend and restate or supplement the original notification where the original notification becomes incomplete or erroneous. Where there are no such changes, the notifying party will certify this fact without delay. The Commission will complete such re-examination within 45 days after receipt of such certification or the amended and restated or supplemented notification.

SECTION 7

MERGER ASSESSMENT CONSIDERATIONS

SUBSTANTIAL PREVENTION OR LESSENING OF COMPETITION

- 7.1 The objective of the Commission's merger policy is to promote and encourage effective competition ultimately in order to enhance consumer welfare (see Section 1.2 above).
- 7.2 Most mergers do not harm competition. Indeed, mergers often result in pro-competitive effects, such as reduced costs and the introduction of new and improved products or services. Such mergers typically benefit consumers.
- 7.3 However, in some circumstances mergers can substantially weaken the incentives of undertakings to engage in competition. Such mergers may result in higher prices, lower output, reduced variety or reduced innovation and will therefore likely lead to an adverse effect on consumers. Such mergers give rise to an SPLC.
- 7.4 The purpose of merger control and the procedures set forth in these Guidelines is to ensure there is an opportunity to prevent or impose appropriate conditions on mergers that are more likely than not to give rise to an SPLC (which is likely to be a relatively small number) while minimising the barriers to implementation of mergers that are not more likely than not likely to give rise to an SPLC (which is likely to be the vast majority of mergers).
- 7.5 In assessing whether a merger is more likely than not to give rise to an SPLC, the Commission will consider both the magnitude and likelihood of the pro-competitive and anti-competitive effects of the merger.

THEORIES OF HARM AND EFFICIENCIES

- 7.6 The Commission will seek to understand the commercial rationale for the merger from the perspective of each of the parties. It will request background, documentary evidence from the parties, including board papers and planning documents, so as to better understand how the transaction fits within each party's wider commercial strategies and in particular within the future strategy of the merged undertaking. In order to assess whether the merger is more likely than not to give rise to an SPLC, the Commission will use an analytical framework, referred to as "theory of harm," in which the likely effects of the merger will be considered against a counterfactual scenario, which describes the competitive situation absent the merger under consideration.
- 7.7 For some mergers, the Commission may consider several theories of harm, sometimes relevant to the same market. However, consideration of multiple theories of harm does not detract from the essential proposition that the Commission must determine whether, overall, it believes that a merger is more likely than not to give rise to an SPLC.

- 7.8 An important part of the commercial rationale for the merger may be potential efficiencies stemming from the merger. In such cases, the Commission may take into account substantiated claims of efficiencies in the assessment. It must be established, on the basis of evidence to the requisite standard, that such efficiencies will be significant, timely, specific to the relevant merger, and sufficiently passed through to customers.

THE “COUNTERFACTUAL” AND THE COMMISSION’S APPROACH

- 7.9 Determining whether a merger is more likely than not to give rise to an SPLC requires a comparison of the competitive situation in light of the merger against the competitive situation without the merger. The latter is called the “counterfactual” scenario.
- 7.10 The nature of the counterfactual is affected by the extent to which events or circumstances and their consequences are foreseeable. The foreseeable period can sometimes be relatively short. However, the Commission may still consider the effects of the merger in the context of an event or circumstance occurring even if that event or circumstance is not sufficiently foreseeable to include in the counterfactual.
- 7.11 Future changes in market conditions, such as regulation or market liberalisation, are often addressed as part of the Commission’s competitive assessment and may affect both the counterfactual and the merger scenarios. However, counterfactual and merger scenarios cannot be constructed to include violations of competition law, such as the effects of a prohibited cartel.
- 7.12 Because the counterfactual may be more or less competitive than the prevailing conditions of competition, the selection of the appropriate counterfactual may increase or reduce the prospects of a finding by the Commission that a merger is more likely than not to give rise to an SPLC.
- 7.13 In practice, the Commission often adopts the prevailing conditions of competition (or the pre-merger situation in the case of implemented mergers) as the counterfactual against which to assess the impact of the merger.
- 7.14 However, the Commission will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that the prospect of prevailing conditions continuing is not realistic (e.g., because the Commission believes that one of the merging parties would inevitably have exited from the market).
- 7.15 The Commission may in principle examine several possible counterfactual scenarios, but typically only the most likely scenario will be selected as the relevant counterfactual. When it considers that the choice between two or more scenarios will make a material difference to its assessment, the Commission may carry out additional detailed investigation before reaching a conclusion on the appropriate counterfactual scenario.

- 7.16 The Commission will typically incorporate into the counterfactual scenario only those aspects that appear likely on the basis of the facts available to it and its ability to foresee future developments. It will seek to avoid importing into its assessments any spurious claims to accurate prediction or foresight. Given that the counterfactual scenario incorporates only those elements of scenarios that are foreseeable, it will generally not be necessary for the Commission to make finely balanced judgements about what is and what is not the counterfactual.
- 7.17 The most notable examples of situations where the Commission may use a counterfactual different from the prevailing conditions of competition are:
- (a) the failing undertaking scenario;
 - (b) the loss of potential entrant scenario; and
 - (c) where there are competing bids or parallel mergers.

The Failing Undertaking Scenario

- 7.18 In forming a view on a failing undertaking scenario, the Commission will consider:
- (a) whether the target undertaking would have exited the market in the near future; and, if so
 - (b) whether there would have been an alternative purchaser for the target undertaking or its assets to the acquiring undertaking.
- 7.19 The failing undertaking scenario is most commonly considered when one of the undertakings is said to be failing financially. When considering any failing undertaking argument, the Commission will give particular weight to evidence that has not been prepared in contemplation of the merger. It may also be relevant for the Commission to understand the rationale for the transaction under review (i.e., to consider why the acquiring undertaking is acquiring the target undertaking or assets that it is claimed would, in any event, have exited from the market).
- 7.20 For the Commission to accept a failing undertaking argument, it will need to be convinced that it was inevitable that the target undertaking concerned would have exited the market and be confident that there was no alternative purchaser whose purchase of the undertaking or its assets would have had a substantially less anti-competitive effect. The Commission would then consider whether the result of the exit of the target undertaking and its assets would be a substantially less anti-competitive outcome than the merger.
- 7.21 Having taken its counterfactual scenario into account, any loss of competition cannot therefore be attributed to the merger under review. If the Commission cannot reach a sufficient level of confidence in relation to each of the

considerations, it will use the pre-merger situation as its counterfactual to assess the merger.

- 7.22 If the Commission considers that there were alternative purchasers, it will try to identify who the alternative purchasers might have been and take this into account when determining the counterfactual. The analysis of the impact on competition of the merger (i.e., whether the effect of the merger under review would be substantially less competitive than the effect of an acquisition by an alternative purchaser) would be part of the SPLC analysis. Similarly, how the merger compares to the effect of exit of the target undertaking and the dispersal of its sales is treated as part of the consideration of the effects of the merger on competition.
- 7.23 Practical considerations relating to the questions in Section 7.18(a) and (b) above are examined below:

Would the Target Undertaking Have Exited?

- 7.24 The Commission will look at the facts of the case to assess whether the target undertaking would have exited. In the context of a target undertaking exiting for reasons of financial failure, the Commission will consider whether the target undertaking would be unable to meet its financial obligations in the near future or restructure itself successfully. The Commission will examine the target undertaking's balance sheet to determine the profile of assets and liabilities. It will also consider any action the Management had taken to address the target undertaking's position and will review contemporaneous documents such as board minutes, management accounts and strategic plans.
- 7.25 If the target undertaking was a part of a larger corporate group, the Commission will look at the nature and value of the transactions within that group to determine the extent to which the losses were caused by intra-group charges, and whether the transactions were on arm's length terms. The Commission will apply the same principle in determining whether a particular subsidiary or division would have exited the market without the merger. It will examine the evidence as to why the parent company would have closed that subsidiary or division. Such cases require particularly careful analysis. There may be several reasons why a profitable parent company would not close down a subsidiary or division which appeared to be loss-making. For example, the allocation of costs within a business may mean that the accounts for the division may not reflect actual operating cash flow, or the division may have some strategic or other value that is not reflected in the accounts.

Would There Have Been an Alternative Purchaser?

- 7.26 Even if the Commission believes that the target undertaking would have exited, there may be other buyers whose acquisition of the target undertaking as a going concern, or of its assets, would produce a better outcome for competition than the merger under consideration. For example, other buyers may be interested in acquiring the target undertaking or its assets as a means of entering the market.

- 7.27 When considering the prospects for an alternative buyer for the target undertaking or its assets, the Commission will look at available evidence supporting any claims that the merger under consideration was the only possible merger (i.e., that there was genuinely only one possible purchaser for the target undertaking or its assets). The Commission will take into account the prospects of alternative offers for the business above liquidation value.

Loss of Potential Entrant Scenario

- 7.28 The Commission will consider whether the counterfactual situation should include the entry by one of the merging parties into the market of another merging party or, if already within the market, whether the first merging party would have expanded had the merger not taken place.

Competing Bids and Parallel Mergers

- 7.29 Where there is more than one bidder for a target undertaking, the Commission will examine each competing bid separately. It will typically not engage in a comparative analysis of multiple competing bids.
- 7.30 However, the Commission may otherwise be required to consider a merger at a time when there is the prospect of another merger in the same market (i.e., a parallel merger).
- 7.31 Unless the parallel merger can clearly be ruled out as too speculative, the Commission will likely assess whether a merger is more likely than not to give rise to an SPLC whether or not the parallel merger proceeds. The Commission will not ignore a parallel merger on the grounds that it has not been notified, or was notified after the merger under review; nor will the Commission give automatic priority to the merger that was notified first. The Commission may, however, give priority to the merger which is least likely to give rise to an SPLC in the absence of other mergers.
- 7.32 When determining the relevant counterfactual for one of such parallel mergers, the Commission will take into account the likelihood that the other parallel mergers will proceed.

SECTION 8

ANALYTICAL APPROACHES AND METHODOLOGIES

INTRODUCTION

- 8.1 In determining whether a merger is more likely than not to give rise to an SPLC, the Commission will generally conduct its assessment to consider the following factors (although each of these factors will not necessarily be expressly indicated in the Commission's decisions or reports):
- (a) market definition;
 - (b) measures of concentration;
 - (c) in the case of horizontal mergers, the following theories of harm:
 - (i) non-coordinated effects (including loss of existing and potential competition and any vertical effects); and
 - (ii) coordinated effects;
 - (d) in the case of non-horizontal mergers, the following theories of harm:
 - (i) non-coordinated effects (including input, total input and customer foreclosure, commercially sensitive information and concerns related to conglomerate and diagonal mergers); and
 - (ii) coordinated effects;
 - (e) entry and expansion;
 - (f) assessment of efficiencies;
 - (g) countervailing buyer power;
 - (h) removal of a "maverick" undertaking; and
 - (i) effects from mergers of competing buyers.
- 8.2 Given the reduced time available to conduct an assessment in Phase 1 as compared to the 120-day period of the combined Phases 1 and 2, the Commission's ability to undertake detailed analysis of all issues may be limited in Phase 1. Thus, the extent of the analysis conducted with respect to each of the factors identified above, and the evidence considered as part of that analysis, is likely to vary according to whether the merger is being considered during Phase 1 or Phase 2.

MARKET DEFINITION

- 8.3 The Commission will determine the relevant markets for each merger being assessed utilising the framework set forth in the Market Definition Guideline under the Regulations.
- 8.4 The Commission will determine the relevant market on a case-by-case basis. In the case of horizontal mergers, it will focus on the overlap between the product and geographic relations supplied by the parties. In the case of non-horizontal mergers, the Commission will determine the relevant markets in conjunction with applicable theories of harm, including non-coordinated and coordinated effects.
- 8.5 In practice, identification of the relevant market will overlap with the assessment of competitive effects in that market and should not be viewed as distinct analysis. Many of the factors affecting market definition are relevant to the assessment of competitive effects and vice versa.

MEASURES OF CONCENTRATION

- 8.6 As part of its assessment of a merger, the Commission may take into account market shares and market concentration, as assessed in the relevant market. The Commission will consider mergers that result in substantially larger market shares or increased market concentration as more likely to give rise to an SPLC.
- 8.7 When assessing market share information and levels of concentration, the Commission may have regard to the following factors:
- (a) the degree, if any, of product differentiation;
 - (b) evidence of market share fluctuations over time;
 - (c) how widely the market is drawn; and
 - (d) the level of variable profit margins (e.g., sales revenue minus direct costs of sales), which can serve as an indication of market power when properly benchmarked.
- 8.8 The Commission may use sales revenue, production volume, capacity or reserves to measure market shares. The measure the Commission will use will depend on the facts of the case and the availability of information.
- 8.9 The Commission is unlikely to find concern in non-horizontal mergers, be it of a coordinated or of a non-coordinated nature, where the market share post-merger of the new entity concerned in each of the markets concerned is below 30% and the sum of the market shares of the top three firms is less than 70%.
- 8.10 The Commission is unlikely to find concern in horizontal mergers, be it of a coordinated or of a non-coordinated nature, where the market share post-merger

of the new entity concerned is below 15% and the sum of the market shares of the top three firms is less than 70%.

TYPES OF MERGERS AND THEORIES OF HARM

- 8.11 The theories of harm that the Commission will consider will depend on the type of merger, industry supply and demand structure, product characteristics and existing and expected evolution of competitive dynamics.
- 8.12 Mergers can be broadly classified as horizontal and non-horizontal (i.e., vertical, diagonal and conglomerate) mergers. Three main theories of harm that may give rise to an SPLC are non-coordinated effects, coordinated effects and vertical or conglomerate effects. Each type of merger and its most likely theories of harm are discussed below.

Horizontal Mergers

- 8.13 Horizontal mergers are mergers between undertakings active in supplying competing products, typically at the same level of the supply chain and in the same geographic market.
- 8.14 Broadly, there are two mechanisms which may give rise to an SPLC. First, a merger may eliminate a competitor which exerted a significant competitive constraint prior to the merger (non-coordinated effects). Second, the merger may change the industry structure and the nature of competition in such a way that it significantly increases the probability that the merged undertaking and its competitors will coordinate their behaviour in an anti-competitive way (coordinated effects).

Non-Coordinated Effects

- 8.15 When assessing the non-coordinated effects of a horizontal merger, the Commission will consider the potential of the merger to cause (i) loss of existing competition (including import competition), (ii) loss of potential competition, and (iii) potential vertical effects. Not all of the factors need to be present for non-coordinated effects to be considered likely. Nor should this be considered an exhaustive list.

Loss of Existing Competition in the Market

- 8.16 The merger of two undertakings can provide an incentive for the merged undertaking to raise the price of the products of one or both merging parties. Without the merger, a merging party which raises its prices loses profits as a result of (i) the sales diverted to the other merging party, as well as (ii) the sales diverted to other undertakings. After the merger, the competitive constraint from the other merging party is eliminated.
- 8.17 When undertakings compete with undifferentiated products, non-coordinated effects are more likely when the market is concentrated, there are few

undertakings in the affected market post-merger, the merger results in a large increase in market share or there is no strong competitive fringe.

- 8.18 Non-coordinated effects for mergers with undifferentiated or differentiated products may also be more likely when a merger involves a merging party which is expected to provide a significant competitive constraint (for example a new entrant, an undertaking with a reputation for aggressive price cutting or an undertaking with a new business model), when the products of the merging parties are close substitutes or when the market is concentrated.

Closeness of Competition

- 8.19 If the products of the merging parties are close substitutes as compared to other products in the relevant market, the merger is more likely to remove a significant competitive constraint and enable the merging parties to profitably raise the price of one or more products after the merger. Some of the lost sales due to the price rise of the product of one merging party will merely be diverted to the product of the other merging party. Depending on relative margins, capturing such sales loss through a merger may make the price increase profitable even though it would not have been profitable prior to the merger. Such a merger is therefore more likely to give rise to an SPLC. The closeness of substitution between products can be indicated by the diversion ratio. A diversion ratio between Product A and Product B represents the proportion of sales that would divert to Product B (as opposed to other products) as customers' second choice in the event of a price increase for Product A.
- 8.20 Another useful indicator of closeness of competition is cross-price elasticity of demand between two products. The cross-price elasticity of demand of Product A to Product B is a measure of the percentage change in quantity of Product A sold when the price of Product B rises by 1%.
- 8.21 The extent of direct competition between the products sold by the merging parties is central to the evaluation of non-horizontal price effects. These effects are greater the more the buyers of products sold by one merging party consider products of the other merging party to be their next choice. Generally, for a substantial price increase of a product post-merger it is required that a significant fraction of the customers purchasing that product view products formerly sold by the other merging party as their next-best choice. However, unless pre-merger margins between price and incremental cost are low, that significant fraction does not need to approach a majority.
- 8.22 For this purpose, incremental cost is measured over the change in output that would be caused by the price change considered. A merger may give rise to an SPLC even though many more sales are diverted to products sold by non-merger undertakings than to products previously sold by one of the merging parties.
- 8.23 A merger is less likely to give rise to an SPLC if non-merger undertakings offer very close substitutes to the products offered by the merging parties. In some

cases, non-merging undertakings may be able to reposition their products to offer close substitutes for the products of the merging undertakings.

- 8.24 In the assessment of the closeness of competition, the Commission may consider the following evidence (which should not be read as an exhaustive list):
- (a) information about product characteristics, such as physical properties and intended use that can indicate similarities between the products;
 - (b) information about relative price levels and the extent to which prices of products within the relevant market are correlated with each other as compared with the prices outside the relevant market (taking account of any common influences other than competitive interaction, such as common costs, inflation, exchange rates, etc.);
 - (c) information on prices and sales volumes over time or across areas that permit analysis of the way that customers respond to changes in prices or to undertakings entering and leaving the market;
 - (d) responses from customers, competitors and interested and informed persons to questions about consumer behaviour and the hypothetical monopolist test; and
 - (e) documents such as marketing studies, consumer surveys prepared in the normal course of business, market analyses prepared for investors and internal business analyses (such as business plans and strategy documents) as well as empirical evidence on diversion ratios or cross-price elasticities.

Variable Profit Margins

- 8.25 If the variable profit margins of the products of the merging parties are large, non-coordinated effects are more likely to take place. This is because, in such cases, as with the closeness of competition, the cost of a price increase prior to the merger (the value of the lost sales to competitors) is particularly high relative to the cost of a price increase after the merger, giving the merging parties the incentive to raise prices.

Market Shares of the Merging Parties

- 8.26 A merger which results in a significant market share increase may be more likely to involve undertakings who sell products such that a large share of the lost sales due to a price rise over the pre-merger level in the product of one merging party will be diverted to the product of the other merging party. This would be the case if the second choices of the customers who switch away from a product the price of which is increasing are distributed in the same way as the first choices.
- 8.27 Although market shares and additions of market shares can provide first indications of market power and increases in market power, they will not serve as the main premise on which the Commission will base its conclusions.

Price Sensitivity of Customer

- 8.28 If customers are generally insensitive to changes in the price of the merging parties' products relative to the prices of the products of the remaining undertakings, non-coordinated effects are more likely. In such circumstances, a post-merger price increase is less likely to lead to a large loss of sales as the remaining competitors are less likely to represent a significant competitive constraint on the merged undertaking.
- 8.29 When assessing price sensitivity, the Commission will assess whether a sufficiently large share of (marginal) customers can easily switch among substitute products. If this is the case, non-coordinated effects are less likely, irrespectively of whether or not a significant share of the remaining customers finds switching hard. However, this is not the case when the merging parties can identify and price discriminate between the groups of customers who find switching easy and those who do not. Subject to this caveat, evidence of past customer switching patterns and reactions to price changes may provide important information in this regard.

Supply-Side Substitution

- 8.30 If the merged undertaking increases prices, undertakings that currently do not produce a substitute product might be able, at short notice and without incurring significant sunk costs, to supply such a substitute product. Similarly to an entry threat, this can represent a competitive constraint. Therefore, the Commission may examine whether suppliers of alternative products could and would switch their existing production facilities to make alternative products in response to a change in relative prices, demand or other changes in market conditions.
- 8.31 The Commission will also consider entry into the relevant market in its merger assessment. The merger is not likely to give rise to an SPLC if entry into the market is so easy that the merged undertaking and its remaining competitors in the market could not profitably raise prices or otherwise reduce competition compared to the level that would prevail in the absence of the merger. The Commission will therefore examine whether entry would be timely, likely and sufficient in its magnitude, character and scope to counteract the competitive effects of concern. This is discussed further in Sections 8.91 through 8.99.

Capacity Constraints

- 8.32 The Commission may also assess whether the market conditions are such that the competitors of the merging parties are unlikely to increase their supply substantially in response to a decrease in output or a price increase by the merged undertaking. This might indeed be the case when the competitors face binding capacity constraints and the expansion is costly or if existing excess capacity is significantly more costly to operate than capacity currently in use.
- 8.33 In such circumstances, a significant price increase by the merged undertaking will not cause any large diversion of sales to the remaining competitors. Similarly,

a reduction in output (and the associated increase in price) by the merged undertaking will not be compensated (or it will be compensated to a lesser extent) by the expansion of output of the remaining competitors. Therefore, the merged undertaking will have stronger incentives to raise prices or restrict output.

Loss of Potential Competition in the Market

- 8.34 Even undertakings that are not currently operating in a relevant market may impose a certain level of competitive discipline on active undertakings. There are two ways in which elimination of a potential entrant can lessen competition. First, it may eliminate an undertaking that is perceived by the incumbent undertakings as a potential entrant. A “perceived potential entrant” constrains the behaviour of the incumbent undertakings irrespective of whether or not the entry actually occurs. An undertaking is more likely to be perceived as a potential competitor if the sunk costs of entry are not substantial and if entry can happen in a relatively short period of time.
- 8.35 Second, the merger may eliminate an “actual potential entrant,” that is an undertaking which is objectively likely to enter a market in a foreseeable future, even if this is not perceived to be the case by the incumbent undertakings.
- 8.36 A merger involving a potential competitor may result in higher prices or lower output and might therefore give rise to an SPLC. The Commission may consider, among other aspects of the market in question, the following factors in its assessment:
- (a) whether entry is imminent,
 - (b) whether the potential competitor has lower costs or other technology advantages, and
 - (c) whether the merger eliminates the only potential competitor.
- 8.37 The Commission may supplement the information gathered on the factors outlined above by other information and calculations which may help in the assessment of the likelihood that the merger will give rise to a price increase or to a decrease in output.

Potential Vertical Effects of a Horizontal Merger

- 8.38 Mergers which are principally horizontal in character may have vertical effects if one or more of the merging parties also operates at a different level of the supply chain for a product or a service. This may leave the merged undertaking in a position where it would have the ability and incentive to make the expansion of smaller undertakings and potential competitors more difficult or otherwise restrict the ability of competing undertakings to compete.
- 8.39 For instance, the merged undertaking may have such a degree of control of, or influence over, the supply of inputs or distribution possibilities that expansion or

entry by competing undertakings may be more costly. Similarly, the merged undertaking's control over patents or other types of intellectual property may make expansion or entry by competitors more difficult. In markets where interoperability between different infrastructures or platforms is important, a merger may give the merged undertaking the ability and incentive to raise the costs or decrease the quality of service of its competitors. In making this assessment the Commission may take into account, *inter alia*, the financial strength of the merged undertaking relative to its competitors.

- 8.40 In assessing vertical effects of a horizontal merger the Commission will use a similar approach as used in assessing a purely vertical merger. In a principally horizontal merger, the merged undertaking will generally need to have a significant position in the market to give rise to an SPLC.

Coordinated Effects

- 8.41 Under certain conditions, a merger may give rise to an SPLC if it significantly increases the probability that the merged undertaking and their competitors could successfully coordinate their behaviour in order to increase profits.
- 8.42 A merger may also give rise to an SPLC if it makes coordination easier, more stable and more effective for undertakings that were already coordinating before the merger either by making coordination more robust or by enabling undertakings to coordinate on even higher prices.
- 8.43 Coordination may take different forms and need not involve all aspects over which undertakings compete. In many instances, it will involve undertakings keeping prices higher than they would otherwise have been by, for example, not engaging in price cutting. However, coordination can in principle affect any aspect of competition, for example by avoiding expansion of production or innovation efforts. Undertakings may coordinate by dividing up the market between them, for example by geographic area or customer characteristics, or by allocating contracts among themselves in bidding competitions.
- 8.44 Coordination can be explicit or tacit. Explicit coordination is typically achieved through direct communication and an explicit agreement between the parties involved. Tacit coordination is achieved through implicit understanding, between the undertakings, of the behaviour that constitutes a coordinated equilibrium, without the use of a formal arrangement and without direct communication. Nevertheless, tacit collusion often involves some form of indirect communication. Both types of coordination can be relevant to an assessment of the effects of a merger.
- 8.45 The risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore when assessing coordinated effects, the Commission will consider the characteristics of the market to assess whether the market could be conducive to coordination. The Commission will presume that this is the case if undertakings representing a substantial share of the relevant market appear to have previously engaged in

coordination, unless competitive conditions in the market have since changed significantly.

- 8.46 If there are indications of previous coordination, the Commission will examine whether the merger makes coordination more stable or effective. If there is no evidence of pre-merger coordination, the Commission will examine whether the merger makes it more likely that undertakings in the market will start to coordinate, given the characteristics of the market. Coordination is unlikely when market concentration is low.
- 8.47 The Commission will assess whether the merger makes a sustainable coordination more likely. The following conditions must be satisfied for coordination to be sustainable:
- (a) undertakings need to be able to reach a common understanding of the terms of coordination and to monitor compliance with these terms;
 - (b) coordination needs to be internally sustainable – i.e., undertakings have to find it in their individual interest to adhere to the coordinated outcome; and
 - (c) coordination needs to be externally sustainable, in that there is little likelihood of coordination being undermined by competition from outside the coordinating group.

Ability to Reach and Implement a Common Understanding

- 8.48 Generally, the less complex and the more stable the economic environment, the easier it is for the undertakings to reach a common understanding.
- 8.49 The degree of complexity of the environment will typically increase with the number of undertakings in the market, the number and types of products sold and the number of aspects of competition over which the undertakings compete (e.g., price or non-price factors) as well as with the extent to which undertakings differ in their capabilities, product portfolios, customer mix and strategies.
- 8.50 Volatile demand, substantial internal growth by some undertakings in the market or frequent entry by new undertakings may indicate that the current situation is not sufficiently stable to make coordination likely and may indicate that this would remain to be the case after the merger. In markets where innovation is important, coordination may be more difficult since particularly significant innovations may allow one undertaking to gain a major advantage over its competitors.
- 8.51 Coordination by way of market division will be easier if customers have simple characteristics that allow the coordinating undertakings to readily allocate them. Such characteristics may be based on geography, on customer type or simply on the existence of customers who typically buy from one specific undertaking. Coordinating undertakings may be able to find other ways to overcome problems stemming from complex economic environments short of market division.

- 8.52 They may, for instance, establish simple pricing rules that reduce the complexity of coordinating on a large number of prices. One example of such a rule is establishing a small number of pricing points, thus reducing the coordination problem. Another example is having a fixed relationship between certain base prices and a number of other prices, such that prices basically move in parallel. Publicly available key information, exchange of information through trade associations, or information received through cross-shareholdings or participation in joint ventures may also help undertakings reach an agreement on the terms of coordination. The more complex the market situation is, the more transparency or communication is likely to be needed for coordination to be successful.
- 8.53 To sustain coordination, undertakings will generally need to be able to monitor each other's behaviour sufficiently to ensure that deviations from the coordinated outcome can be detected. Price transparency will typically assist such monitoring, but coordination may be sustained by mechanisms other than price, such as market sharing along geographical dimensions.
- 8.54 Transparency in the market is often higher if there is a lower number of active participants in the market. Further, the degree of transparency often depends on how market transactions take place in a particular market. For example, transparency is likely to be high in a market where transactions take place on a public exchange or in an open outcry auction.
- 8.55 Conversely, transparency may be low in a market where transactions are confidentially negotiated between buyers and sellers on a bilateral basis. When evaluating the level of transparency in the market, the Commission will try to identify what undertakings are able to infer about the actions of other undertakings from the available information.
- 8.56 In some markets where the general conditions may seem to make monitoring of deviations difficult, undertakings may nevertheless engage in practices which have the effect of easing the monitoring task, even when these practices are not necessarily entered into for such purposes. These practices, such as meeting competition or most-favoured customer clauses, voluntary publication of information, announcements, or exchange of information through trade associations, may increase transparency or help competitors interpret the choices made. Cross-directorships, participation in joint ventures and similar arrangements may also make monitoring easier.

Internal Sustainability of Coordination

- 8.57 Coordination will be sustainable only where it is internally sustainable, i.e., the additional profit from coordination is sufficiently high, and there is an effective mechanism to punish deviation. A merger may increase internal sustainability of coordination, but such an increase is not required to give rise to an SPLC.
- 8.58 An undertaking may deviate if the short-term gain that the undertaking makes from having a more competitive offer than the coordinating undertaking

outweighs the costs to it of future punishment. Such punishment may take the form of a reversion to more intense competition by the other undertakings rather than a deliberate punitive strategy on their part.

- 8.59 In order to be effective, the punishment must be sufficiently swift and this is related to the issue of transparency. If undertakings are only able to observe their competitors' actions after a substantial delay, then retaliation will be similarly delayed and this may influence whether it is sufficient to deter deviation.
- 8.60 An undertaking will have weaker incentives to deviate from pricing more competitively if sales are small and frequent, rather than via occasional large and long-term contracts or if relatively few customers will switch to it before coordinating undertakings are able to respond.
- 8.61 An undertaking will have stronger incentives to deviate if it has little stake in the status quo. For example, an undertaking with a small market share that can quickly and dramatically expand constrained neither by limits on production nor by customer reluctance to switch providers, is unlikely to be deterred. Undertakings are also less likely to be deterred by potential punishment if competition in the relevant market is marked by leapfrogging technological innovation, so that response by competitors leave the gains from successful innovation largely intact.
- 8.62 The greater the number of undertakings – all else being equal – the larger the profits that deviation produces and the less sustainable coordination becomes. At the same time, the cost of a reversion to a more competitive pricing in case of a punishment is lower when the incremental profits from coordination are shared between more undertakings.
- 8.63 When asymmetries between undertakings are significant, there are typically weaker incentives to coordinate. For example, it may not be in the interest of larger coordinating undertakings to retaliate when faced with a small deviating competitor, if this would eliminate profits from coordination as a whole. This lack of incentives to retaliate can undermine coordination.

External Sustainability of Coordination

- 8.64 For coordination to be successful, the actions of non-coordinating undertakings and potential competitors, as well as customers, should not be able to jeopardise the outcome expected from coordination. If coordination aims at reducing overall capacity in the market, this will only hurt consumers if non-coordinating undertakings are unable or have no incentive to respond to this decrease by increasing their own capacity sufficiently to prevent a net decrease in capacity, or at least to render the coordinated capacity decrease unprofitable. For example, an undertaking may have substantially different incentives to coordinate than its competitors and a sufficient capacity to take significant share from any group of undertakings which tried to coordinate without its participation. Such an undertaking, sometimes termed a "maverick," may have a reputation for aggressive pricing or a disruptive business model and could destabilize any attempt of the remaining undertakings at coordination. A merger which eliminates

such an undertaking may increase the risk of a successful coordination and may therefore be more likely to give rise to an SPLC.

- 8.65 The Commission may also consider barriers to entry and whether customers have buyer power in its assessment of the likelihood of successful coordination. In such cases coordination is less likely to be successful.

Non-Horizontal Mergers

- 8.66 Non-horizontal mergers, which include vertical, conglomerate and diagonal mergers, involve undertakings that do not operate in the same market. As such, non-horizontal mergers do not involve a direct loss of competition between undertakings in the same market, and it is a well-established principle that most are benign or efficiency-enhancing and do not raise competition concerns.

- 8.67 A characteristic of vertical mergers and certain conglomerate mergers is that the activities and/or the products of the companies involved are complementary to each other. The integration of complementary activities or products within a single undertaking may produce significant efficiencies and thus be pro-competitive. In vertical relationships, as a result of the complementarity, a decrease in mark-ups downstream will lead to higher demand also upstream.

- 8.68 A part of the benefit of this increase in demand will accrue to the upstream suppliers. An integrated undertaking will take this benefit into account. Vertical integration may thus provide an increased incentive to seek to decrease prices and increase output because the integrated undertaking can capture a larger fraction of the benefits. This is often referred to as the internalization of double mark-ups. Similarly, other efforts to increase sales at one level (e.g., improve service or stepping up innovation) may provide a greater reward for an integrated undertaking that will take into account the benefits accruing at other levels.

- 8.69 Integration may also decrease transaction costs and allow for a better coordination in terms of product design, the organization of the production process, and the way in which the products are sold. Similarly, mergers which involve products belonging to a range or portfolio of products that are generally sold to the same set of customers (be they complementary products or not) may give rise to customer benefits such as one-stop-shopping. Non-horizontal mergers sometimes also lead to the development of new products.

- 8.70 Non-horizontal mergers can be broadly characterized as:

- (a) “Vertical mergers” between undertakings which operate at different levels of a supply chain in a given industry, such that the different levels in the production chain at which the merging parties are active, are complementary. An example is a merger between a manufacturer and a distributor in an industry.
- (b) A special case of a vertical merger is a “diagonal merger” between an upstream supplier and a downstream competitor of the customers that purchase the supplier’s goods or services – in a diagonal merger the

downstream merging party is not purchasing inputs from the upstream merging party.

- (c) “Conglomerate mergers” between two suppliers of goods or services which do not operate within the same market, but which are nevertheless related in some way; for example because the goods or services that they sell are complements (so that a fall in the price of one good increases the customer’s demand for another); or they are weak substitutes; or because there are economies of scale in purchasing them (so that customers buy them together).

8.71 Despite the potential efficiencies, some non-horizontal mergers may give rise to an SPLC through non-coordinated effects. The theories of harm raised by such mergers typically involve the merged undertaking harming the ability of its competitors to compete post-merger, for example by raising effective prices to its competitors, or by refusing to supply them completely. Such actions may harm the ability of the merged undertaking’s competitors to provide a competitive constraint into the future. A non-horizontal merger might also give rise to coordinated effects.

8.72 In practice, mergers may entail both horizontal and non-horizontal aspects. This may for instance be the case where the merging parties are not only in a vertical or conglomerate relationship, but are also actual or potential competitors of each other in one or more of the relevant markets concerned). The Commission may therefore assess the likelihood of a merger giving rise to an SPLC via horizontal, vertical and/or conglomerate effects.

Non-Coordinated Effects of Non-Horizontal Mergers

8.73 Despite differences in detail between cases, the Commission will typically frame its analysis of non-coordinated effects of non-horizontal mergers by reference to the following three questions:

- (a) Ability: Would the merged undertaking have the ability to harm competitors, for example through raising prices or refusing to supply them?
- (b) Incentive: Would it find it profitable to do so?
- (c) Effect: Would the effect of any action by the merged undertaking be sufficient to reduce competition in the affected market to the extent that, in the context of the market in question, it is likely to give rise to an SPLC?

8.74 In practice, the analyses under these questions may overlap and many of the relevant factors may affect more than one question. Therefore, the Commission’s analyses of ability, incentive and effect may not be in distinct chronological stages but rather as overlapping analyses. In order to reach a finding that a merger is more likely than not to give rise to an SPLC, all three questions must be answered in the affirmative.

8.75 The following sections describe some of the theories of harm that the Commission may consider in its assessment.

Input Foreclosure

8.76 In assessing input foreclosure, the concern is that the merged undertaking could increase the price it charges for the input to competing manufacturers or service providers. This in turn would make it harder for competing manufacturers or service providers to compete by increasing their costs, making them less competitive. Competition in manufacturing or the relevant service may thus be lessened.

Ability

8.77 With respect to ability, the Commission may consider evidence on the following factors:

- (a) The cost of the input relative to all costs of the final product. All else being equal, if the input accounts for only a small part of the total costs incurred, the merged undertaking will be less able to harm its competing manufacturers' or service providers' ability to compete than if the input accounts for a greater part of the total costs.
- (b) The extent to which competing manufacturers or service providers can avoid a price increase by switching away from this input. If downstream competitors can turn to many good substitutes for the input, the merged undertaking will be less able to impose a price increase than if there were few alternative providers of the input.

Incentive

8.78 To assess whether the merged undertaking would have an incentive to increase the prices charged for the input to its competing manufacturers or service providers, the Commission will consider the factors affecting the profitability of such an increase in the input price, and the extent to which these factors change as a result of the merger. In particular, the Commission may assess the following:

- (a) Loss of profits in the input market. The merged undertaking increases the input price but loses sales of the input as competing manufacturers or service providers switch to alternatives for the input. This switch typically will be easier and therefore more costly to the merged undertaking if competition in the input market is intense.
- (b) Gain in profits in the market for the final product or service. The merged undertaking may gain from partial input foreclosure if it forces competing manufacturers or service providers to raise their prices for the final product or service, and, as a result, customers in the market for the final product or service switch to the merged undertaking's own final product or service.

- 8.79 The gain described in Section 8.78(b) will be reduced if (i) customers in general do not react strongly to changes in prices for the final product and (ii) the merged undertaking's final product or service is a poor substitute for those made by competing manufacturers or service providers, so that the diversion ratio to the merged undertaking is low.
- 8.80 The relative level of variable profit margins on the input and the final product. If variable profit margins are higher in absolute terms for the input than for the final product, the negative impact on profitability of lost sales in the input market may outweigh the positive impact on profitability of additional sales in the market for the final product.

Effect

- 8.81 To the extent that the merged undertaking has both the ability and incentive to increase prices so as to foreclose to some extent its competing manufacturers, the Commission will consider the impact of such foreclosure on competition in the downstream market. The Commission may also need to take account of any stimulus to competition in the downstream market that may arise as a result of efficiencies from the merger.

Total Input Foreclosure

- 8.82 In some cases, the merged undertaking may stop supplying its competitors altogether. This has the effect of reducing the set of suppliers available to competing manufacturers, which might in turn effectively reduce competition in the input market leading to higher input prices for competitors and potentially other harmful effects. In evaluating the ability of the merged undertaking to engage in total input foreclosure, the Commission may consider how easily the merged undertaking can commit not to re-enter the input market, for example by adopting an input technology that is incompatible with the production techniques of competitor manufacturers of the final product.

Customer Foreclosure

- 8.83 In mergers involving a manufacturer and a distributor, the merged undertaking might increase retail prices when selling competitors' products (partial customer foreclosure), or stop stocking competitors' products altogether (total customer foreclosure), thereby diverting customers to its own products. Customer foreclosure requires that access to sufficient customer base is made harder, so that it becomes significantly harder for the upstream competitor to supply inputs to the remaining customers, for example because the upstream undertaking cannot reach the economics of scale. In particular, an SPLC arising from customer foreclosure will typically require that:
- (a) it affects an important route to market, and the merged undertaking has a significant position in the distribution market;
 - (b) the merged undertaking has the incentive to engage in customer foreclosure because the profit gained by the merged undertaking from selling more of its

manufactured goods exceeds the profit lost from customers who switch to a different distributor; and

- (c) the impact of such customer foreclosure on the upstream market would be significant in terms of competition, taking due account of any efficiencies that enhanced the merged undertaking's own incentives to compete.

Commercially Sensitive Information

8.84 A vertical merger may allow the merged undertaking to gain access to commercially sensitive information about the activities of non-integrated competitors in the input market or the market for the final product, allowing it unilaterally to compete less aggressively in the market for the final product or otherwise to put competitors at a competitive disadvantage. For the merger to give rise to an SPLC, it is not sufficient that competitors are put at a competitive disadvantage. However, if such an outcome is likely to harm the customers, the Commission may find that the merger is likely to give rise to an SPLC.

Concerns Related to Conglomerate Mergers

8.85 A conglomerate merger can raise concerns that the merged undertaking might increase the selling price of one of its products when sold on a stand-alone basis, but might not do so if customers buy both the merged undertaking's products. This would give customers an incentive to buy the second product from the merged undertaking as well, putting competitors in the second product market at a disadvantage.

8.86 The Commission's approach will involve analysing the ability, incentive and the effect of this strategy. This takes into account the following factors:

- (a) whether customers have a demand for more than one of the products, and whether the products are complements;
- (b) customer preferences for variety and one-stop shopping; and
- (c) the costs to competitors of providing variety and one-stop shopping at a scale to enable them to compete effectively with the merged undertaking.

Concerns Related to Diagonal Mergers

8.87 A diagonal merger could, for example, arise where there are two competing manufacturers in the market for the final product, which use two different technologies, and where the merger is between a supplier of the input for use in one technology and the manufacturer that uses the competing technology. The merged undertaking could harm competitors of its downstream manufacturing arm by raising the prices it charges for the input to the competing manufacturer.

8.88 The Commission's approach to analysing the ability, incentive and effect of this strategy may take into account:

- (a) whether the input is an important component of the final product;
- (b) whether the merged undertaking has a significant position in the input market; and
- (c) how closely competitors' final products compete with the merged undertaking's final product.

8.89 In diagonal mergers there is often less scope for pricing efficiencies than in standard vertical mergers.

Coordinated Effects Arising from Non-Horizontal Mergers

8.90 A non-horizontal merger, like a horizontal merger, may create or strengthen coordinated effects. In assessing the potential for coordinated effects arising from a non-horizontal merger, the Commission will adopt the same general framework as for horizontal mergers, i.e., it will consider whether the conditions for coordination are met following the merger, and the effect of the merger on the likelihood and effectiveness of coordination. However, the details of the analysis of the impact of the merger may differ. The following are some examples of the ways that vertical mergers could affect coordination:

- (a) A vertical merger may allow the merged undertaking to gain access to commercially sensitive information about the activities of non-integrated competitors; this can facilitate coordination.
- (b) A vertical merger that results in foreclosure could reduce the number of players in the affected market, making it easier for the remaining players to coordinate.
- (c) A vertical merger may also increase the level of symmetry (e.g., in costs, if other undertakings in the market also are vertically integrated) and/or transparency in the market (e.g., by giving input producers control of the prices of final products), making it easier to reach and monitor a coordinated outcome.
- (d) A vertical merger may better align the incentives of undertakings in the market to maintain coordination (e.g., by enabling the vertically integrated undertaking to punish deviation more effectively if it becomes an important supplier to, or customer of, other undertakings in the market after the merger).
- (e) A vertical merger may also increase barriers to entry, which can reduce the scope for entry to disrupt coordination, or it may reduce buyer power if it involves the acquisition of a customer who could otherwise disrupt coordination.

ENTRY AND EXPANSION

- 8.91 An assessment of the likelihood of a merger to give rise to an SPLC will include consideration of the responses of other undertakings in the market, including competitors, potential competitors and customers of the merged undertaking. In the longer term, competition in the market may be affected as new undertakings enter, or the merged undertaking's competitors take actions to enhance their ability to compete against the merged undertaking. Some actions can mitigate the initial effect of the merger on competition, and in some cases may prevent an SPLC. Some of these actions may include:
- (a) investment in new capacity, or conversion of existing capacity to a new use;
 - (b) entry using new technology to enable new production methods;
 - (c) investments in marketing and product design to reposition existing brands so that they compete more directly or effectively with those of the merged undertaking;
 - (d) sponsorship by customers of a new entrant with guarantees of business; and
 - (e) investment in capacity by customers to make their own input so that they no longer need to buy from the merged undertaking.
- 8.92 In assessing whether entry or expansion might mitigate or prevent an SPLC, the Commission will consider whether such entry or expansion would be timely, likely and sufficient.
- 8.93 The Commission will examine the timeliness, likelihood, and sufficiency of the entry or expansion efforts an entrant or a competitor expanding might practically employ. An entry or expansion effort is defined by the actions the undertaking must take to produce and sell in the market. Various elements of the entry or expansion effort will be considered. These elements can include:
- (a) planning, design and management; permitting, licensing or other approvals;
 - (b) construction, debugging, and operation of production facilities; and
 - (c) promotion, marketing, distribution and satisfaction of customer testing and qualification requirements.
- 8.94 Recent examples of entry or expansion, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry or expansion efforts. They can also be informative regarding the scale necessary for an entrant or competitor to be successful, the presence or absence of entry or expansion barriers (including tariff and regulatory barriers), the factors that influence the timing of entry or expansion, the costs and risk associated with entry or expansion, and the sales opportunities realistically available to entrants or competitors.

Timeliness

- 8.95 In order to deter the competitive effects of concern, entry or expansion must be rapid enough to make unprofitable overall the actions causing those effects and thus leading to entry or expansion, even though those actions would be profitable until entry or expansion takes effect.
- 8.96 Even if the prospect of entry or expansion does not deter the competitive effects of concern, post-merger entry or expansion may counteract them. This requires that the impact of entrants or competitors in the relevant market be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry or expansion.
- 8.97 The Commission will not presume that an entrant or competitor can have a significant impact on prices before that entrant or competitor is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry or expansion would have such an effect on prices.

Likelihood

- 8.98 Entry or expansion is likely if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved, including the need for the entrant or competitor to incur costs that would not be recovered if the entrant or competitor later exits. Profitability depends upon:
- (a) the output level the entrant or competitor is likely to obtain, accounting for the obstacles likely faced;
 - (b) the price the entrant or competitor would likely obtain in the post-merger market, accounting for the impact of that entry or expansion itself on prices; and
 - (c) the cost per unit the entrant or competitor would likely incur, which may depend upon the scale at which the entrant or competitor would operate.

Sufficiency

- 8.99 Even where timely and likely, entry or expansion may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry or expansion may be insufficient because the products offered by entrants or competitors are not close enough substitutes to the products offered by the merged undertaking to render a price increase by the merged undertaking unprofitable. Entry or expansion may also be insufficient due to constraints that limit entrants' or competitors' competitive effectiveness, such as limitations on the capabilities of the undertakings best placed to enter or expand or reputational barriers to rapid expansion. Entry or expansion by a single undertaking that will replicate at least the scale and strength of one of the merging parties is sufficient. Entry or expansion by one or more undertakings

operating at a smaller scale may be sufficient if such undertakings are not at a significant competitive disadvantage.

ASSESSMENT OF EFFICIENCIES

- 8.100 A primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged undertaking's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a non-coordinated effects context, incremental cost reductions may reduce or reverse any increases in the merged undertaking's incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a coordinated effects context, incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick undertaking.
- 8.101 For the Commission to take account of the efficiencies in its assessment, these must be cognizable, timely and must benefit consumers. Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or level of service.
- 8.102 The Commission will credit only those efficiencies likely to be accomplished with the merger and unlikely to be accomplished in the absence of either the merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies. Only alternatives that are practical in the business situation faced by the merging parties are considered in making this determination. The Commission will not insist upon a less restrictive alternative that is merely theoretical, however, it is incumbent upon the merging parties to provide in due time all the relevant information necessary to demonstrate that there are no less anti-competitive, realistic and attainable alternatives than the notified merger which preserve the claimed efficiencies.
- 8.103 Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging parties. Moreover, efficiencies projected reasonably and in good faith by the merging parties may not be realized. Therefore, it is incumbent upon the merging parties to substantiate efficiency claims so that the Commission can verify, by reasonable means, the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged undertaking's ability and incentive to compete, and why each would be merger-specific. The Commission will be more likely to recognize the efficiencies that will be realized immediately after the merger or in the very near future and will give less or no weight to delayed benefits from efficiencies because they are less proximate and more difficult to predict.
- 8.104 Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies

may be viewed with scepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited.

- 8.105 In its assessment of whether a merger is likely to give rise to an SPLC, the Commission will consider whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm customers in each relevant market, e.g., by preventing price increases in that market. In that regard, it is incumbent upon the merging parties to demonstrate that the efficiencies would be passed through to consumers sufficiently for them to be considered in the assessment.
- 8.106 The Commission will not find a merger is more likely than not to give rise to an SPLC if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. However, the Commission may consider cognizable efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall.
- 8.107 In conducting its analysis, the Commission will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger, the greater must be the efficiencies, and the more they must be passed through to customers, for the Commission to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly substantial, extraordinarily great efficiencies would be necessary, and these have to be passed through to consumers to a great extent to prevent the merger from being anticompetitive.
- 8.108 Efficiencies are most likely to make a difference in merger assessment when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies will rarely justify a merger to monopoly or near-monopoly. Just as adverse competitive effects can arise along multiple dimensions of conduct, such as pricing and new product development, so too can efficiencies operate along multiple dimensions. Similarly, purported efficiency claims based on lower prices can be undermined if they rest on reductions in product quality or variety that the customers value.
- 8.109 Certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging parties to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification. Yet

others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

8.110 When evaluating the effects of a merger on innovation, the Commission considers the ability of the merged undertaking to conduct research or development more effectively. Such efficiencies may spur innovation but not affect short-term pricing. Nevertheless, such efficiencies may often eventually generate significant benefits for consumers. The Commission also considers the ability of the merged undertaking to appropriate a greater fraction of the benefits resulting from its innovations. Licensing and intellectual property conditions may be important to this inquiry, as they affect the ability of an undertaking to appropriate the benefits of its innovation rather than passing it through to the customers. Research and development cost savings may be substantial and yet not be cognizable efficiencies because they are difficult to verify or result from anticompetitive reductions in innovative activities.

8.111 Some examples of different types of efficiencies are presented below.

Supply-Side Efficiencies

8.112 Supply-side efficiencies arise if the merged undertaking can supply its products at lower cost as a result of the merger. Common examples of supply-side efficiencies are:

- (a) cost reductions;
- (b) the removal of double marginalization in vertical mergers; and
- (c) solving the 'free-rider' and 'investment 'hold-up' problems.

Cost Reductions

8.113 There are several ways in which horizontal, vertical and conglomerate mergers may give rise to efficiencies in the form of cost savings. For example:

- (a) The merged undertaking may benefit from economies of scale (from having a larger scale of operations) or economies of scope (e.g., from the joint supply of different products). Either of these can also produce reductions in fixed costs.
- (b) The merged undertaking may be able to benefit, across its portfolio of products, from the more efficient production processes or working methods of one of the merging parties.
- (c) Vertical mergers may improve the coordination of upstream production and downstream distribution, leading to lower transaction and inventory costs.

8.114 The Commission is more likely to take cost savings into account where efficiencies reduce marginal (or short-run variable) costs as these tend to

stimulate competition and are more likely to be passed on to customers in the form of lower prices. The Commission will not in general give as much weight to savings in fixed costs because they may often represent private gains to undertakings and are less important in short-run price formation, although reductions in fixed costs may play an important role in longer-term price formation.

Removal of Double Marginalization

- 8.115 Vertical mergers may allow the merged undertaking to remove (i.e., internalize) any pre-existing double mark-ups. These arise when, pre-merger, undertakings supplying the input and producing the final product set their prices independently and both charge a mark-up, resulting in prices to customers for the final product being higher than would suit the joint interests of both undertakings. A vertical merger may enable, and provide incentives for, the merged undertaking to internalize this double mark-up resulting in a decrease in the price of the final product.
- 8.116 In some cases double marginalization may not be significant pre-merger. This may be the case, for example, if existing vertical supply agreements include a price mechanism which eliminates the mark-up on the input.

Solving the 'Investment Hold-Up' or 'Free-Riding' Problems

- 8.117 A supply-side efficiency that may arise in vertical mergers results from aligning the incentives within the merged undertaking to invest in, for example, new products, new processes or marketing. For instance, a distributor of the manufactured products of an undertaking further up the supply chain may be reluctant to invest in promoting those products because its investment may also benefit competing distributors/retailers. A vertical merger can alleviate this 'free-riding' problem.
- 8.118 Sometimes undertakings in a vertical relationship have to make non-contractible relationship-specific investments and the specific form of the optimal transaction cannot be determined with certainty beforehand. This raises the concerns that after one of the undertakings commits to such investments, this will give the other undertaking increased bargaining power, thereby reducing the first undertaking's profits. This situation is sometimes termed 'hold-up' and might lead to underinvestment. A vertical merger can alleviate this problem.

Demand-Side Efficiencies

- 8.119 Demand-side efficiencies arise if the attractiveness to customers of the merged undertaking's products increases as a result of the merger. Common examples of demand-side efficiencies include:
- (a) pricing effects; and
 - (b) 'one-stop shopping.'

Pricing Effects

- 8.120 Demand-side efficiencies may arise in a conglomerate merger when the merging parties' products are complements, so that lowering the price of one product increases demand for it and for other products that are used with it. Bringing products that are complements under common ownership may allow the merged undertaking to obtain the positive effect of a fall in the price of one on sales of the others. Achieving this effect through a merger may result in lower prices for all products in the bundle, because it may become profit-enhancing for the undertaking which sells all the complements to sell them at a lower combined price than the sum the customer would have paid to assemble the same package from different suppliers before the merger.

'One-Stop Shopping'

- 8.121 An additional demand-side efficiency may arise when the merging parties' products are not substitutes and customers may have a stronger incentive to buy a range of products from a single supplier. This could be, for example, because purchasing from a single supplier reduces transaction costs or, where products are complementary, ensures improved product compatibility or quality assurance. Sometimes called 'one-stop shopping,' this is an economy of scope in the purchase rather than in the production of goods.

COUNTERVAILING BUYER POWER

- 8.122 In some circumstances, an individual customer or a group of customers may be able to use their negotiating strength to limit the ability of a merged undertaking to raise prices. This is often referred to as countervailing buyer power. Countervailing buyer power may be a factor in determining a merger is more likely than not to give rise to an SPLC.
- 8.123 If all customers of the merged undertaking possess sufficient countervailing buyer post-merger, then an SPLC is unlikely to arise. However, often only some – not all – customers of the merged undertaking possess countervailing buyer power. In such cases the Commission will assess the extent to which the countervailing buyer power of these customers may be relied upon to protect all customers.
- 8.124 Buyer power can be generated by different factors. An individual customer's negotiating position will be stronger if it can easily switch its demand away from the supplier, or where it can otherwise constrain the behaviour of the supplier.
- 8.125 Typically the ability to switch away from a supplier will be stronger if there are several alternative suppliers to which the customer can credibly switch, or the customer has the ability to sponsor new entry. Where customers have no choice but to take a supplier's products, they may nonetheless be able to constrain prices by imposing costs on the supplier. For example, customers may have sufficient buyer power with respect to some other products produced by the

supplier, or, in the case of a retailer, position the supplier's products in less eye-catching parts of the store.

- 8.126 Even where the market is characterised by large customers, it does not necessarily follow that there will be countervailing buyer power. The Commission will assess whether and to what extent the merger is likely to reduce the customer's ability and incentive to pursue credibly any of the strategies set out above. It is possible that a merger may reduce a customer's ability to switch or even to sponsor new entry and, if this reduction adversely affects the negotiating position of a customer significantly, that customer's buyer power will not be sufficient to be countervailing.
- 8.127 Where a supplier is engaged in bilateral negotiations with each of its customers, the relative bargaining strength of the supplier and each of its customers is determined by their mutual dependency. In such situations it may be easier for large customers to threaten to sponsor new entry or to vertically integrate with another supplier than it would be for smaller customers who could not commit a sufficiently large volume of purchases to make either viable. Conversely, small buyers may be in a better position to switch suppliers because of the lower volume of their purchases.
- 8.128 The extent to which the buyer power of one customer, or group of customers, can constrain the merged undertaking's prices to all its customers (sometimes referred to as the 'umbrella effect') will depend on the market concerned. Where individual negotiations are prevalent, the buyer power possessed by any one customer will not typically protect other customers who do not possess such buyer power from any adverse effect that might arise from the merger.
- 8.129 In cases where there are no bilateral negotiations between suppliers and customers, and the market price of the input is transparent to all suppliers and customers, buyer power may arise simply because of a buyer's size. In these cases, the buyer power of one or more customers may act to protect other customers with less or no buyer power by preventing a rise in the price ultimately paid by all customers.
- 8.130 For countervailing buyer power to prevent an SPLC, it is not sufficient that it merely existed before the merger. It must also remain effective following the merger. To assess this, the Commission will consider the impact of the merger on any countervailing buyer power.

REMOVAL OF A 'MAVERICK' UNDERTAKING

- 8.131 A 'maverick' is an undertaking with a significant competitive advantage. Such an undertaking might have particularly low marginal costs, may be more innovative relative to its competitors or has a better product. Such an undertaking may also have a better corporate control. Mergers involving a maverick are more likely to result in a significant and sustainable increase in the unilateral market power of the merged undertaking or increase the ability and incentive of a small number of undertakings to engage in coordinated conduct. Vigorous and effective

competitors may drive significant aspects of competition, such as pricing, innovation or product development, even though their own market share may be modest. These undertakings tend to be less predictable in their behaviour and deliver benefits to consumers beyond their own immediate supply, by forcing other market participants to deliver better and cheaper products. They also tend to undermine attempts to coordinate the exercise of market power.

8.132 A merger that removes a vigorous and effective competitor may therefore remove one of the most effective competitive constraints on market participants and thereby give rise to an SPLC.

8.133 The following are examples of the types of information the Commission may require to ascertain the extent to which each merging party would separately be considered as a vigorous and effective competitor in the relevant market(s):

(a) evidence of past competitive pricing behaviour, for example discounting and promotions;

(b) levels of point of sale service (for example opening hours and store format) and after sales service;

(c) past and expected innovation, for example in design or production technology; and

(d) past evidence of leadership in non-price competition, for example product quality and loyalty programs.

EFFECTS FROM MERGERS OF COMPETING BUYERS

8.134 Mergers of competing buyers can enhance buying power in the upstream markets, particularly when upstream supply is fragmented such that there are many sellers. This increase in buying power is sometimes called “monopsony power.”

8.135 Mergers resulting in increased buying power can lead to a reduction in prices paid by the merged undertaking, for example, by reducing transaction costs or allowing the merged undertaking to take advantage of volume-based discounts. These reductions do not arise from the enhancement of market power in the buyer’s market and are unlikely to give rise to an SPLC. In fact, they can be significant in the evaluation of pro-competitive efficiencies from a merger.

8.136 While price reduction following a merger on the buying side of the market can – and often will – be pro-competitive, enhanced buyer power of the merged undertaking may, in principle, also give rise to an SPLC. This might be the case, in particular, when the merged entity has market power downstream. The incentive to reduce prices downstream maybe impaired by the prospect that higher quantities downstream and hence higher input purchases will lead to an increase in the price of the inputs.

8.137 In situations in which the merged undertaking cannot affect the final prices, for example because it faces severe competition, this effect is unlikely and the merger would also be unlikely to give rise to an SPLC. Buyer power may, however, also lead to suppliers having lower incentives to invest in new products and processes and this can, in principle, give rise to an SPLC.

8.138 In assessing the effects of mergers of competing buyers, the Commission may, for example, investigate whether:

- (a) the merged undertaking has an incentive to lower the amount it purchases so as to reduce the purchase price it pays; and
- (b) the merged undertaking also has sufficient market power over its customers so that, as it reduces the quantity sold to them in the market, it can increase the price at which it sells to them.
