ICN Merger Working Group: Analytical Framework Subgroup

PROJECT ON MERGER GUIDELINES

Report for the third ICN annual conference in Seoul

April 2004

PREFACE

This report on merger guidelines, finalised for the 2004 ICN conference in Seoul, follows on from the draft report discussed at the ICN's second annual conference (Merida, 2003). For the first ICN conference (Naples, 2002), the Analytical Framework Subgroup prepared an issues paper, 'The Analytical Framework for Merger Control', which discussed general issues ranging from the purpose of merger policy to the substantive test for merger appraisal and broad questions about remedies. The Subgroup's focus of inquiry since the inaugural ICN conference has been merger guidelines.

At least 26 jurisdictions around the world now have merger guidelines. The draft report focuses on 12 of these, highlighting in particular their common themes and main differences. This overview chapter draws some of these threads together.

The authors of the chapters in this report come from 13 jurisdictions. Each chapter, including this overview chapter, was led by a team with representation from Europe, North America and the rest of the world. Reflecting the ICN's openness and welcome to private sector participants, authors from 16 law firms have contributed to this report. Indeed, it is predominantly the private antitrust bar that has carried out the work reported here, with the OFT as coordinator.

Since the Merida conference, each team of authors has revised and updated their contribution both to incorporate feedback from ICN members at the Merida conference and to reflect the ongoing evolution of guidelines in various ICN jurisdictions. However, this is not the end of the ICN's work on merger guidelines and the overview chapter indicates how the project might be taken forward.

As chair of the ICN's Analytical Framework for Mergers Subgroup, I am most grateful to all who have contributed their time and expertise to this report, and it has been a pleasure to work with Allan Fels and Bill Kolasky on the overview chapter. My particular thanks go to the OFT team that has worked on this project – Simon Priddis, Simon Pritchard, Amelia Fletcher, Clare Tweed, Samina Khan, and especially Steve Lisseter who as secretary to the Subgroup has guided the project.

John Vickers
Chairman
UK Office of Fair Trading

CONTENTS

All chapters of the report are being published on the ICN website – see **www.internationalcompetitionnetwork.org**

CHAPTER 1 - MERGER GUIDELINES: AN OVERVIEW[1]

INTRODUCTION

1. The merger review policies that apply around the world can be compared on three levels. The most general level involves appraisal of merger laws and regulations. For the first ICN conference in Naples in 2002 the Analytical Framework Subgroup prepared an issues paper, 'The Analytical Framework for Merger Control' (the 2002 Paper),[2] which discussed general issues ranging from the purpose of merger policy to the substantive test for merger appraisal and broad questions about remedies. The paper's themes were illustrated by country studies for Australia, Germany, South Africa and the US. The most detailed level of comparative work – which might require a treatise – would examine bodies of casework.

2. The intermediate level, and the subject of the more recent work of the Subgroup, is merger guidelines. Guidelines set out how the authorities intend to apply the laws and regulations in their respective jurisdictions to the cases that come before them. Guidelines are important not only for deliberation on those cases but also for obtaining consistent results in law enforcement. They might influence which merger proposals are made in the first place and they are a mechanism for the authorities to be transparent about the operation of policy, and to be held to account for its proper implementation.

3. For these reasons we believe that merger guidelines are a potentially important and fruitful level to undertake comparative study. This paper is the result of work carried out since Naples and Merida for the Seoul ICN conference. It has five substantive chapters, which deal in turn with topics ranging from market definition to the treatment of efficiencies.

4. This introduction has three aims. The first is to explain how the merger guidelines project has been shaped and carried out. Second, we highlight some findings and themes from the chapters that follow, including major

[1] This project has been overseen by Allan Fells, Bill Kolasky and John Vickers (chair of the subgroup). We have prepared this paper in consultation with the members of the Analytical Framework Subgroup, who have commented on the initial outline and earlier drafts. We are most grateful for their helpful and thoughtful contributions, and to the OFT staff who have seen the project through.

[2] That paper is available on the ICN web site and in the published proceedings of the Naples conference.

developments since the Merida conference. Finally, we list options for future work that will be presented to ICN members at the Seoul conference.

BACKGROUND

5. We agreed at Naples that the guidelines project would have the following elements and would be driven by the private sector:

   a) identify merger guidelines around the world
   b) catalogue their common features and meaningful differences
   c) prepare a template of illustrative analytical practices from the various guidelines that would assist other jurisdictions in preparing their own guidelines, and
   d) present a summary paper to the Merida conference.

6. We identified 26 jurisdictions with merger guidelines and have summarised their scope and coverage in Annex A of this introductory paper. We have divided the guidelines into two groups: those whose guidelines appear to be prescriptive and more or less binding on the authorities, and those whose guidelines appear to be more general and advisory. In drawing this distinction we sought to assess the extent to which the content of the guidelines could be relied upon by parties to a merger as a clear indication of how they could expect the authorities to examine a merger.

7. We recognised that it would not be possible to examine every aspect of all of these guidelines during the period between the Naples and Merida conferences. We therefore decided to examine the five most significant areas:

   - market definition
   - unilateral effects
   - co-ordinated effects
   - barriers to entry/expansion
   - efficiencies

8. We established teams of at least three private sector authors, being one each from Europe, North America and the Rest of the World to work on each of these areas. The members of each team are identified in Annex B. Each team drew on their own contacts and other members of the Working Group to prepare their chapters with particular reference to the guidelines from the 12 countries which were identified as being 'prescriptive':

   - Australia
   - Brazil
   - Canada

- European Union
- Finland
- Germany
- Ireland
- Japan
- New Zealand
- Romania
- United Kingdom
- United States of America

9. Since the original draft chapters were in preparation for the Merida conference, developments in the field of ICN members' merger guidelines have continued apace. For example, in the UK the Office of Fair Trading and the Competition Commission each published guidance in advance of the new merger regime that came into force in June 2003; the New Zealand Commerce Commission issued revised guidelines effective January 2004; in February the European Commission adopted its inaugural guidelines in final form after publishing a draft in late 2002; and the Department of Justice and Federal Trade Commission held a joint workshop to review the U.S. horizontal merger guidelines; most recently, the Canadian Competition Bureau sought comment on its new draft guidelines in March.

10. In an effort to keep abreast of such developments, the chapter teams were invited to provide a post-script to their chapters revised since Merida, or otherwise bring their contribution up to date as they considered appropriate.

FINDINGS

11 In this section we present short summaries of the five chapters noting in particular their key findings on the similarities and differences in the treatment of major topics. We have also added below our own commentary and evaluation of some points raised by the teams, and have indicated where this is so. Moreover, we have also identified a number of other issues that we consider merit further attention, and have similarly identified these. (These added views are expressed as our own, rather than those of the author teams.)

12. We should begin with an overarching point. Since the function of guidelines is to explain an underlying legal test, it is self-evident that guidelines should clearly state how the principles of economic analysis that they set out relate to the underlying legal test. Without this connection, guidelines may well fail in their task of explaining how the legal test will be applied.

Market definition

13. The principal, if not exclusive, goal of merger control in these 12 jurisdictions is the identification and prevention of transactions that create or enhance market power. The most widely used screen for the determination of the possible existence of market power is based on market share, i.e., the percentage of total sales of the relevant product to be held by the merged firm and the distribution of the remaining share among its rivals. Market share values have well-known limitations as a means of measuring market power, which are discussed in the market definition chapter and in the unilateral effects chapter.

14. But market share is nevertheless a basic component of merger analysis. For example, the authors note that high market shares – and significant increases therein resulting from merger – are an imperfect but useful indication of the possible existence and increase of market power. The calculation of market shares presupposes the definition of a market and the identification of the firms participating in it. It is the goal of the market definition process to ensure that these calculations, and thus indications of the possible existence (or not) of market power, correspond as closely as possible to market realities.

15. The team found that the guidelines surveyed shared a broad consensus on the value of sound market definition as a framework for the application of their merger review standard (irrespective of the specific substantive test employed). It might be asked whether a specific market definition exercise is needed as part of merger assessment: if the role of market definition is simply to identify the competitive constraints faced by the merging parties could this not be included within the competitive assessment, where the extent and effectiveness of the identified constraints are assessed? In practice, however, market definition, properly conducted, can bring intellectual rigour and discipline to the identification of competitive constraints.

16. Thus the authors recognise that, although market definition is a useful discipline in screening for market power, it is not an end in itself. It needs to be considered in the context of market dynamics. Put differently, market definition must reflect the relevant underlying competitive constraints faced by the merging parties. Conceptually, these constraints could be analysed directly – for example, by using demand and supply elasticities – but is this practical or desirable? We consider that market definition is a valuable exercise: it focuses analysis of possible changes to, and levels of market power and helps identify the competitive constraints to which the merging parties are subject.

17. The team found that a majority of the guidelines use similar concepts and tools to define markets, again irrespective of the substantive test employed. Nonetheless, we would add that care is needed when applying market definition concepts and tools of the type identified by the authors. This is because it is rarely the case that a market can be easily delineated, and taking too strong a position on the limits of a market might in fact exclude some constraints that do affect competition in that market. In reality, there is normally a spectrum of substitution possibilities that the analytical framework needs to accommodate.

18. Most of the guidelines surveyed by the authors explicitly adopt a version of the hypothetical monopolist test, using existing prices as a baseline, and an increase of five to ten per cent, but preserving flexibility to use different prices or ranges for the test where appropriate. The 2002 Paper asked whether the hypothetical monopolist test is indeed the 'best' test for establishing the boundaries of the relevant market. The authors address this issue by arguing that the SSNIP test represents core concepts of demand and supply elasticity which are integral to sound merger analysis. We note that the precise formulation of the test can lead to different results in practice.

19. The reliability of the SSNIP test[3] however depends fundamentally on the base price chosen for the test. The base price in merger analysis will usually be pre-existing prices (as a proxy of what might be expected in the absence of the merger). But the chapter also discusses whether a different base price might be needed in certain circumstances, such as when there is an already substantially supra-competitive price. Without care, application of the test might then imply that the range of products competing is wider than it really is. This situation is commonly known as the 'cellophane fallacy'. The authors note that this principle might be more relevant in regimes where the substantive test is based on dominance, in as much as the level of market power needs more attention than in SLC regimes which focus attention on the change in the market. We would suggest this as a useful further area of work.

20. The authors note a broad consensus on the importance of supply-side constraints, but identify differences of approach among the surveyed guidelines in whether these are considered as part of market definition, as part of the analysis of barriers to entry, or in the assessment of competitive effects. The chapter concluded that these different approaches should not change the outcome of the analysis. It notes, however, that defining markets by reference to some supply-side considerations could sometimes allow earlier determination that an undertaking would have no significant market power, thus avoiding the need for further analysis.

---

[3] SSNIP is a widely used acronym for a small, significant non-transitory increase in price.

21. We agree that identification of supply-side constraints is a complex area: not only does recognition of supply-side competitive constraints vary from guideline to guideline, but the conditions for recognising such constraints also vary. For example, some guidelines treat capacity expansion or product repositioning by existing players as part of the entry analysis under competitive assessment, rather than as part of supply-side substitution in market definition. It is clear, however, that what matters fundamentally is recognition of constraints, rather than the labels attached to them. It might be a useful area for further work to clarify the conditions under which supply-side constraints are properly taken into account. Indeed, the authors suggest that a good guideline on supply-side substitutability might involve early consideration of supply-side responses which could occur with little or no investment, with other aspects to be considered later in the analytical process (i.e., after the market has been defined).

22. The guidelines were found to be in broad agreement about the approach to geographic market definition, although some jurisdictions indicate that foreign competition will be taken into account in the competition assessment rather than market definition. The authors consider that this might unduly limit or complicate the analysis, especially of market share.

23. The team found that the treatment of other market definition issues varied considerably. For example, the question of how to treat supply by a vertically-integrated firm to its own downstream business was not always clear. Similarly, the temporal dimension to market definition, the period over which substitution should be assessed, the use of chains of substitution, and the impact of price discrimination (including the question of whether a group of customers is 'captive' to the merging parties) were often expressed in rather vague or flexible terms (and sometimes not at all). The team notes that this provides the possibility of an open-ended and legally uncertain process. They note that there is scope for more guidelines to make more explicit and clear reference to these concepts.

24. Overall, the team found the guidelines on market definition to be helpful and generally transparent. They believed a balance needed to be struck between transparency and flexibility to respond to the real-life situations presented by each case. They note that citation of case law and explanation of general principles can both be very helpful, but that guidelines should avoid becoming so detailed as to become confusing.

25. Finally, the team noted that while some ICN members have recently revised their guidelines, the approach of earlier specific guidelines on market definition has been retained in each case.

Unilateral effects

26. Unilateral effects arise when the merged group is able profitably to raise price, or reduce value for money, choice or innovation through its own acts without the need for a co-operative response from competitors. The chapter examines the treatment of unilateral effects in horizontal, vertical and conglomerate mergers.

27. The 2002 Paper questioned whether there is a wide consensus on the broad analytical framework for evaluating whether a merger will increase market power. The chapter on unilateral effects concentrates more fully on this analytical framework question. It identifies that – with some variations – the guidelines examined generally offer a seven-step approach to examining unilateral effects (i.e., market definition, positions of the merging parties, competitors' positions, market dynamics, new entry, buyer power, assessment against the 'counterfactual').

28. In revising their chapter since Merida, the authors have taken account of recent developments relating to the merger guidelines applicable in the European Union, New Zealand and Canada. In examining how the surveyed guidelines analyse unilateral effects in their latest versions, the authors begin by noting that not all guidelines use this term; the UK and EC guidelines refer to 'non-coordinated effects' to emphasise that the issue in such analysis is not simply whether the merged firm will find it profitable to increase prices post-transaction, but whether it rivals will be similarly situated (because the merged firm's higher prices will drive some customers to its rivals, thus increasing demand for their products).[4]

29. The authors note the existence of a reasonable consensus that high market shares are a prima facie indicator of likely unilateral effects, with higher combined shares increasing the likelihood of concern. As to the application of unilateral effects analysis, the authors suggest that the analysis is more complex and possibly more controversial when the merger combines smaller players in an oligopoly (than in cases where the merged firm is the clear market leader).

30. This observation may well be correct, although we note that the potential competition concern is the same whether or not the distribution of market share suggests the merged firm is 'dominant': as the authors point out in relation to the example given, the concern in such a case will be that the

[4] The proposed advantage of such terminology is that 'unilateral effects' is liable to be misunderstood as referring exclusively to action by a single firm, in particular the merged entity. In merger guidelines, the term is mainly used to refer more generally to independent and hence 'non-coordinated' action by market participants. Future authors of guidelines might wish to consider if this kind of clarification would be helpful to their own readerships.

merger eliminates an important competitive constraint as between the parties and potentially also on their rivals, leading to higher market prices.

31. In introducing unilateral effects, the authors have removed the references in their Merida draft to three basic categories of unilateral effect to take account of the corresponding change between the draft and final versions of the EC guidelines. Thus, rather than identifying the creation of “monopoly” and a “paramount market position”, respectively, as analytically distinct categories within unilateral effects, the authors now identify a single category from among the guidelines that address such effects in detail, with a tendency to focus on two particular fact patterns:
- where the merger combines close substitutes in a differentiated product market; or
- where the merged firm’s rivals face capacity constraints.

32. The articulation of a unified theory of unilateral effects brings welcome clarity as the profusion of terms within merger analysis had been confusing and potentially obscured the real analytical task of identifying whether or not a merger is likely to give rise to competition concerns. Various guidelines, most recently those of the EC, stand for the proposition that two concepts – coordinated effects and non-coordinated effects – capture the possible theories under which a horizontal merger might raise competition concerns.

33. In respect of unilateral effects in a differentiated product market, the authors summarise the analysis here as an inquiry into whether or not
i) the rivalry between the merging parties is important, for example, because the parties’ products are particularly close substitutes (e.g. in terms of product attributes, geographic location or perceived quality or reliability); ii) such rivalry is unlikely to be replaced, for example, by the re-positioning of products by rivals to become closer substitutes;
iii) efficiency gains by the merged entity will create incentives to increase output (and lower price).

34. As to the example of capacity-constrained rivals, the authors summarise the guidelines as predicting adverse non-coordinated effects where the merged entity could profitably decrease output and raise price because its rivals could not respond with increased output and entry was likewise an insufficient deterrent. Reflecting the thinking behind the term ‘non-coordinated effects’ the authors make the observation that even if rivals are not capacity-constrained (i.e. have the ability to increase output), they will lack the incentive to do if it would be more profitable to them to restrict output and enjoy higher market prices initiated by the merged firm.

35. Foreshadowing their discussion of 'safe harbours' relating to market share are used in some jurisdictions, the authors highlight that undue focus on

market share, particularly in differentiated goods markets, may embrace the '0/1 fallacy' whereby all goods 'in' the market are assigned equal weight, regardless of their distinctive qualities, and those outside are accorded zero weight. We agree that rigid conclusions on market definition and reliance on share data can easily obscure the continuum of constraints that characterises competition in many industries and could detract from the fundamental question as to the likely effects of the merger upon competition.

36. Turning to safe harbours based variously on market shares or concentration indices (e.g. HHIs or CR4), the authors observe that these are employed either on a 'strong' basis, with absolute guarantees, or on a 'weak' basis with advisory levels. They can conserve the resources of the authority and offer benefits to notifying parties. An important question raised in the 2002 Paper was the extent to which safe harbours[5] can be relied upon in screening out mergers that raise competition concerns. In addressing this issue, the authors are sceptical about the use of strong safe-harbours. First, such safe-harbours can potentially exclude a questionable transaction from scrutiny. Second, and more practically, because market definition is a difficult exercise (as discussed above), concentration ratios based on particular market definitions are not always reliable indicators of an absence of competition concerns.

37. Accordingly, we note that jurisdictions that seek to place a strong emphasis on precise identification of markets may place greater weight on quantitative concentration measures (reflected in presumptions of anti-competitive effect). In contrast, jurisdictions that use market definition just as an analytical tool to identify the most immediate competitive constraints on the merging parties may approach concentration measures with greater caution. Absent a confidently precise market definition, it is arguable that concentration measures can never be more than a general indicator of the presence or absence of competition concerns. It might not be appropriate then to use a concentration measure either as an absolute safe harbour or as a presumption of competitive harm.

38. Moreover, in deciding how to approach questions of concentration measures and safe harbours, competition authorities need to balance ease of application (for both regulators and business) against predictability of outcomes. Another way of looking at this is that authorities may need to decide whether to focus attempts to minimize Type 1 errors (challenging non-problematic mergers) or Type 2 errors (clearing problematic mergers). This may impact on the choices made as to whether to adopt 'hard' or 'soft' safe-harbours, for example.

[5] A safe harbour is a threshold concentration measure below which a merger will not be challenged.

39. The authors raise five issues related to estimation of market shares and concentration: (i) the overall objective (is it to arrive at the best proxy for market power, or a worst-case screen?); (ii) the appropriate criteria for measuring share, including (iii) the time frame; (iv) treatment of captive production; and (v) measurement of market concentration. In relation to the latter, the authors note that HHIs are generally preferred as a measure of concentration since the measure relates not only to the position of the merging parties but also the positions of rivals.

40. We also consider that guidelines using concentration measures – including HHIs – need to incorporate an indication of the levels and prospective changes in concentration as a result of the merger that are likely to give rise to further investigation. Setting the appropriate levels of concentration and increases in concentration is not, however, straightforward. It is also arguable that different levels and increases are appropriate for different sizes of economy and for economies at different stages of development (e.g., transition or mature economies).

41. The authors also raise questions as to whether guidelines state clearly enough how unilateral effects theory might apply to (i) acquisition of potential competitors; (ii) monopsony issues i.e. the creation or enhancement of market power in a procurement market and (iii) a failing firm defence. The authors also note scope for (more) guidelines to acknowledge that market shares may be of limited use in assessing unilateral effects in differentiated product industries.

42. In sum, the basis on which guidelines describe unilateral effects may vary, but there appears to be a reasonable consensus on the sorts of factors that will be taken into account by competition authorities in reaching a view.

Coordinated effects

43. Competition law has long been concerned that the loss of a firm through a merger, joint venture or other concentration may facilitate coordination among the remaining firms in the industry, leading to reduced output, increased prices or diminished innovation. The analytical framework used by competition authorities has recognized this fundamental competitive effect in a variety of forms, treating it in some cases with detailed discussion and analysis, but just briefly in others.

44. The team observed that the treatment of coordinated effects in the surveyed guidelines was potentially sensitive to the nature of the substantive test. More specifically, the authors conclude that, although the original EC Merger Regulation was applied in coordinated effects cases (and upheld by the CFI), jurisdictions utilizing a 'dominance' standard may require judicial

confirmation that they have legal authority to challenge mergers on coordinated effects grounds using the dominance test.

45. This is an interesting assessment by the authors since at first sight there would appear to be no real difference between the dominance and SLC tests in the way in which they treat coordinated effects. Separately, in addition to the thesis advanced by the authors, another possible implication of the choice of substantive test for treatment of coordinated effects is in relation to handling of possible non-coordinated oligopoly cases. It is arguable that, given doubt as to the precise terms of the dominance framework, cases that partly involve non-coordinated effects concerns have been brought instead under the coordinated effects concept, which can involve significantly more complex economic analysis than non-coordinated effects cases. Thus, there may be greater risks of clearing anti-competitive mergers under the dominance framework than under the SLC framework.

46. The authors then discuss the relationship between concentration ratios and the scope for coordinated effects, noting that some guidelines establish absolute safe harbours while others provide indicative, but non-binding, safety levels. In addition, we note that some jurisdictions place substantial weight on concentration measures to found, or in some cases presume, coordinated effects.

47. The 2002 Paper asked how the merger review process should evaluate whether a market is susceptible to coordination. The authors highlight that there is uniform recognition of the three main factors that might lead to co-ordination. First, the coordinating parties must be able to establish terms for coordination. Second, the participating parties must be able to monitor adherence to the coordinating behaviour. Third, effective deterrence mechanisms must exist to prevent parties reneging on coordinating behaviour. The chapter also notes that some guidelines list additional factors, or market characteristics, which might be relevant in particular circumstances. The authors suggest that more detailed discussion of these areas in merger guidelines could reduce uncertainty of merger review and deter some potentially anti-competitive mergers.

48. Finally, the chapter notes that some guidelines consider how the merger itself might facilitate coordination other than by simply reducing the number of competitors in the market. For example, the United States considers whether the merger leads to the elimination of a collusion-destabilizing maverick.

Barriers to entry and expansion

49. A merger that materially increases market concentration may not be anti-competitive if new firms could enter the market, or if incumbents could readily expand production, to prevent the exercise of market power.

50. At the outset, we note that entry considerations should be integral to the competition assessment and not just as a 'defence' to possible concerns. Though entry may often constrain market power post-merger, some guidelines acknowledge that a merger may have adverse effects on competition because it increases barriers to entry to a particular market and thus reduces the effectiveness of entry as a competitive constraint. This is not, however, common across all guidelines.

51. The chapter describes how various jurisdictions assess entry and expansion, including a discussion of the possible forms of new entry. The authors also address the issue of the effectiveness of entry. In short, most guidelines require that to be effective in constraining post-merger market power entry must be likely, sufficient and timely. There is broad agreement between the surveyed guidelines on the basic concepts, but the chapter notes some differences on the harder question of how to perform the assessment in specific cases.

52. When assessing the likelihood of entry, the US and Brazil approach is based on a quantitative minimum viable scale (MVS) analysis. It is usually the case that the MES test requires a higher level of sales activity than the minimum viable scale. The team is however unsure if the different approaches might lead to different outcomes in practice and notes the scope for further work in this area.

53. Judgments of the likelihood of entry must be fact-based. Firms relying on prospective entry to rebut concern about a potentially problematic merger will need to produce evidence of genuine likely entry. It will rarely be enough for firms to show, in the abstract, that entry is possible: most guidelines also state – though not all are clear on this – that actual entry must be likely.

54. In most guidelines the issue of entry being sufficient (to offset potential problems) is closely linked to that of likelihood, but some guidelines note particular exceptions – e.g. where the new entrant would be able to compete for only a small or distinct part of the market.

55. Finally, there is broad agreement that entry must be timely – i.e. it must occur in a timescale that is short enough to deter or render unprofitable the exercise of market power in the context of the market concerned. The authors note that this time period may differ from case to case, depending

on the particular facts. They observe that most merger guidelines indicate time periods of up to two years in which such entry may take place (with some regarding activity within one year as supply-side substitution to be taken into account in market definition).

56. We have already noted above the relationship between supply-side substitution and entry as constraining factors. What matters is that all real competitive constraints are taken into account, rather than the labels attached to them.

Efficiencies

57. Since Merida, the authors have revised this chapter to take into account the new merger guidelines of the OFT and the Competition Commission in the UK, as well as the new European Community Merger Regulation (ECMR) and the new horizontal merger guidelines. The chapter also considers recent developments and case law in New Zealand and in Australia, and addresses developments in Canada in respect of its draft legislation to remove the statutory efficiency defence in force. There is further discussion on the types of efficiencies that may be considered together with the method under which efficiencies may be balanced against the anti-competitive effects of a merger. The authors also raise the applicability of a more flexible consideration of efficiencies for countries with small or developing economies.

58. The authors of this chapter begin by noting, as did the 2002 Paper, that the way in which efficiencies are incorporated into the review of mergers by a competition authority is itself an important policy question.

59. In particular, the 2002 Paper asked whether efficiency evidence was best taken into account as part of the competition analysis (showing that a market might be made more competitive by the merger) and/or as a countervailing justification for an anti-competitive merger (in which an adverse effect on competition may be permitted on the grounds that efficiency benefits, especially those accruing to consumers, outweigh the competition problem). The 2002 Paper noted that this depended in part on how the merger law was expressed and how its core purpose was interpreted.

60. The authors look at the surveyed guidelines in this light. They note the debate about whether efficiencies reaped by producers in the form of profit gain should be considered in addition to those that benefit consumers, and in particular the extent to which cost savings are passed on to consumers in the form of lower prices. From the economic stand-point, the authors consider that there appear to be a number of reasons for assessing efficiency gains to both consumers and producers. By assessing only

benefits to consumers, they conclude, a zero weight is assigned to producer profits which they argue disregards the fact that gains to producers can be socially positive. (We would add, however, that the stance of merger policy affects not only how mergers that present themselves are assessed, but also which mergers are proposed in the first place. A full welfare assessment of policy would take account of the latter as well as the former issue.)

61. The fact that the surveyed guidelines do not, in the main, account for increases in producer efficiencies is, in our view, largely a policy decision. Legislatures and those responsible for merger decisions have generally concluded that the core purpose of their merger control regime is to protect consumers (or customers). It seems clear that – of all the substantive issues raised in the chapters – the issue of efficiencies raises some of the sharpest questions about the underlying goals of merger control laws. For this reason, and because of the information asymmetry issue discussed below, competition authorities should give particularly careful thought to the efficiencies sections of guidelines.

62. The authors make a further point about the requirement in many guidelines that efficiencies be passed on to consumers (at least in good part).[6] They conclude that, with this requirement, the efficiencies defence will rarely be of use because the transactions where 'passing on' is likely to arise will themselves rarely be problematic. This is because they consider that the 'passing-on' requirement effectively requires a competitive market. (We would note, however, that as a matter of economics, even a monopolist would pass on a proportion of marginal cost savings to consumers.)

63. The authors also address the issue of whether efficiencies ought to be merger specific – i.e. they would not arise in the absence of the merger. Almost all jurisdictions studied state that any efficiencies claimed must be merger specific, thus they must be considered within the context of alternative means by which they could be achieved. This requirement can generate complications, requiring competition authorities to consider the realism of hypothetical alternatives.

64. The 2002 Paper raised the question of whether competition authorities should be sceptical of efficiency claims in mergers that raise competition issues. Scepticism (in relation to such mergers) arises from informational asymmetry and difficulties in measuring the expected value of any efficiency. The authors comment that in some cases the evidentiary burden of proof imposed on the merging parties appears to be greater with respect to efficiencies than that imposed on competition authorities with respect to anti-

[6] There is also the question of which consumers count in the reckoning of benefits – just those in the affected markets, or others too?

competitive effects. This may reflect a cautious approach (either at the screening or at the determinative stage of merger review) to transactions that are perceived to have anti-competitive effects. The chapter argues that this could have detrimental effects on welfare given the social costs that are incurred in blocking mergers that may produce synergies.

65. But in our view this sceptical stance – or at any rate, placing the burden of proof on the parties when they make efficiency claims about mergers raising competition concerns – may be the correct approach given the very significant information asymmetries between the merging parties and the competition authority in relation to efficiency claims. That said, there is question of how far scepticism should go, and the risk that if carried too far, pro-competitive (or pro-consumer) mergers would be stopped.

66. The team reviews the detailed approaches to efficiency analysis and argues that competition authorities should adopt more consistent approaches. This would imply further work on which efficiencies should be considered; how they should be quantified (and discounted if necessary); and how they should be weighed against perceived detriment to competition and consumers.

67. In sum, the guidelines reveal a diversity of approaches to the treatment of efficiencies. The authors have provided a thought-provoking analysis which should lead to an interesting debate.

CONCLUSIONS AND SUGGESTIONS FOR NEXT STEPS

68. We began by remarking that the merger policies that apply around the world can be compared on three levels: laws and regulations; guidelines; and casework. Our first concluding observation is that, notwithstanding international diversity of the wording of merger laws and regulations, the merger guidelines that this project has compared have a lot – perhaps a surprising amount – in common.

69. For example, there is a great deal of common ground in the approaches to market definition, with almost universal acceptance of a form of the hypothetical monopolist test and with recognition that market share values are a tool to be used as a step in a case-by-case analysis rather than providing an answer that needs no further consideration.

70. Our second conclusion is that, nevertheless, there are important differences between guidelines. These differences relate in part to the nature of guidelines and in part to their treatment of substantive issues.

71. As to the nature of guidelines, some are considerably more detailed and comprehensive than others. No doubt this partly reflects differences in the accumulation of case law, decisional practice and experience under different regimes. But it also illustrates an underlying dilemma. Guidelines, by their nature, are independent of the facts of particular cases. Detailed prescriptive guidelines may have merits in terms of clarity about how the authorities will treat cases, but the risk is that they will unduly constrain case analysis, or become so long and complex that clarity is diminished rather than enhanced. (This dilemma is somewhat reminiscent of the debate between *per* se and rule-of-reason analysis in non-merger antitrust.) But a dilemma is not a reason to do nothing. Good and transparent merger guidelines, without unduly constraining the analysis of cases, should bring benefits in terms of highlighting what kinds of evidence matter most in merger appraisal. Thus they can usefully focus the fact-based analysis of cases.

72. On the treatment of substantive issues, there is much in common across approaches to market definition, unilateral effects and co-ordinated effects. However, the relative importance attached to the latter two kinds of competitive effect perhaps varies according to the substantive merger test.

73. There appears to be more variation in the treatment (i) of supply-side constraints from entry and expansion of firms other than the merging parties, and (ii) of efficiencies. On (i) it is partly a question of how competitive constraints are labelled: what might count in market definition as 'supply-substitutability' in some regimes might be treated separately as 'entry' in others. This should not lead to different final results of the competition assessment provided that all relevant supply-side constraints are properly reckoned into the analysis at some point.

74. On efficiencies, there are several sources of difference – for example, as to whether efficiencies should count within and/or after the competition assessment; whether producer surplus should have weight; and what is the burden of proof on parties making efficiency claims in cases of competition concern.

Next Steps?

75. Now that this part of the project is complete, the question is how to develop this line of ICN work. A number of options, have been identified, and ICN members are invited at the Seoul conference to vote on their preferred choice. The favoured option will be taken forward and its development will be jointly chaired by the OFT and the Irish Competition Authority: In brief the options are:

    i) Compilation of an agreed checklist of topics which should be covered in merger guidelines

ii) Review of market share data associated with merger prohibitions/challenges
iii) Review of a variety of merger remedies
iv) Compilation of a case database with links to reasoned decisions
v) More in-depth study of a topic already considered under the guidelines study
vi) Wider application of the guidelines study to regimes that have yet to develop guidelines.
vii) Consideration of the nexus between guidelines and cases
viii) Investigation of the analytical economic basis for elements of the merger guidelines
ix) Any alternative topics

76. On these and other points we keenly anticipate the discussion at Seoul!

ANNEX A -
SCOPE OF MERGER GUIDELINES IN JURISDICTIONS REVIEWED

Country		Substantive Test				Scope of Guidelines			Market Definition			Market Structure and Concentration				Competitive Effects/Market Characteristics										Special Provisions					
	Statutory Provision	Dominance	Restriction of Competition	Public Interest	Other	Horizontal	Vertical	Conglomerate	Product Market	Geographic market	Other (eg temporal)	Market Shares	Concentration Ratios (eg CR4)	HHI	Other	Unilateral Effects	Coordinated Effects	Market wide effects	Barriers to Entry/Expansion	Buyer Power	Import Competition	Failing Firm	Innovation Effects	Efficiencies	Other	Financial Strength	De Minimis Considerations	Public Interest	Undertakings offered	Exemptions/Exclusions	Other
Australia	√		√	√		√	√		√	√	√	√	√			√	√		√	√	√	√	√	√	√			√	√		
Brazil	√				√	√	√	√	√	√	√	√	√			√	√		√	√	√		√	√				√			
Canada	√		√			√	√	√	√	√		√	√			√	√		√		√	√	√	√	√						
EU	√	√				√						√		√		√	√	√	√	√		√	√	√					√		
Finland	√	√				√	√	√	√	√		√				√	√		√	√	√	√		√	√				√		
Germany	√	√				√	√					√				√	√	√	√	√		√	√		√	√					
Ireland	√		√			√	√	√	√	√		√	√	√	√	√	√	√	√	√		√	√	√							
Japan	√		√			√	√		√	√	√	√	√		√				√		√				√						√
New Zealand	√		√			√	√	√	√	√	√	√	√		√	√	√		√	√	√	√		√	√						
Romania	√					√	√		√	√																					
UK (CC)	√		√			√	√		√	√	√	√	√	√	√	√	√	√	√	√		√		√	√			√	√		
UK (OFT)	√		√			√	√	√	√			√	√	√		√	√	√	√	√		√		√			√	√	√	√	√
USA	√		√			√			√	√		√		√	√	√	√		√			√		√							

ANNEX B - PRINCIPAL MEMBERS OF THE WORKING GROUP

Secretariat

Steve Lisseter*, Simon Priddis, Amelia Fletcher, Simon Pritchard Clare Tweed and Samina Khan (Office of Fair Trading, London)

Team 1 (market definition)

Mark Leddy*, Stéphanie Hallouët, and Michael Kehoe (Cleary, Gottlieb, Steen & Hamilton, Washington DC); Mauro Grinberg and Priscila Benelli Walker (Araujo e Policastro, São Paulo); and Javier Ruiz Calzado and Annukka Ojala (Latham & Watkins, Brussels).

Team 2 (unilateral effects)

Alistair Lindsay* (Allen & Overy, London); Larry Fullerton (Sidley Austin Brown & Wood, LLP, Washington DC); and Andrew Matthews (Minter Ellison Rudd Watts, Auckland).

Team 3 (co-ordinated effects)

James F. Rill* and John M. Taladay (Howrey Simon Arnold & White, LLP, Washington DC); Anthony Norton and John Oxenham (Webber Wentzel Bowens, Johannesburg); Professor Mitsuo Matsushita (Professor of Law, Seikei University, Tokyo, and Professor Emeritus, Tokyo University, Tokyo); and
Frank Montag and Andreas Rosenfeld (Freshfields Bruckhaus Deringer, Brussels).

Team 4 (barriers to entry and expansion)

Deborah Garza* (Fried, Frank, Harris, Shriver & Jacobson, Washington, DC);
Luis Ortiz Blanco and Konstantin Joergens (Garrigues, Abogados y Asesores Tributarios, Madrid); and Jose Augusto Caleiro Regazzini (Tozzini Friere Teixeira e Silva, São Paulo)

Team 5 (efficiencies)

Calvin Goldman* and Michael Piaskoski (Blake, Cassels & Graydon LLP, Toronto);
Tony Woodgate and Oliver Gilman (Simmons & Simmons, London);
Bob Baxt and Melissa Randall (Alleno Arthur Robinson, Melbourne); and
Ilene Knable Gotts (Wachtell, Lipton, Rosen & Katz, New York).

* These individuals were the leaders of the teams concerned.