FRAMEWORK FOR HORIZONTAL COMBINATION ASSESSMENT

A Project Work submitted in partial fulfillment of the requirements of internship* at Competition Commission of India

by

V.SRIRAJ**

Under the Guidance of

Mr.K.K.SHARMA, IRS, Advisor (Law),

Competition Commission of India [CCI].

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** I Year, LL.M (Business law), National Law School of India University (NLSIU), Bangalore-72.
e-mail: srirajvenkat@gmail.com

DECLARATION

I do hereby declare that the project work on **"FRAMEWORK FOR HORIZONTAL COMBINATION ASSESSMENT"** is my original and bonafide work. This project work is done by me in partial fulfillment of the requirements of internship at **Competition Commission of India (CCI)**, between 15th January and 15th march.

Station: New Delhi

Date:

V.SRIRAJ,
I, LL.M (Business Law),
National Law School of India University (NLSIU),
Bangalore – 72.

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EXECUTIVE SUMMARY

The experience from other jurisdictions shows that about 90 percent of the mergers do not raise substantive competitive concerns. Jurisdictions include both suspensive and non-suspensive merger control regimes. Prolonged suspension deters the normal economic activity of market and such a mechanism, by itself, is anti-competitive. Thus, combinations unlikely to have adverse effects on competition should be allowed to come into effect as early as possible. This requires an effective pro-market screening mechanism, in which the authorities should be able to find out the likely competitive effects of the merger expeditiously.

Indian competition law follows suspensive model of merger control. Any combination, which is required to be notified under section 5 of the Competition Act 2002, will not come in to effect till the expiry of 210 days from the date of valid notice to the commission[1]. This implies that the whole assessment process should be completed within the said time.

Section 29 of the Competition Act says that the Commission, after forming a prima-facie opinion about the merger's likely adverse competitive effect, shall issue a notice to the merging firms to show cause why investigation of such combination should not be conducted.

Sub-regulation (2) of regulation 27(opinion on the existence of prima-facie case) of the proposed draft of combination regulation[2], published by Competition Commission reads that

> The Commission shall form its prima facie opinion within-
>
> (a) thirty days of receipt of a valid notice, if the notice is in Form 1;
>
> (b) sixty days of receipt of a valid notice, if the notice is in Form 2

[1] However the commission may effect an merger before such period by issuing clearance order under section 31(1) of the act

[2] Available at http://competition-commission-india.nic.in/ (accessed on 12/02/2008)

Further the proviso added to the above sub regulation says that in the absence of any notice under section 29, the receipt of notice given under regulation 16 (2) will be deemed to be an order of approval given under section 31(1).

Though the act fixes 210 days time, the mechanism under the draft regulation approves mergers within a month or two, if it is unlikely to have an impact on competition[3]. Once the implementing regulations of the competition Act gets enforced the commission would be put in to trouble unless they have an efficient preplanned approach for combination assessment. Other jurisdictions like Australia, US, Canada have their own merger guidelines which incorporates an analytical framework for merger assessment. Such a framework helps the competition authorities to have a timely and effective combination assessment.

The endeavor under this project would be to give a complete basic picture about the process involved in combination assessment and to suggest a framework for prima-facie anti-competitive determination.

The report will be based on the common practice prevalent in 9 jurisdictions selected for the purpose of this study. The merits and glaring differences among these jurisdictions will also be mentioned whenever necessary. The jurisdictions selected for the purpose of the study are

- Australia
- Brazil
- Canada
- European Union
- Ireland
- Japan
- New Zealand

[3] This adopts the ICN's recommended practices for notification procedures, See RP IV C, comment 5.

- United Kingdom (OFT's procedure)[4]
- United States

For the purpose of this study, a brief elaboration of the concepts involved will be made. The idea behind explaining various concepts of combination assessment is to have a preliminary idea, sufficient to appreciate the possibilities of prioritizing the various steps involved. Thus the spirit of this study needs to be differentiated from a study involving the assessment of technicalities and effectiveness of various steps involved in combination assessment.

The report will be divided into four segments. The first chapter will be dealing with the need for combination control. In the second chapter there will be a briefing about the significant concepts involved in combination assessment. Third chapter will deal with the structure of framework adopted in different jurisdiction, and finally in the fourth chapter a model framework will be suggested for India.

[4] Since the project involves the study of preliminary combination assessment, the researcher finds it appropriate not to discuss the procedure of Competition Commission, U.K., which performs the final assessment.

1. INTRODUCTION

Why combination regulation?

In free market, participants tend to collude and abuse their dominance for better survival and higher profits. In doing so they don't consider about the diffused interest of the consumers. The underlying object of any competition law is to restrict anti-competitive practices in market, to achieve this purpose jurisdictions incorporate provisions prohibiting anti-competitive agreements and abuse of dominant position.

Though collusion and abuse of dominance are not possible in general, a combination may internalize these aspects and it can indirectly achieve the purpose of collusion and dominance which is otherwise prohibited under law. Thus in the absence of effective combination control, market participants are left with an alternative option to achieve anticompetitive things in an indirect manner.

Horizontal combination:

A horizontal combination is nothing but an agreement of, acquisition, or merger, between two entities in the same market. In all horizontal combinations there is an increase in economic concentration, but such concentration is sufficient to exercise market power or not is the concern of competition. As of now, more than hundred jurisdictions have competition enactments to control market concentrations. The underlying presumption is that, competition promotes consumer welfare and market concentrations impede competition by the exercise of market power. Thus the task of the competition authorities in respect of combinations is to see whether any combination impedes consumer welfare by affecting competition. The fact of efficiencies, consumer choices and fair market also comes in to picture when we speak about consumer welfare.

Need for Pro-market regulation:

While speaking the probable ill effects of capital driven economy one should not ignore its benefits. Experience has shown that after liberalization, the employment opportunities, government's revenue and infrastructure development in the nation, all have improved. Further it has shown to have the potential to supply the needs of increasing population. The mechanism to regulate market needs to be pro-market, but at the same time effective in protecting public interest.

Pro-market regulation refers to control that do not obstruct the normal activities of the market. A merger is a normal recurrent activity of market. Experience from other jurisdictions shows that most of the mergers create efficiencies and competition, some are competition neutral and very few are anti-competitive. In the process of restricting anticompetitive mergers, the state authorities should not disturb other mergers which have no anticompetitive effects. Jurisdictions adopt different measures to avoid hindrance to combinations, which do not raise any anti-competitive concerns.

2. CONCEPTS INVOLVED IN COMBINATION ASSESSMENT.

Competition assessment of a combination is carried out to promote and preserve consumer welfare. In this process, competition authorities take into account a variety of factors which can lead to exercise of enhanced market power, and compare it in the presence and absence of merger. This analysis of future should also take notice of the general dynamics of the market. This chapter gives a brief idea about the various concepts involved in combination analysis. This discussion about concepts helps in appreciating the ordering of relevant factors in the framework for combination assessment.

2.1. Market definition

Market definition is the first step in any combination assessment, since it is the competition within that market that concerns competition authorities.

The object of defining market is to assess the degree of market power that can be exercised by the resulting entity. Thus, while defining the market, the authorities have to keep in mind the said purpose. There are many dimensions of a market[5] but for the purpose of competition, the following two dimensions are more relevant

- Product &
- Geographic dimension. These two aspects need to be separately defined in every case.

Relevant product market: **"**A relevant product market comprises of all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products characteristics, their prices and intended use[6]".

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[5] In Australia and New Zealand, in addition to product and geographic market, the functional, temporal and customer dimensions are also defined. (see ¶3 of New Zealand and ¶ 5.40 of Australian guidelines)

[6] European commission notice on the definition of the relevant market for the purpose of community competition law. Published in OJ C 372 dated 9.12.1997.

Delineation of relevant product market is a two-step process. *Firstly* the actual goods/services of the merging entities are identified *secondly* each product of the merging firms is gradually expanded to incorporate the available substitutes.

Substitutability from the view point of the consumers is one of the main elements to be considered in defining product market (demand-side substitution). That is the extent to which the customers can switch among the substitute products in response to any price rise.

Though demand-side substitution is the predominantly used factor in delineating product market, the recent trend in different jurisdictions shows the significance of supply-side substitution considerations. Considering supply side-side substitution helps in identifying the market participants, conditions of entry, and the possibilities of existing suppliers to switch their production or distribution facilities to supply substitute products.

<u>Small but Significant and Non-transitory Increase in Price (SSNIP) test:</u> Majority of the jurisdictions apply SSNIP test, as a tool for delineating the scope of relevant market. According to this method "A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a *'small but significant and non-transitory increase in price',* assuming the terms of sale of all other products are held constant[7]".

The endeavor of the authorities under this test is to identify each and every product of the merging entities. Then, for each identified product the authorities pose themselves a question of what would happen if a hypothetical profit making firm makes 'a small but significant and non-transitory increase in price'(provided the sale of the other products remaining constant). The purpose of this question is to find out

[7]§1.0, U.S. Dep't of Justice & Federal Trade Commission, Horizontal Merger Guidelines (1992, revised 1997).

the buyers behavior in switching to available substitutes. If the price rise leads to the use of substitutes by buyers, leaving no room for the hypothetical firm to yield profit, such substitutes are also included in to the product market. At this stage the authorities will consider substitution (both demand and supply side) factors, switching cost and time for substitution. The SSNIP question is asked again and again, till the time an exclusive product market is defined, i.e. a market where no substitute for the product of hypothetical monopolist is available. The market as defined under this process is one in which the hypothetical profit earning firm can go for a small but significant and non-transitory increase in price without any impediment.

Generally this mechanism is followed in the absence of any *price discrimination* between buyers. When the hypothetical profit earning firm can be profitable by discriminatory pricing to a sect of targeted buyers[8], the analysis of product market is different. In such situation the authorities will take into account the particulars about the use and uses by different class of buyers and define product market either in a little narrow sense or different definition for different sects of buyers.

Relevant geographic market: "The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighboring areas because the conditions of competition are appreciably different in those areas"[9].

Geographic market implies the territorial area in which the buyers are supplied with the goods and services of the merging entities. As said in the product market, a narrower definition will not work for the purpose of competition assessment. The definition of geographic market should include the potential area in which the buyers shift their purchase in response to price service.

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[8] Those who would not defeat SSNIP by switching to any substitutes or by engaging in any arbitrage because of the price differences in different markets.

[9] Supra 7.

Product and geographic market are overlapping concepts and one cannot be delineated in isolation of the other. Further, SSNIP test prescribed under US guidelines is a common test for delineating both product and geographic market. Under the test, all the areas, in which a small but significant and non-transitory increase in price would not be profitable to the hypothetical profit making firm, because of customers switching to alternative source of supply, are included in the definition of relevant geographic market. The underlying criterion to outline geographic market is the buyer's ability and willingness to shift their purchases, in sufficient quantity from one location to another, in response to increase in price.

The general factors (both price and non-price considerations) that are taken in to account for deciding substitution in source of supply are evidence that two products have similar functions, technical characteristics, or end-uses; similar price levels or movements between two products or two geographic areas; fragility and perishability of the goods; customer switching costs; customers convenience in accessing alternative source of supply, transport costs, and shipment patterns. This is not an exhaustive list the authorities may well inquire in to the other similar factors.

Table 1: comparative chart about market definition practice

Jurisdiction	MARKET DEFINITION		
	Product market	Geographic market	SSNIP test
Australia	Yes	Yes	Yes
Brazil	Yes	Yes	Yes
Canada	Yes	Yes	Yes
European Union	Yes	Yes	Yes
Ireland	Yes	Yes	Yes
Japan	Yes	Yes	Yes
New Zealand	Yes	Yes	Yes
U.K[OFT]	Yes	Yes	Yes
U.S	Yes	Yes	Yes

2.2. Market Concentration

Market concentration refers to the number and size of participants in the relevant market. An increase in market concentration implies the gain of pricing power and decrease in competition. Majority of the combinations results in elimination of a player, and an increase in the market share of a concern, these aspects of the combination gives rise to both unilateral and coordinated competitive concerns. Sometimes a combination may give rise to the emergence of unilateral market power, having the ability to control the supply and price of a product in the relevant market. A reduction in the number of player increases the probabilities of the coordinated conduct, between the players. A long time concentrated market structure also shows the existence of entry barriers in the relevant market. Determination of concentration involves the following three stages

1. Identification of all the players who participate in the relevant market,
2. Quantification of their respective shares in market,
3. Calculation of the levels of concentration (both pre and post-merger concentration).

The computation of concentration may be little adjusted to reflect near future market. For instance the EU guidelines say that market share can be adjusted to reflect reasonable future changes, for instance entry, expansion or exit.

Identification of participants: All the firms engaged in production of the identified goods are included as participants in the relevant market. The identification process generally includes the potential suppliers, commonly referred as participants through supply response[10]. All those firms who might participate in the relevant market, in the near future, in response to the price rise are called participants through supply response. The participation may be due to their existing production or technological capacity, or identical or similar operation in adjacent geographic market. These players by reason of their market position can produce and supply the

[10] 'Un-committed entrants' in U.S.

relevant product without any sunk costs (market specific investments that cannot be recovered through its utilization outside the relevant market) investment.

Market share: Market share signifies the competitive significance (present and future) and total stake of the concern in the relevant market. Market share also reflects the consumer preferences and brand loyalty for a firm's product. Higher the market share, higher the market power the firm enjoys.

Market shares of firms are quantified on the basis of revenue yielded or units of production or units of sales or the production capacity depending upon the situation of market[11]. In majority of the cases these data are available in market itself, but still it is necessary for the competition authorities to know about the basis of calculation, so that they can be sure on the authenticity of such readymade data.

In case where the products are homogeneous and the market participants operate at their full capacity, the result based on any of the above said indicator would be more or less the same.

In case of homogeneous product market, where firms are differentiated on the basis of capacity, capacity well reflects the future competitive significance of the firms. But capacity of the firm may not be a good indicator, if the firm utilizes any of its capacity outside the relevant market or the unused capacity of the firm does not have any competitive significance (for instance the excess capacity is not used by the firm for a long time due to marketing difficulties).

If firms are differentiated by products in the market, revenue yielded by the firm can be used to calculate the market share. In this market, one product is the imperfect substitute of another.

[11] Basis of market share calculation are better discussed in Canadian guidelines, see ¶4.5 to ¶4.10 of the said guidelines.

For firms that participate through supply response, the unit sales or the units of production made available in relevant market well reflect the market share. In these situations capacity of the firm is irrelevant, since substantial capacity of the firm is being used outside the relevant market. If firms are in relative advantage by discriminating different buyers or group of buyers, then also output of the firm better reflects the market share.

Measures of Market concentration: There are many measures of market concentration, but the predominantly used measures in different jurisdictions are

- **Market share (MS):** The percentage of individual firms holding in the computed total market share. Market share of the individual firm is taken in to account to test the probable future unilateral competitive concerns.
- **Industrial Concentration ratios (CRs):** CRs are nothing but the sum total of the market share of few leading participants. CR4 is the commonly used index which implies the aggregate of shares, of first four leading participants in the market. CRs are used to predict the future coordinated competitive concerns.
- **Hirfindahl-Hirschmen index (HHI)**: HHI is the summation of the squares of the Market shares of all the market participants. Delta refers to the difference between post and pre-merger HHI. This index is also used for the purpose of assessing coordinated competitive concerns.

For the purpose of finding the coordinated competitive concerns, HHI is considered a better measurement than CRs, since HHI is based on the market share of all the players but CRs considers only few players in the market. Countries fix thresholds (commonly called as ***safe harbours***) based on these measurements for merger assessment.

CONCENTRATION THRESHOLDS, Comparative chart.

Jurisdiction	Use of: Market share MS	Use of: CRs	Use of: HHI	Separate limits for unilateral & coordinated effects	Thresholds (safe harbours limits): Unilateral effects	Thresholds (safe harbours limits): Coordinated effects
Australia	Yes	Yes	No	No	MS >15% & CR4>75% or MS > 40%	
Brazil	Yes	Yes	No	Yes	MS > 20%	CR4 >75% & MS > 10%
Canada	Yes	Yes	Optional	Yes	MS >35%	CR4 >65% & Market share >10%
European Union	Yes	No	Yes	Yes	MS >50% (strong) MS>40% (moderate) & MS <25% (no inference)	HHI >2000& delta >150 or HHI 1000 to 2000&delta>250
Ireland	No	Optional	Yes	No	HHI>1800 & delta >100 (significant inference) HHI>1800 & delta >50 (significant inference) HHI 1800 & delta >100 (strong inference) (MS is taken in to account while considering unilateral effects)	
Japan	Yes	No	Yes	No	HHI >1500to 2500& delta >250 or HHI >2500&delta>150 HHI < 2500 and MS 35 % (no inference)	
New Zealand	Yes	Yes	No	No	MS>40% CR3>70% & MS > 20%	
United Kingdom [OFT's procedure]	Optional	Optional	Optional	No	HHI>1800 & delta >50 (potential concern) HHI>1000 & delta >100 (potential concern)	
United States	Yes	No	Yes	Yes	MS >35%	Post merger HHI>1800 & delta >100 (strong inference) Post merger HHI>1800 & delta >50 (moderate inference) Post merger HHI 1000 to 1800 & delta >100 (moderate inference)

2.3. EXTENT OF COMPETITION IN THE MARKET

The substantial competition analysis begins with the understanding of existing competition in relevant market. Understanding of existing competition is an essential prerequisite for determining the factual. Analysis of existing competition also lays the basis for analyzing the probable unilateral and coordinated effects of a merger.

Merger analysis is not a comparison between the present and future market situation i.e. comparing pre-merger and post-merger situation. It is a comparison between two future market situations, one with merger and another without merger. The existing market competition is the tool to predict the status of future competition, both in the presence and absence of merger. As a result of this analysis if the competition authorities were of the opinion that, existing level of competition is not going to be reduced by the merger, the merger will be approved without further analysis.

The scope of existing competition may be well understood by considering (i) the rivalry between the participants and (ii) extent of innovation.

RIVALRY BETWEEN FIRMS:

The extent of rivalry is determined by looking in to the factors like pricing strategies, discounting, and distribution and marketing methods, prevalent in the market.

The competition between the merging firms is also a relevant factor of rivalry. Unilateral exercise of market power is highly probable, if rivals merge in a differentiated product market where products of the merging firms are first and second choices of consumers. Acquisition of a vigorous competitor (not in maverick sense) in homogeneous product market will have the effects similar to a merger in differentiated product market, were the products of the firm are first and second choices of the consumers[12].

Stability of market shares of the merging entity over a period of time, market share difference between competitors, post- merger capacity of the merged firm, excess capacity of non-merging firms, and homogeneity of the market are the factors of focus in this analysis.

Maverick firms: Presence of a firm with maverick character acts as a constraint for both unilateral and coordinated exercise of market power. "A maverick firm is one that has a greater economic incentive to deviate than do most of its rivals and constitutes an unusually disruptive force in the market place[13]". This type of firms pressurizes the other firms to extend the scope of competition. Canadian and Australian guidelines characterize maverick firms as *"vigorous and effective competitor".* The size of a firm to be maverick is immaterial. Acquisition of a maverick firm gives rise to potential competitive concerns, but it does not by itself a ground to prevent a merger. In respect of such acquisition the competition authorities will assess the extent to which the remaining competition is restricted or made ineffective.

NATURE OF GROWTH AND INNOVATION IN THE MARKET:

For the purpose of this part, growth refers to speculations in market share of the participants. If the growth of the market is not stable, the future market shares of the participant will be different from the existing level. If the growth is speculative, the factors responsible for it and chance of its occurrence in near future are relevant to determine future competition.

Pressure exerted by innovation on the market is a relevant factor in competition analysis. Innovation does not restrict to the production but also to the other functional aspects of market. Significant competition also results in innovation.

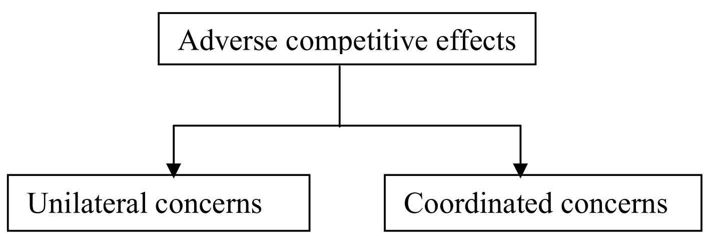
[12] For further clarifications refer the discussion in unilateral competitive concerns part at P.g. 17 & 18.
[13] ICN's Project on Merger Guidelines 2004, Chapter IV, Pg.20.

Market shares in innovative markets are speculative, thus market leaders often change.

Innovative markets are less conducive to coordination, since the innovative step of one firm gives huge advantage over its rivals. A merger of two small firms may increase the ability of a resultant entity to innovate. On the other hand merger between two innovative competitors may decrease the innovation in market or monopolize the scarce IP resources required for participation.

2.4. ADVERSE COMPETITIVE EFFECTS

The core of combination assessment is to test adverse competitive effects. In this part the probable unilateral and coordinated constraints to competition is assessed. Some jurisdictions have separate indicators for unilateral and coordinated competitive concerns.



The common understanding is that, market share [MS] reflects the possible unilateral concerns, and market concentration [CR and HHI] reflects the coordinated concerns.

UNILATERAL COMPETITIVE CONSTRAINTS: This refers to the ability of a firm to act independently irrespective of the reactions of other competitors. It is not only the possible post-merger reactions of the resulting entity, but also the unilateral conduct of other market participants, that needs to be assessed in this part. It is because of this reason U.K and E.U guidelines refer unilateral effects as non-coordinated concerns. The substance of unilateral concern analysis is to find out the ability of the resulting entity to increase the price of the product, irrespective of the reactions of its competitors. The analysis of unilateral concern differs between firms differentiated by products and firms differentiated by their capacity.

Unilateral concerns → Firms differentiated by products
Unilateral concerns → Firms differentiated by capacity

In *differentiated product market* there is an imperfect substitution between the products. Merger between firms in differentiated product market results in reduction of choice among consumers. Such merger may internalize substitution within the resulting entity, provided the products of the merging entities are first and second choice of the consumers. Further the internalization factor compensates the sale loss occurring due to price rise in pre-merger situation. Thus the resulting entity finds it profitable to raise the price of one of the product irrespective of the sale loss that might occur.

In respect of *homogeneous product market,* firms are differentiated by capacities, price is the factor that matters for the buyer. If the merged firm is the major supplier of the relevant product, then it may find it profitable to raise the price of the product with a reduction in supply. The probable sale loss is overlooked by the profit yielded through price rise and artificial demand created. The success of the post-merger price raise also depends on the ability of the other competitors to constrain the efforts of resulting firm.

The seven factors[14] commonly used to assess unilateral effects are

1. DEFINITION OF RELEVANT MARKET
2. REVIEW OF POSITION OF THE MERGING PARTIES
3. PRESSURE OF COMPETITORS
4. MARKET DYNAMICS

[14] See Chapter III, 'Unilateral effects', of ICN's "Project report on Merger Guidelines 2004".

5. POSSIBLE NEW ENTRIES
6. PRESSURE FROM BUYERS
7. CAUSATION BY MERGER (COMPETITIVE CONCERNS)

The analysis of above factors is so extensive and it includes the analysis of entry, countervailing bargaining power, and changing market situations. The said factors will be dealt in the following pages separately. The factors above are not exhaustive, in appropriate cases factors like imports, vertical integration, brand loyalty for the firm's product, also become relevant.

COORDINATED COMPETITIVE CONSTRAINTS: In an oligopolistic market structure all the movements of a market participant will be based on the conduct of the other participants. Making of profit by any firm in oligopoly is much dependent on other players. Thus all the players will find it better to have coordination so as to reap mutual benefits. Coordination may be overt or tacit. The object of such coordination is to maintain the status quo of the coordinating players. The probabilities of entry in a coordinated market are relatively low. Usually coordinated competitive concerns are highly probable in concentrated market structure, since heavy concentration implies the existence of oligopoly.

Coordinated concerns are also market specific. It is present in those markets which are conducive to coordination. The probability of coordination in a differentiated product market is very low, since the difference in the functional aspects of different products acts as an obstacle for coordination. Presence of a maverick[15] firm also reduces the probability of coordination in market.

Majority of the jurisdictions does not have detailed explanation about coordinated concerns, as elaborated for unilateral concerns since the probability of a merger giving raise to coordinated concerns is lesser than unilateral concerns.

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[15] Supra 14

The general presumptions about coordinated market are presence of (i) market conditions conducive to coordination (ii) mechanism for detecting participants who deviate from the terms of coordination. (iii) retaliation measures against deviation"[16]. Keeping in mind these presumptions the competition authorities will examine the presence of various factors favoring these presumptions[17].

Pressures from other participants, probabilities of entry are assessed in this analysis. The ultimate purpose of this process is to find whether the merger leads to a situation were few firms together dictate the conditions of market.

2.5. MARKET ENTRY

ENTRY

Where the nature of the market is such that entries are highly probable, combinations likely adverse impact on competition is very less. Entry analysis should be differentiated from response supply analysis done in market definition and participants' identification stages. Such a differentiation is made under the US guidelines by separately defining committed and uncommitted entrants[18], the difference between both is that the former invests sunk-cost but the latter did not make such investment.

The usual process involved in entry analysis is as follows.

- Firstly, the authority will examine whether an entry can achieve significant market impact within a *timely* period. The commonly accepted reasonable time is two years[19].

- Secondly, profitability of entry is assessed, so that *likelihood* of entry is known. If profit is not possible within reasonable time then entry is unlikely.

[16] §2.1 of U.S guidelines.
[17] ¶9.2 to ¶9.4 of New Zealand guidelines clearly points the various factors favoring these presumptions.
[18] See § 1.32 and §§ 3.0 to 3.3 of US guidelines.
[19] Note, it is not entry but the ability of the entrant to become a competitor should happen within reasonable period.

The profitability is computed by keeping pre-merger price level as base price. If the sale opportunity available to the entrant is less than the minimum sales at which the entrant may be profitable, the entry is unlikely.

For the purpose of assessing the likelihood of entry, Canadian framework recommends to look at the presence of 'Entry Advantaged' firms. Fringe firms, firms in adjacent geographic market, firms in vertically related market and firms with similar functional traits are considered as entry advantaged firms[20].

- Thirdly, *sufficiency* of the entry is measured; in this step the extent of competition that can be generated by the entrant is considered. To be a sufficient entry it should be capable of generating competition lost due to merger. If price raise is probable, then threat of entry or entry must be capable of bringing back the price at pre-merger level.

In assessing the profitability, sale opportunity and sufficiency aspects it becomes necessary to look at the entry barriers of the market. Barriers may be broadly classified in to structural, regulatory and functional barriers of the market. Structural barriers refer to the investment of huge sunk-cost, scarce capital inputs in the possession of the incumbents, economies of sale, etc. Regulatory barriers refer to the statutory requirements like license, approval and permit. Functional barriers are difficulties present in marketing, distribution, testing, etc.

In entry assessment, nature of the products also has a good say in competition. If the merger is in differentiated product market, the ability of an entrant to neutralize the internalization of substitution is very low. If the products have potential life or good brand loyalty, the success of the entrants are highly questionable.

IMPORTS

Under the globalized market regime the barriers between the nations are almost erased and there is an international convergence in trade practices. These aspects

[20] See ¶ 6.4 of Canadian guidelines.

have made the possibilities of import much easier and simple. Significant potential imports also places constraints against price raise by the merged firm. Imports are similar to entry and expansion analysis.

If the history of the market reveals that market share of imports are significant, then the ability of the merged entity to raise price is improbable. However the ability of the imports to supply the sale opportunity is assessed in a fashion similar to entry analysis.

For assessing imports, the competition authorities should in addition to the considerations in entry analysis, consider the import specific tariff and non-tariff barriers. Qualitative evidences like independence of imports from domestic suppliers, anticipated institutional barriers, manifest plans of overseas players to enter domestic market, international price movements, market conditions of adjacent nation were the importing is already done[21].

In assessing the competitive impacts of a horizontal merger, imports in vertically related markets becomes relevant at times. The increased imports in the upstream market may reduce the input cost of downstream market and significant import in downstream market can reduce the demand in upstream market.

2.6. COUNTERVAILING BUYER POWER

If the buyers have the potential to off-set the probable price raise, then adverse impact on competition is unlikely. Mere presence of buyer concentration is not sufficient to generate countervailing power. It is buyer concentration with the presence of suitable economic alternatives constitutes the countervailing power. Some of the instances were it exists are

- If the buyers can switch to substitutes within a reasonable time then countervailing power exists. In this respect dispersion of suppliers, degree of substitutability and switching cost are relevant factors of consideration.

[21] See ¶ 5.112 of Australian guidelines.

- In a vertically related market the heavy competition in downstream market demands its producer to go for cheaper inputs. If the merged firm in upstream market raises the price of raw materials, the down stream producer will stop buying inputs from the incumbent. Thus the competition in downstream market acts as constraint to price rise in upstream market.

- Where the buyer group is of such nature which can foster or sponsor probable entrant then also buyer power exists. This is possible when the buyer society is highly sophisticated. Fostering and sponsoring is also possible in vertically market.

Majority of the jurisdictions have passing reference about this factor[22]. Buyer pressure though not relevant in every instance, it acts as an effective constraint against price rise at times.

2.7. DEFENSES

Defenses are usually considered at the final stage of assessment. This is the stage were the commission is sure of the fact that the merger gives rise anti-competitive effects, but still it looks whether any justification is available to approve such merger.

The general defenses available to the parties are

- Failing firm
- Efficiency defense
- Economic development

Failing firm:

If one of the merging entities is in pitiable financial situation and by that reason it is about to exit the market, the competitive effects of its merger is neutral. However the market position of the other firm may give rise to potential competitive

[22] US, & Brazil guidelines have no mention about the factor. Irish guidelines have no separate step for bargaining power it is done as a part of unilateral effects assessment. EU guidelines have a little but constructive discussion about buyer power.

constraint. It is all the test of causation i.e. what impact the merger raises on competition. The authorities should answer the following questions in considering the failing firm defense

- What will happen to the assets in the absence of merger?
- What are the Chances of revival[23]?
- What are all the alternatives to merger that would result in greater level of competition?
- Is there any alternative purchaser available whose purchase is less anti-competitive or competitive neutral?

If the impact of the merger on competition is neutral because of its failing then the merger is approved.

Efficiencies

If the efficiencies achieved out of merger outweigh the anticompetitive effects of the merger then such mergers are approved without objections. Efficiencies are generally classified as *allocative* efficiency- better utilization of resources, *productive* efficiency-production at minimum average cost, *dynamic* efficiency- increase in consumer choice, quality of goods and service available (usually difficult to measure).

There is a difference between jurisdictions in recognizing efficiencies. The result of efficiency should promote the welfare standard adopted by the law of the land. US adopts consumer surplus standard, whereas Canadian courts gives credit to producer surplus to some extent. Besides these things merger specificity and pass-on requirements should be there to recognize efficiencies. Merger specificity refers the

[23] Other statutory factors in this regard may be taken in to account by the competition authorities, for example in India chances of revival of a failing company are dealt under Sick Industrial Companies Act 1985.

inability to attain such efficiency absent the merger and pass-on requirement needs the benefit of efficiency to be passed on to the consumers[24].

Economic development:

Some of the jurisdictions recognize the principles of public interest, economic development and public benefit. Even our Competition Act 2002, under sec 20(m) recognizes economic development as a factor to be taken into account. These concepts are dynamic terms capable of different interpretation. In states like UK and Germany the power is vested with the respective ministries to decide cases on this ground. In Australia the concept of public benefit comes at last, during authorization stage. To deal with this aspect the authorities should keep in mind the purpose and object of the act in mind.

The aspects of vertical integration are also relevant in horizontal combination assessment. Though it is not separately dealt with as a concept in this chapter, its significance is emphasized whenever necessary.

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[24] Brazilian guidelines discuss the various instances of efficiencies like economics of sale, economies of scope, introduction of new technology, etc… (See ¶ 75 to ¶ 84).

3. FRAMEWORK ADOPTED IN DIFFERENT JURISDICTION

3.1. AUSTRALIAN MODEL

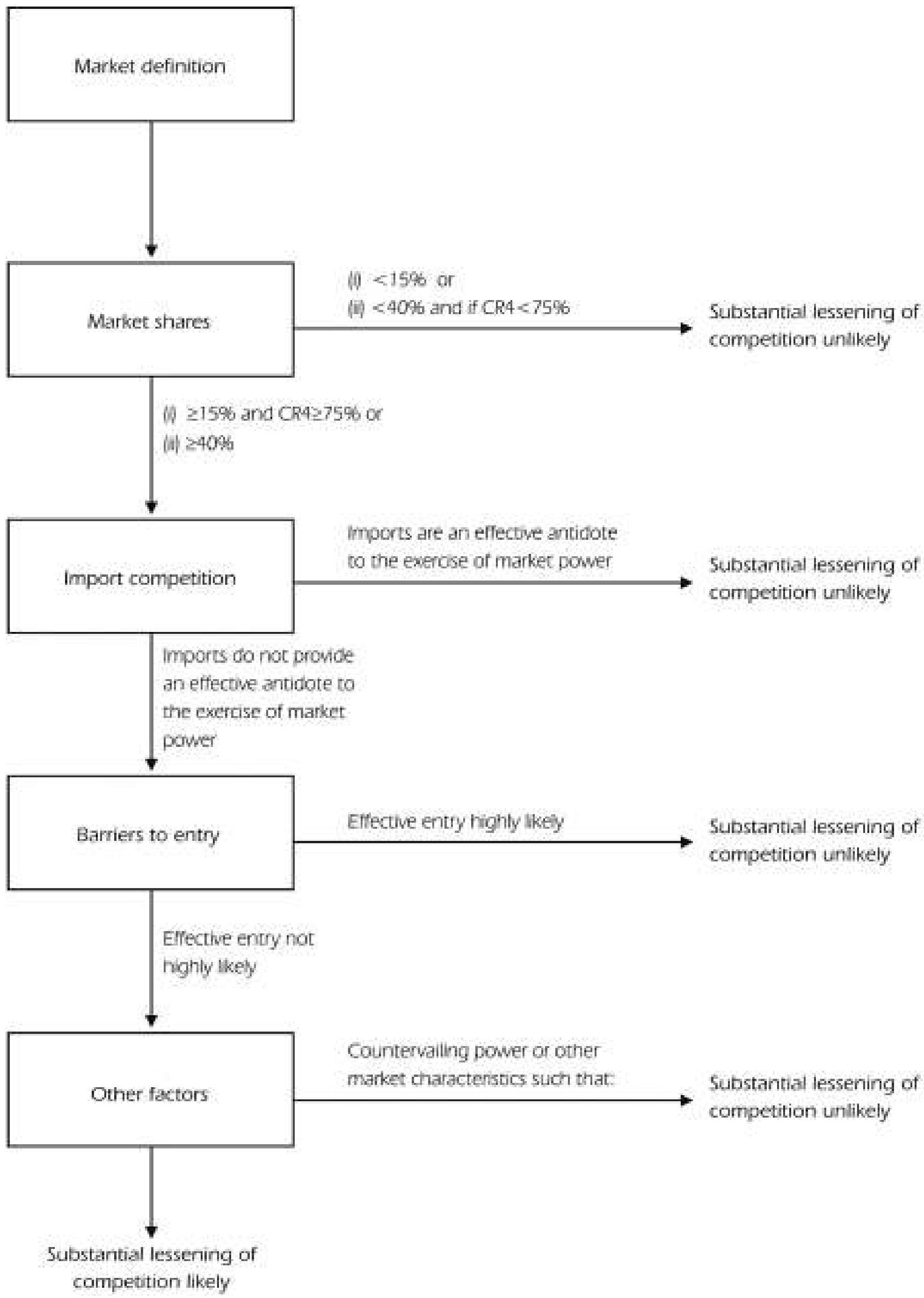


Fig.1,
Source: Merger Guidelines, June 1999, ACCC, Pg.29[25].

[25] Available at www.accc.gov.au (accessed on 29/01/2008)

The guidelines incorporate all its significant historical experience, which is evident from the reference made to past mergers and decisions of its higher judiciary. At the beginning of the guidelines itself it was cleared that the guidelines do not have any binding force in determining breaches under the Trade Practices Act 1974.

The guidelines explain the framework adopted by Australian Competition and consumer Commission (ACCC) to decide whether to challenge a merger or not. The frame work incorporates the various factors enlisted under sec 50 (3) of the above said Act.

The frame work adopted by the guidelines is a stepwise procedure and is ordered as follows

- Firstly, the relevant market defined
- Secondly, the concentration of the market computed. If the concentration exceeds the thresholds specified then it is subjected to next step analysis.
- Thirdly, significance of import in the market is determined.
- Fourthly, if there is no effective import competition to outweigh the anti-competitiveness of the merger then probabilities of entry are examined.
- Finally if ACCC even after assessing the probable entries feels that the merger might lessen competition, it considers the other factors specified under Sec. 50 (3).

There are no separate thresholds for unilateral and coordinated concerns. The guideline says that if the concentration falls outside the safe harbours, it gives raise to both coordinated and unilateral concerns. In the said framework, there is no express mention about separate considerations for unilateral and coordinated concerns. However in the latter part of the guidelines, specific concerns of coordinated effects are discussed.

The guidelines have an elaborate discussion about the significance of imports; the discussion also includes the impact of import on vertically related markets. The entry barriers part addresses the problems of competition generated by one-off products and products with brand loyalty. While considering the aspect of elimination of vigorous competitor the commission considers the presence of maverick firm and failing firm defense.

3.2. BRAZILIAN MODEL

The Brazilian competition statute is not clear with respect to the substantial test that is adopted by it. The Horizontal Merger Guidelines issued in 2002 state that all mergers having negative impact on the economic welfare of the nation can not be allowed to happen. The authorities under the guidelines are Secretariat of Economic Law of the Ministry of Justice (SDE) and Secretariat for Economic Monitoring of the Ministry of Finance (SEAE). The guidelines also illustrate the following scenarios as those which do not have negative impact on economic welfare. Those mergers that

> "(a) do not generate control over a substantial market share; or
>
> (b) generate control over a substantial share of the market in a market in which the exercise of market power is improbable; or
>
> (c) generate control over a substantial share of the market in a market in which the exercise of market power is probable, but whose potential negative effects, derived from the possibility of exercising market power, are not higher than the potential increments to welfare generated by the concentration[26]".

The guidelines adopt a five step procedure for the analysis of horizontal merger. The procedure is amenable to the convenience of the authorities since the instrument by itself declares that it is not-binding on the authorities. The procedure specified is as follows

- Firstly the relevant market is defined
- Secondly the market share of the resulting entity is computed. In the absence of probability for the resulting entity to control substantial share of the market SDE and SEAE will allow the merger without further analysis.

[26] ¶14 of Brazil guidelines.

- Thirdly the probable exercise of market power is assessed. If exercise of market is probable the merger is subjected to next step of analysis.
- Fourthly examination of the efficiencies generated by the transaction is weighed.
- Finally the cost and benefits of the merger is assessed to have a final opinion. If the efficiencies generated by merger are greater than or equal to the cost of the merger, SDE and SEAE will approve the merger.

The guidelines prescribe different thresholds for unilateral and coordinated competitive concerns. In the third step of the procedure the authority assesses both unilateral and coordinated competitive concerns. In considering the unilateral effects of a merger the pressure from imports, entry and other rivalry between the competitors are considered. For analyzing coordinated competitive concerns in addition to the above factors those factors conducive to coordination are considered.

While considering the rivalry between firms, the ability of the non-merging participants to increase their output in response to the price raises, availability of substitute in differentiated product market are given credence.

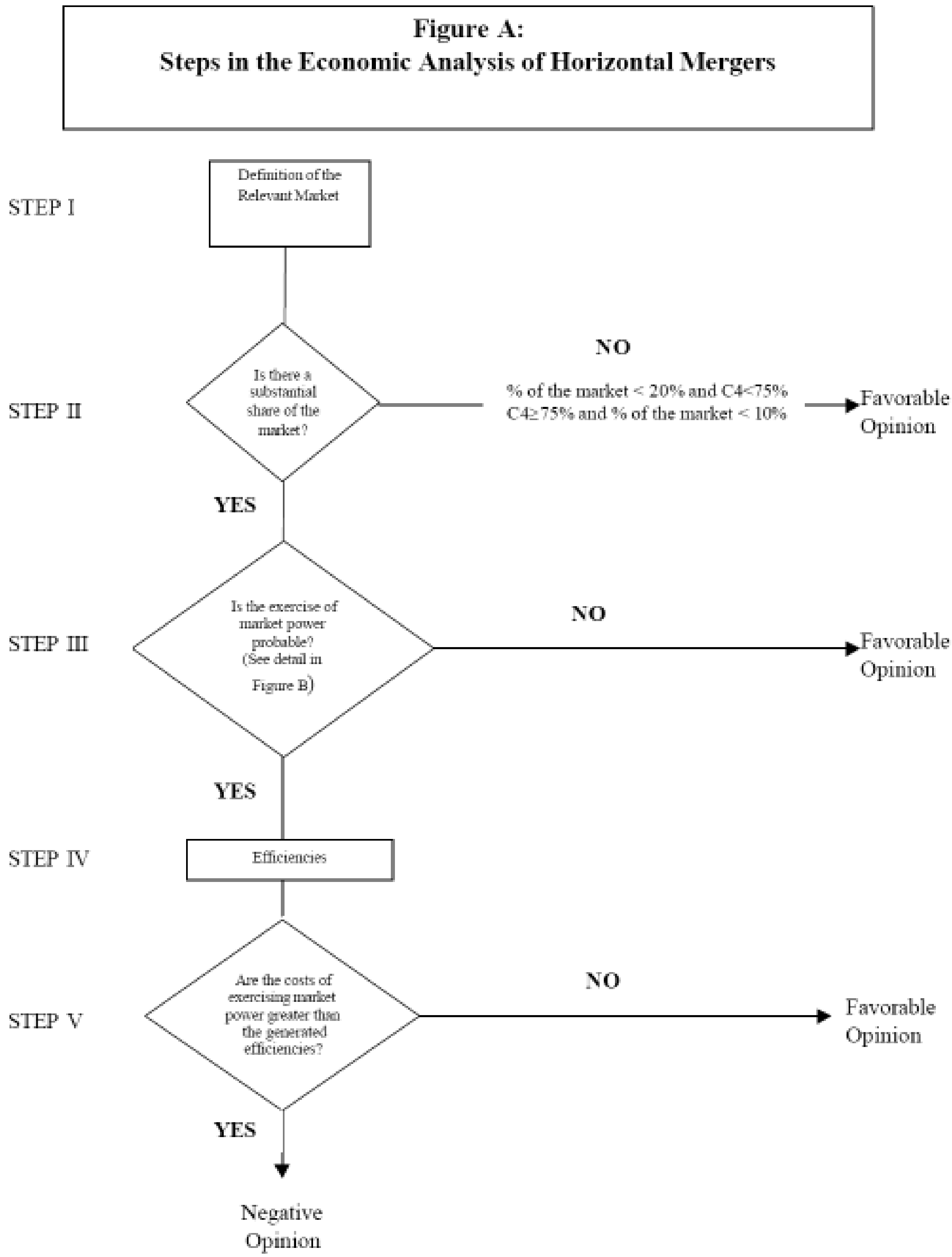


Fig 2, Source: Horizontal Merger Guidelines, Brazil, Pg. 6[27].

[27] Available at www.cade.gov.br (accessed on 5/02/2008).

Figure B:
Detail of Step III – Exercise of Market Power

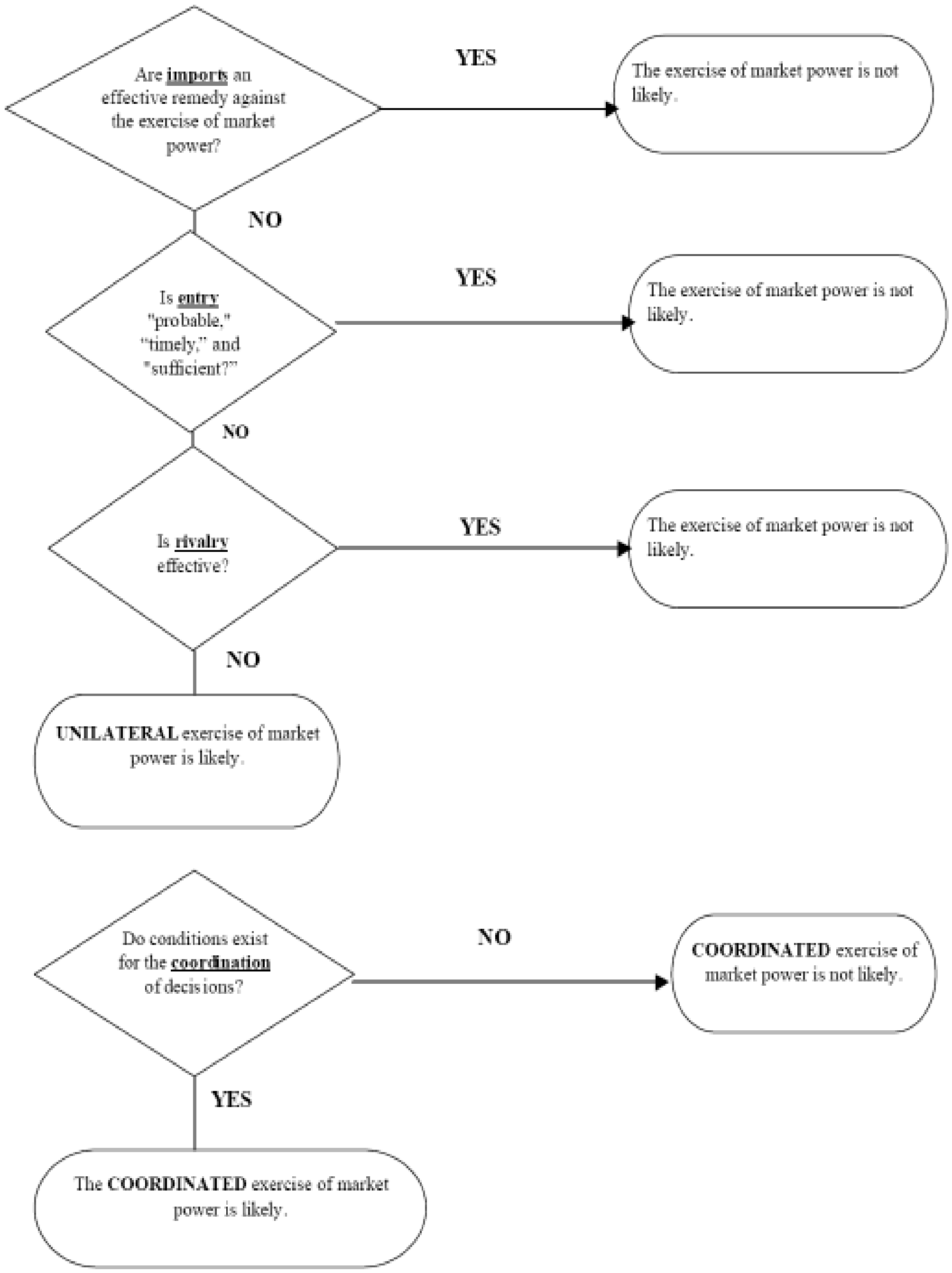


Fig 2.1, Source: Horizontal Merger Guidelines, Brazil, Pg. 7[28].

[28] *Ibid*

3.3. CANADIAN MODEL

Since Indian competition law has borrowed some of its factors from Canadian jurisdiction meticulous review of Canadian guidelines are will be informative. The beginning of the Canadian guidelines itself holds that it provides the general approach followed by the Competition Bureau to review mergers. It declares that the guidelines are not rigid and not binding on the bureau. The guidelines further say that depending upon the facts of each case and nature of information available the bureau decides the methodology to be adopted for a particular merger review.

The analytical framework prescribed under the guidelines prescribes a seven step analyses for merger review.

- Firstly the relevant market is defined.
- Secondly the market concentration is assessed. If the result of the assessment falls outside the safe-harbour limits then it is subjected to the next step of review.
- Thirdly the probable anticompetitive effect of the merger is assessed. Both unilateral and coordinated effect is assessed in this step.
- Fourthly the possibilities of new entries are found.
- Fifthly the pressure of the buyers on the probable anticompetitive effects is assessed
- Sixthly the Bureau examines whether any generated efficiencies outweighs the anti-competitiveness of the merger.
- Finally the Bureau considers failing firm defense.

The guidelines do not expressly speak about supply-side substitutability in market definition discussion but a comprehensive explanation about participants through supply response is made under market concentration discussion. The guidelines fairly discuss about the basis of calculation of market shares under different circumstances.

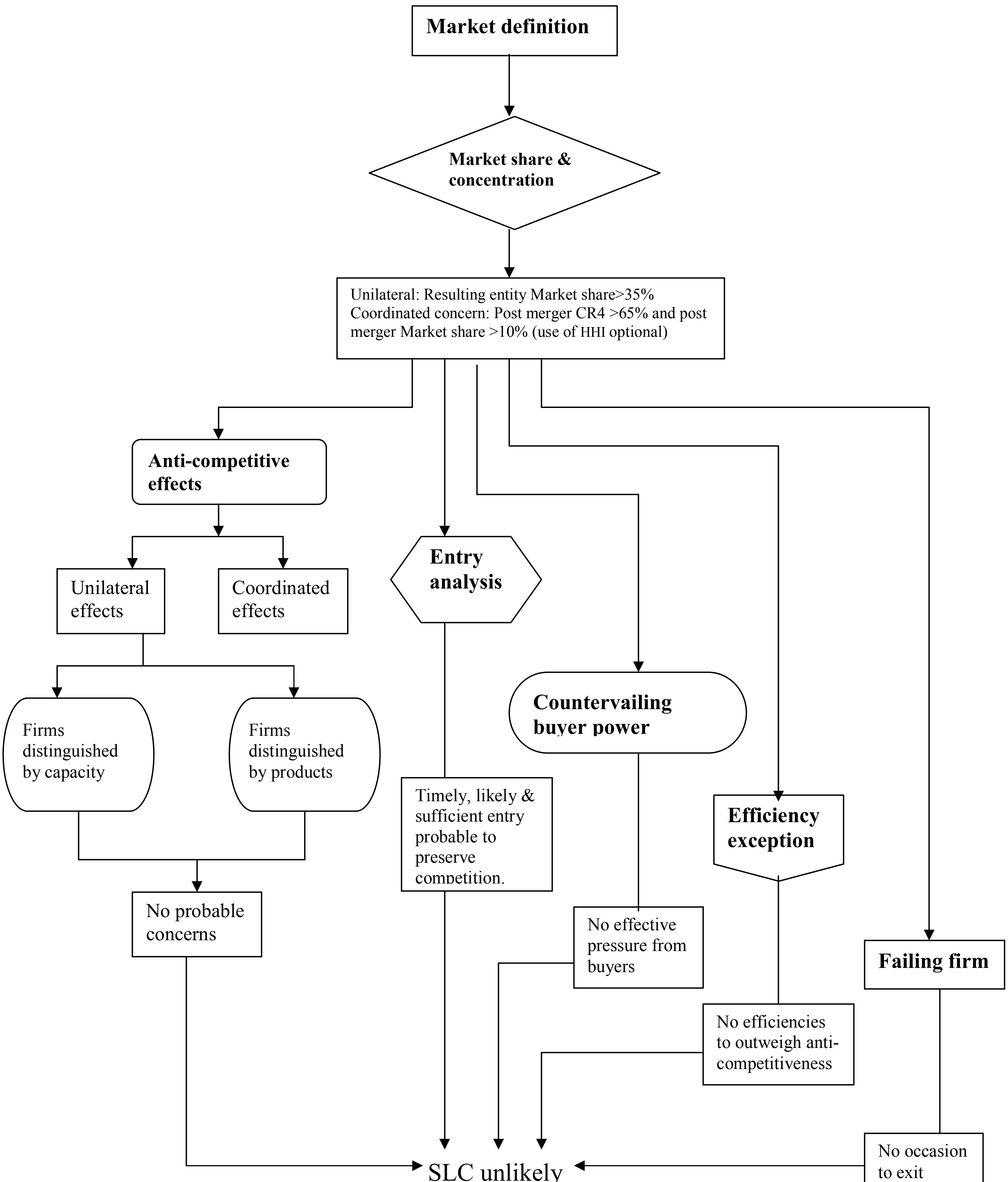


Fig.no.3, Source: Drawn on the basis of Merger enforcement Guidelines 2004[29]

[29] Available at http://www.competitionbureau.gc.ca (accessed on 3/02/2008).

The frame work does not assess the possible impacts of imports on competition, however it considerers foreign participants through supply response. In the third step of the process before analyzing the unilateral and coordinated effects, the Bureau examines the likely post-merger competition in the lights of prevailing competition in the market. In doing so the (i) competition between the merging firms, (ii) nature of the merging firms particularly whether any one of the merging firm has maverick character and (iii) level of innovation in the market[30], are considered.

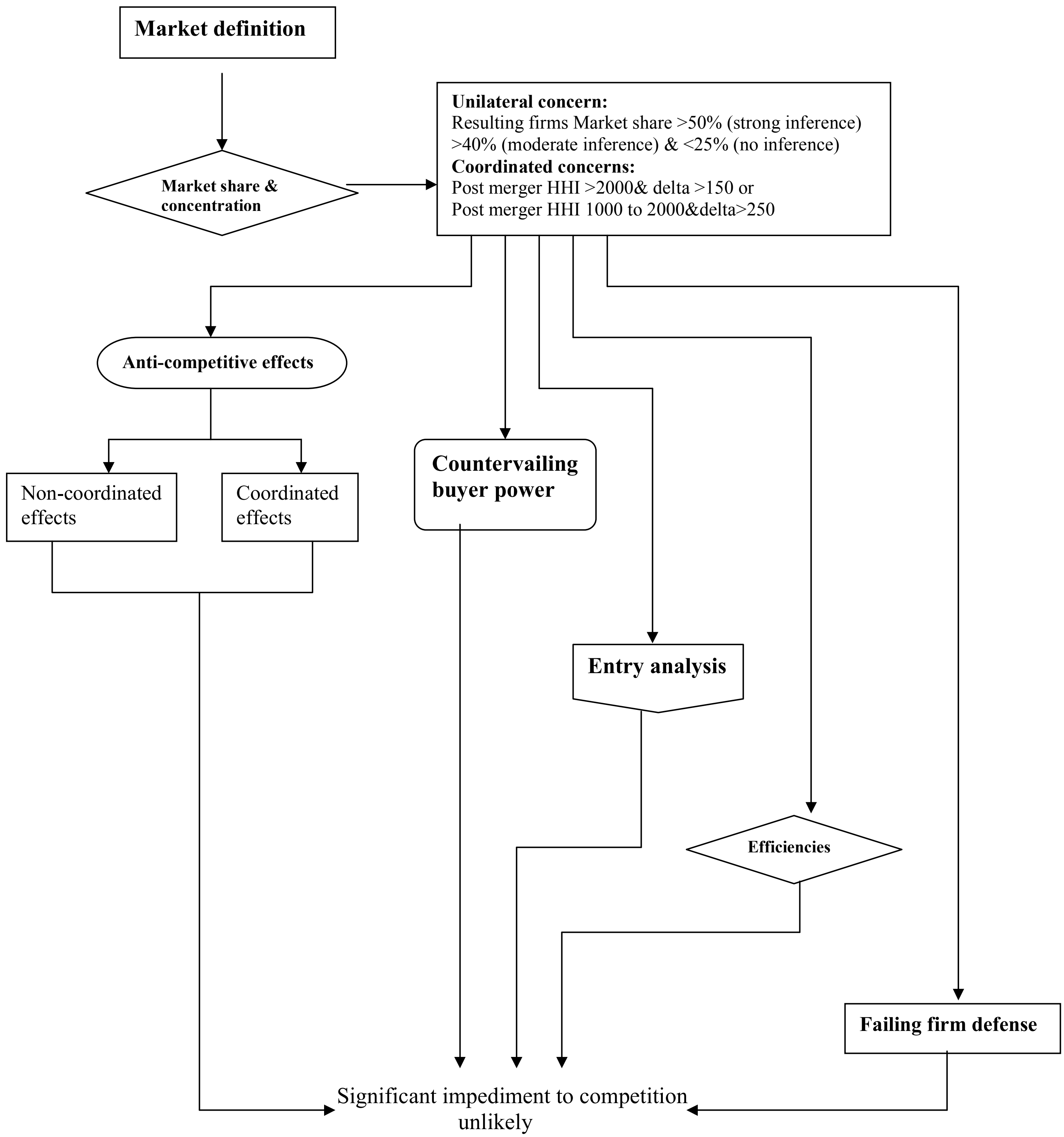
Though the 2004 guidelines are said to be similar to that of American guidelines but the Canadian instrument is little more comprehensive. It better points out the various factors that are to be considered within each step.

3.4. EUROPEAN UNION MODEL

The guidelines claim it to be drafted on the basis of old merger regulation and the case laws decided by European Communities courts. The guidelines makes it clear that the factors provided for consideration is not a mechanical check list for all mergers notified to it. The framework set by the guidelines is similar to Canadian one it proceeds as follows,

- Firstly the relevant product market is defined,
- Secondly the market concentration is computed
- Thirdly, probable anticompetitive effects of the merger are looked into both unilateral and coordinated effects are assessed in this step.
- Fourthly the countervailing buyer pressure are examined
- Fifthly, probable entries and extent of entry barriers are considered
- Sixthly, the efficiencies are assessed,
- Finally the possible exit of any of the merging firm absent the merger is looked into.

[30] Not only in production but innovation in all the functional aspects of the market is taken in to account. This is similar to market dynamics under Australian guidelines.



Source: Drawn on the basis of European Union's Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004/C 31/03)[31]

[31] Available at http://europa.eu (accessed on 2/02/2008).

Some of the glaring features of the guidelines are,

It does not contain the considerations that are to be taken into account in market definition stage. It incorporates its earlier notice regarding market definition. The guidelines say that present market shares can be adjusted to reflect reasonable future changes for instance entry, expansion or exit.

Among all the jurisdictions EC fixes the highest HHI concentration level (HHI >2000& delta >150 or HHI 1000 to 2000&delta>250). Very differently buyer pressure is placed before entry analysis whereas in other jurisdictions the reverse happens.

Though there is no separate step to deal market dynamics and vertical relations in market they are adequately discussed in different parts of the guidelines. In entry analysis part there is an elaborate narration of various advantages that acts as entry barrier.

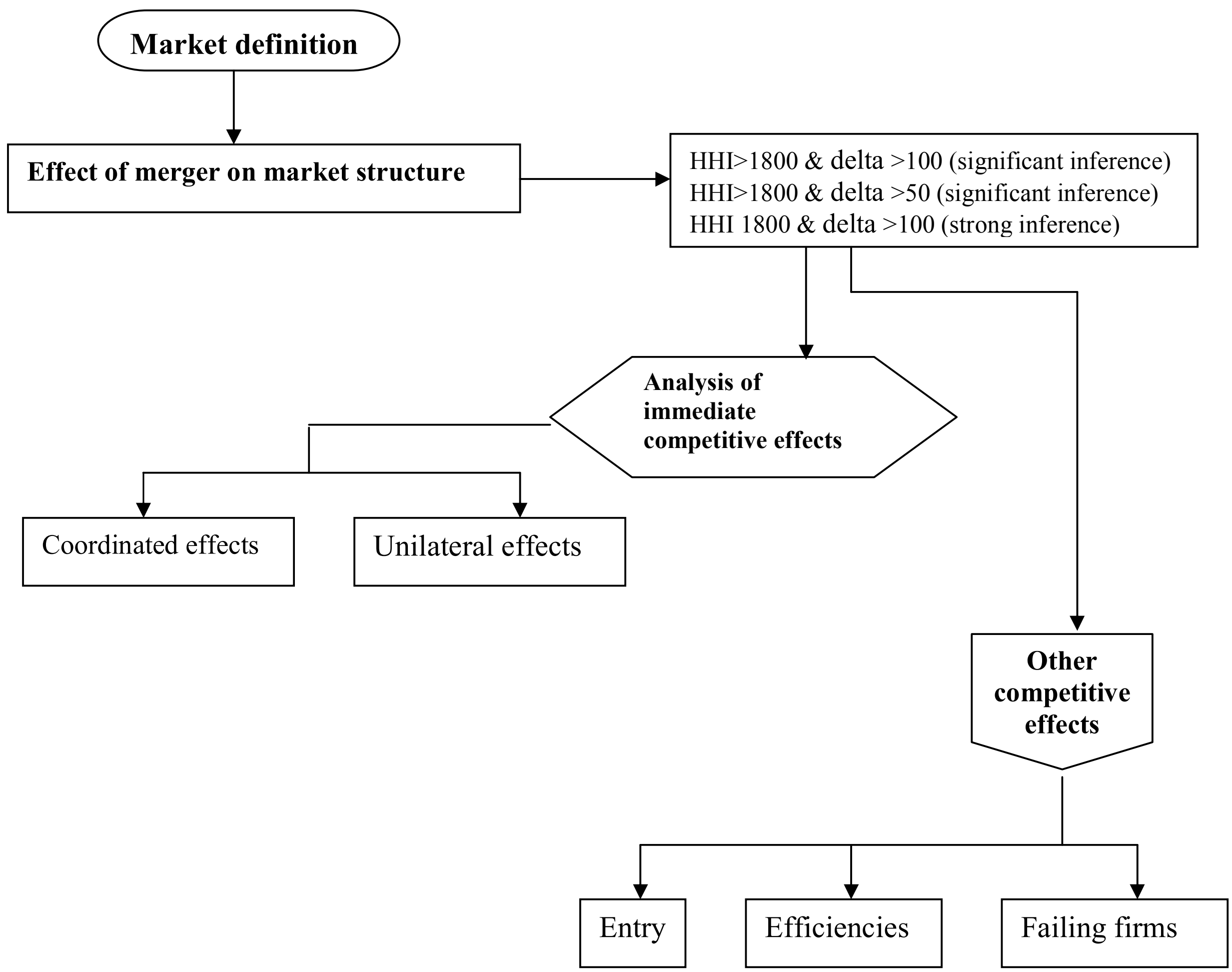
3.5. IRISH MODEL

The framework set forth by Irish guidelines is simple and precisely structured. The guidelines show that its merger review process is a four step process wherein the first three steps constitute preliminary determination and the fourth step is the final assessment of merger. The guidelines also make it clear that the factors specified in the guidelines are not exhaustive and it is open for the authorities to deviate from the notice if it feels appropriate. The four step process envisaged under the guidelines is as follows

- Firstly the authorities define the relevant geographic and product market to establish the framework for competition analysis
- Secondly for every defined relevant market, the effect of merger on market structure is determined.[32]

[32] This is nothing but calculation of the market concentration. Irish guidelines use HHI as the measures of concentration.

- Thirdly the effect of merger on the rivalry between the competitors is considered. This step includes the assessment of both unilateral and coordinated effects on competition.
- Lastly if the result of the above analysis makes the authority to feel that the merger gives rise to competitive concern, as a final assessment the authorities will go in to the possibilities of new entrants, efficiency claims and failing firm defense.



Source: drawn based on the "Notice in respect of guidelines for merger analysis 2002[33]", competition authority, Ireland.

[33] Available at http://www.tca.ie/MergersAcquisitions/mergersAcquisitions.aspx (accessed on 13/02/2008)

The interesting part of Irish guidelines is it says that in the presence of any direct material reflecting market power the authorities may dispense with the definition of relevant market.

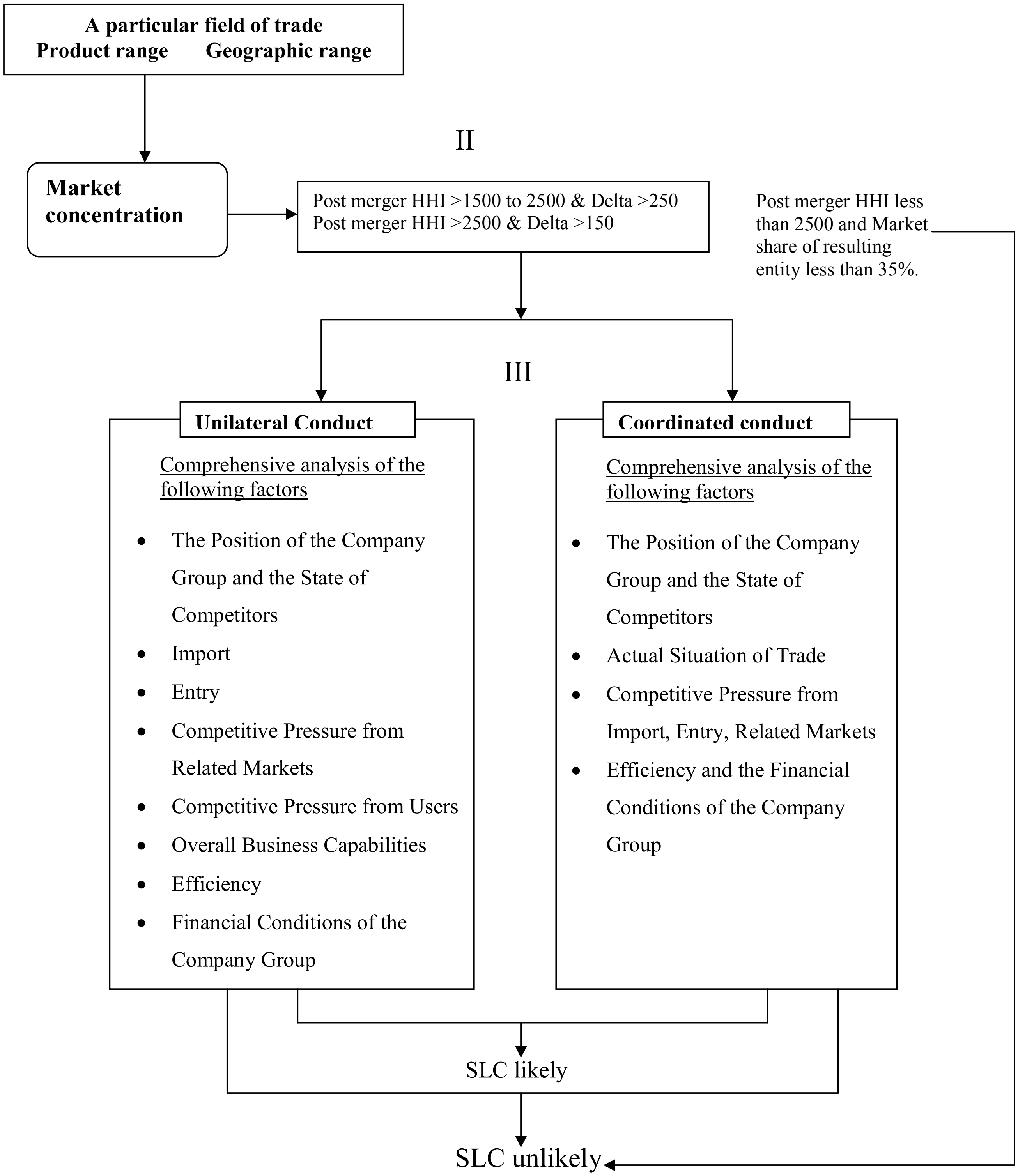
The guidelines follow a flexible four step process in assessing the unilateral effects of the merger. In which the (i) ability of the resulting entity to raise price irrespective of the efforts of competitors, (ii) the degree of internalization of substitutes with in the merged firm, (iii) possibilities of other firms in increasing outputs or developing substitutes so as to deter the price raise & (iv) finally the pressure from the buyers are considered. The guidelines does not have separate step for assessing countervailing bargaining power, it is done as part in unilateral effects assessment. A model similar to United States is adopted for assessing the coordinated competitive concerns.

3.6. JAPANESE MODEL

The Japan antimonopoly law prohibits excessive economic concentration[34]. It does not specifically deal about combination control but the guidelines of Japan Fair Trade Commission (JFTC) alone set forth the test for combination and it also specify the factors to be considered in combination assessment. Part I of the guidelines deal with the combinations that attracts review. Part II of the guidelines deals with the delineation of particular field of trade, both product and geographic range. Part IV of the guidelines deals regarding the framework for horizontal combination assessment. Broad reading of the guidelines shows that JFTC follows a three step process in combination assessment.

- Firstly delineation of product range and geographic range
- Secondly assessment of the market concentration and
- Finally a two fold parallel analysis, one for unilateral and other for coordinated competitive concern.

[34] Art 9 of Act on Prohibition of Private Monopolization & Maintenance of Fair Trade 1947.



Source: Drawn on the basis of "Guidelines to application of the Antimonopoly Act concerning review of Business Combination 2004[35]" (tentative translation).

[35] Available at www.jftc.go.jp/e-page/legislation/ama/RevisedMergerGuidelines.pdf (accessed on 15/02/2008)

In case any combination satisfies the requirement of part I and falls outside the concentration thresholds in part IV then it is compulsorily subjected to two parallel analyses, one is for unilateral and other for coordinated competitive concerns. Unlike the other guidelines Japanese guidelines are rigid and adopt a comprehensive framework in which the authorities have no room to leave any of the factors specified.

The guidelines does not fix separate concentration thresholds for unilateral and coordinated competitive concerns but in the analysis of unilateral concerns the market share of the resulting entity is compared with its competitors. Defenses are not considered as a separate step, it is done as a part of the above said parallel processes itself. One main draw back about the Japanese guidelines is that it does not provide any flexibility for the assessing authorities and it is not clear about the exhaustiveness of the factors specified for assessment.

3.7. NEW ZEALAND MODEL

The guidelines at the beginning itself describes the basis of the analysis, the task of the commerce commission all along the analysis is to consider the specified factors in the lights of the comparison between the factual and counter factual scenario of the merger and to draw a conclusion out of it i.e. comparison of two hypothetical situations, one on the happening of merger and the other without the merger.

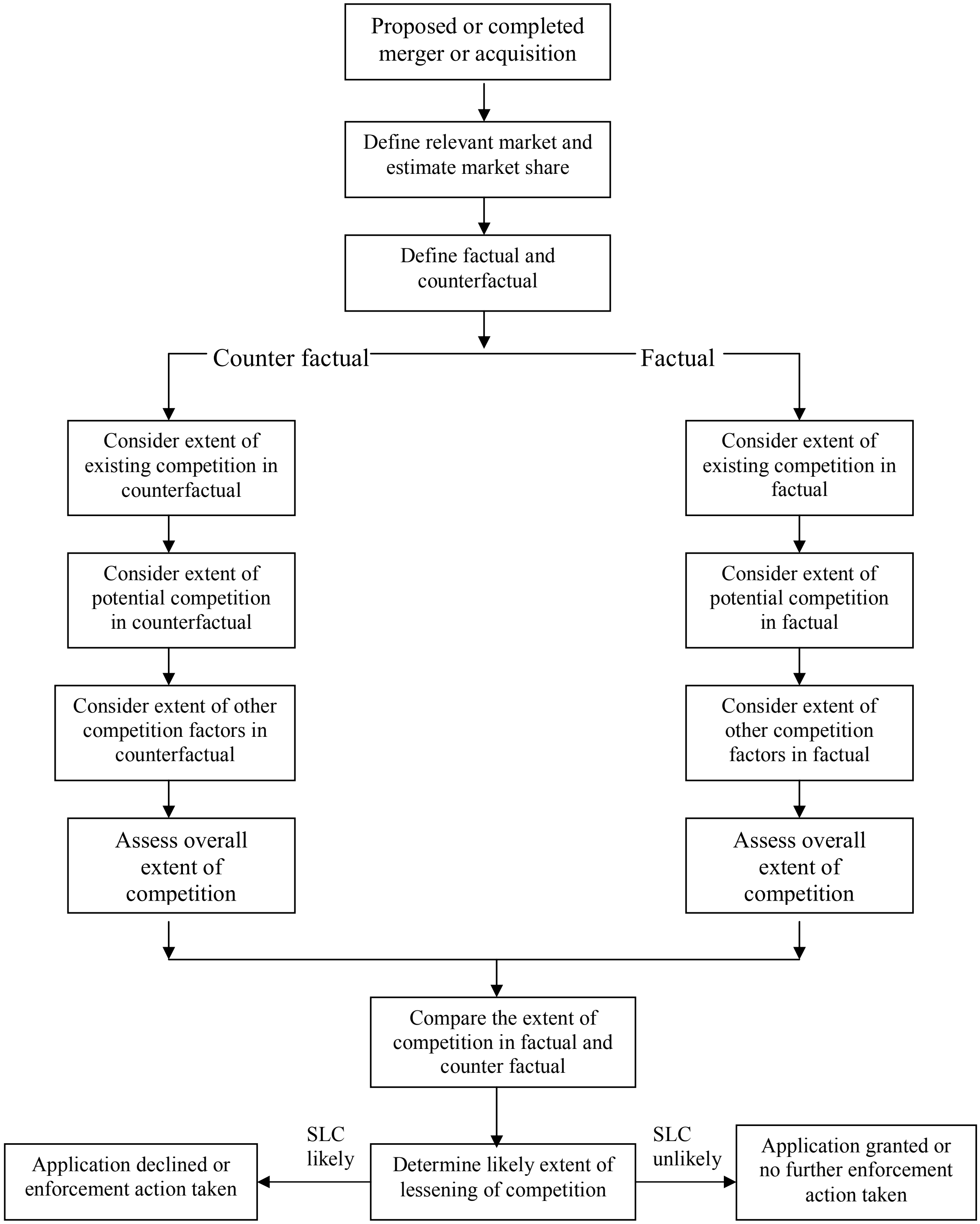
The framework suggested by the guidelines is flexible and it says that the commerce commission does not always consider all the specified factors nor conduct a complete analysis said in the analytical framework. The guidelines suggest the following five step process for testing the anti-competitiveness of a merger.

- Firstly the relevant dimensions of market are defined,
- Secondly the concentration of the market is assessed. This step involves identification of various participants, their market share and post-merger HHI levels.
- Thirdly the analysis of existing competition is done. Changing nature of the market, specific concerns of differentiated product and undifferentiated product market are considered.
- Fourthly the potential competition is assessed. Potential competition refers to possible entries in market which are capable of preventing the anti-competitiveness effects of the merger.
- Finally other competition factors like elimination of vigorous competitor, countervailing buyer power and efficiency claims are considered.

In addition to the product and geographic dimensions of the market the guidelines speaks about the functional (level of production and distribution), temporal (time frame within which the market operates) and customer (different types of customers within the market) dimensions of the market.

The guidelines address's the difficulty in delineating the scope of product market in a differentiated product market. Further it says that a structural analysis of market definition and market share may not be helpful in a differentiated product market were the degree of substitutability is very less. In such cases the commerce commission is directed to analyze the impact on localized price without defining product market.

Impact of import on competition is assessed as a part of potential competition analysis. Specific considerations of unilateral and coordinated competitive concern were not placed within the framework, it is considered after the above said process.



Source: Merger and acquisition Guidelines 2004, Pg.7[36].

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[36] Available at www.coccom.govt.nz/BusinessCompetition/MergerAcqusition/MergerAcqusitionGuidelines/Keytermsintheguidelines.aspx (accessed on 11/02/2008).

3.8. UK MODEL

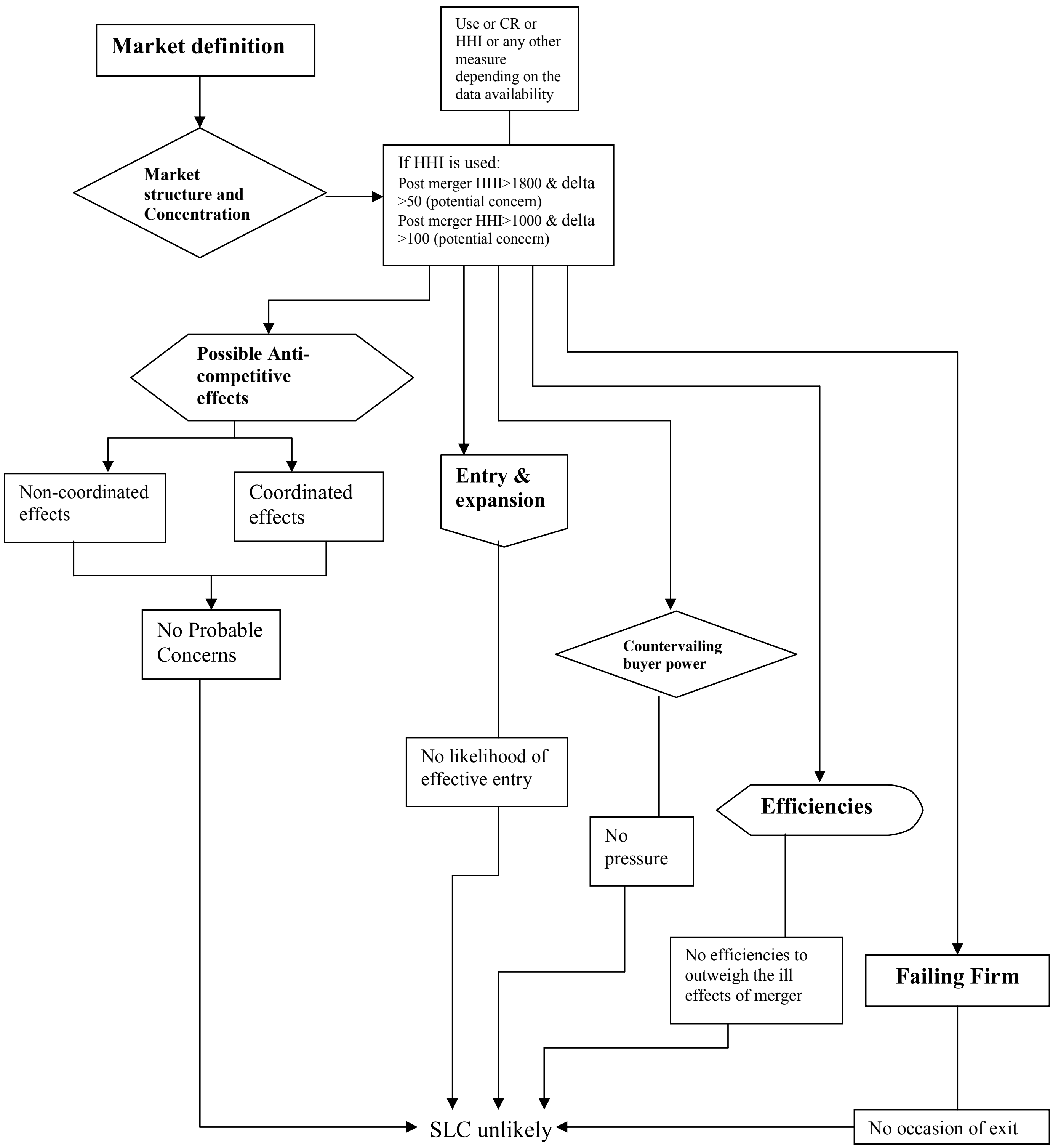
Since this study is primarily concerned about the prima-facie anti-competitive determination the researcher finds it appropriate not to discuss the guidelines followed by UK's Competition Commission which performs the final assessment. The Substantive Assessment guidance 2003 which is going to be discussed here is the procedure followed by Office of Fair Trading (OFT) for determining whether a particular case should be referred to competition commission or not.

The guidelines say that the principles laid should not be regarded as a mechanical framework for analysis. The consideration of a particular factor depends on the facts of each case. The framework adopted is as follows

- Firstly, relevant market is defined.
- Secondly, review of the market structure (market share and concentration) is done.
- Thirdly, probable anti-competitive effects of the merger are assessed. Both non-coordinated and coordinated effects are analyzed in this stage.
- Fourthly entry and expansion possibilities are looked into.
- Fifthly, countervailing power of buyer and its impact on price raise are considered.
- Sixthly, efficiencies claims and
- Finally the failing firm defense is considered.

For defining relevant market the guidelines refers to the exclusive guidelines issued by OFT for the purpose market definition[37]. Unilateral effects are being referred as non-coordinated effects to mean that it is not only the independent conduct of the resulting entity but any other firm may also give raise to competitive concerns because of merger.

[37] OFT has come up with new guidelines on Market definition in 2004, available at http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft403.pdf



Source: Drawn on the basis of Substantive assessment guidance 2003[38].

[38] Available at http://www.oft.gov.uk (accessed on 9/02/2008).

OFT is given room to use any of the concentration measure among HHI, CR and market share depending on the data available to it. The guidelines also illustrate the nature of evidences that are taken into account for purpose of merger review.

The guidelines are lucidly worded and it has a lengthy procedure similar to Canada. The guidance is also not as deep as the guidelines used by competition commission for merger assessment.

3.9. UNITED STATES MODEL

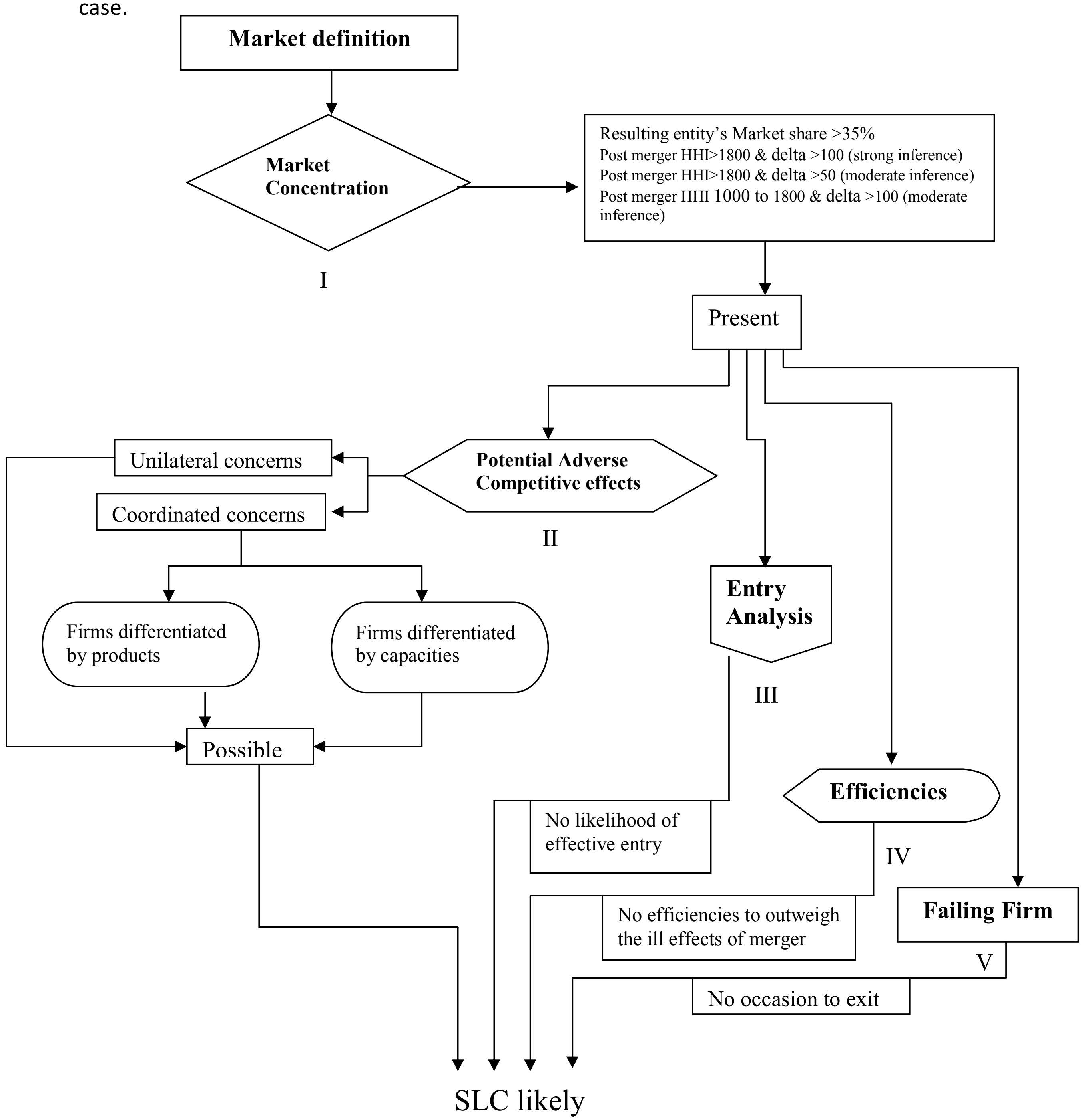
A careful reading of the US guidelines will ponder the organized evolution of anti-trust laws in United States. The merger guidelines of United States claims its merger review process as a five step analytical one and at the end of this process the authorities will be in a position to decide whether to have an ultimate enquiry. The frame work prescribed by the guidelines is as follows

- Firstly the agency determines the concentration of the market properly defined and measured.
- Secondly the core issue of potential adverse anticompetitive effects is tested in the lights of the nature of market and its concentration.
- Thirdly the authorities will assess the possibilities of the timely, likely and sufficient entry which will deter or counteract the competitive effects of the resulting entity.
- Fourthly the agency will look whether the efficiency gains outweigh the ill effect of merger.
- Finally the agency will consider whether in the absence of merger any of the merging firm exits from the market.

Though the guidelines seem to have a rigid stepwise process in assessing the anti-competitiveness of a merger, it is left to the authorities to have their own priorities among these steps. Further the *Commentary on the Horizontal Merger Guidelines 2006*[39] jointly issued by U.S. Department of justice and Federal Trade Commission makes it clear that these guidelines are flexible and the agencies will not apply it as a

[39] Available at http://www.usdoj.gov/atr/public/guidelines/215247.htm (accessed on 11/02/2008)

linear step-by-step progression. Thus merger review is an integrated process were all the necessary considerations are taken in to account depending on the facts of each case.



Source: Drawn on the basis of 1992 Horizontal Merger Guidelines [with April 8, 1997, revisions to section 4 on efficiencies][40].

[40] Available at http://www.ftc.gov/bc/docs/horizmer.htm (accessed on 17/01/2008)

Some of the glaring features of the US guidelines are,

If the post-merger market concentration and market share of the resulting entity exceeds the thresholds specified under § 1.5 and § 2.2 respectively, the agency will presume[41] that the merger is likely to enhance or facilitate the exercise of market power.

The market concentration part of the guidelines does not explicitly make separate indicators for possible unilateral and coordinated competitive concerns but a clear reading of § 2[42] of the guidelines shows that there are different indicators.

The guidelines distinguishes committed entrant and uncommitted entrant, the former is dealt in entry analysis and the latter is discussed in participant identification at market concentration analysis.

There is no express mention about assessment of the imports in to the relevant market and countervailing bargaining power of the buyers.

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[41] Rebuttable on showing the presence of any of the justifications specified in the other parts of the guideline

[42] Part relating to Lessening of Competition through Unilateral Effects.

4. MODEL SUGGESTED FOR INDIA

FACTORS TO BE CONSIDERED: Section 20 of the competition act deals with inquiry into combinations. Sub section 4 of the section deals regarding factors to be considered for the determination of adverse effect on competition.

Section 20 (4) of the competition act 2002 reads as follows

"For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission shall have due regard to all or any of the following factors, namely:—

(a) actual and potential level of competition through imports in the market;

(b) extent of barriers to entry into the market;

(c) level of combination in the market;

(d) degree of countervailing power in the market;

(e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;

(f) extent of effective competition likely to sustain in a market;

(g) extent to which substitutes are available or arc likely to be available in the market;

(h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;

(i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;

(j) nature and extent of vertical integration in the market;

(k) possibility of a failing business;

(/) nature and extent of innovation;

(m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;

(n) whether the benefits of the combination outweigh the adverse impact of the combination, if any".

The wording of the section gives flexibility to the authorities either to consider all or any of the factors specified. It is incumbent on the authorities to test the anti-competitiveness of the combination in a timely and systematic manner. For framework convenience and precision the factors are classified as follows.

CLASSIFICATION OF FACTORS MENTIONED UNDER SEC. 20(4)	
Factors in general	**Factors specified under section 20(4) of the act.**
Market concentration	• Level of combination in the market 20(4) (c) • Market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination 20 (4) (h)
Unilateral competitive concerns	Unilateral Effects: Considerations of *market concentration* • Extent of effective competition likely to sustain in a market 20(4) (f) • Likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins 20(4) (e) • Likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market 20(4) (i) • Nature and extent of innovation 20 (4) (l) • Extent to which substitutes are available or arc likely to be available in the market 20 (4) (g) • Nature and extent of vertical integration in the market20 (4) (j) Considerations of *market entry and expansion* and *buyers pressure*
Coordinated competitive concerns	Coordinated Effects: Considerations of *market concentration* • Extent of effective competition likely to sustain in a market 20(4) (f) • Nature and extent of vertical integration in the market20 (4) (j) • Likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market 20 (4) (i) • Nature and extent of innovation 20 (4) (l) Considerations of *market entry and expansion*
Market entry and expansion	• Actual and potential level of competition through imports in the market 20 (4) (a) • Extent of barriers to entry into the market 20 (4) (b) • Extent to which substitutes are available or arc likely to be available in the market 20 (4) (g)
Countervailing bargaining power	• Degree of countervailing power in the market 20 (4) (d)
Failing firm	• Possibility of a failing business 20 (4) (k)
Efficiency	• Whether the benefits of the combination outweigh the adverse impact of the combination, if any.20 (4) (n)
Economic development	• Relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition 20(4) (m)

The positions of other jurisdictions discussed above clearly shows that a rigid stepwise review process will not work effectively at any point of time. Heterogeneity of market situation makes it impossible to have a common methodology for merger review. Further the various factors used in combination analysis are inter-related concepts one can not be assessed in isolation of other. There are too many situations were a particular step in merger review process becomes unnecessary or impossible. Some of these situations are addressed in the guidelines of different jurisdictions itself for example

- The Irish guidelines say that in the presence of direct materials on market power there is no need for market definition itself[43].
- The aspect of differentiated product market though mainly relevant in the analysis of adverse competitive effects, it has a significant say in market definition stage itself. The New Zealand guidelines says that a structural analysis of market definition and market share may not be helpful in a differentiated product market, were the degree of substitutability is very less. In such an instance the commerce commission is directed to continue the competition analysis with out defining market[44].
- Supply side substitutability considered while defining market and identifying firms (for the purpose of computing market concentration) are nothing but a part of entry analysis.

The above said instances are illustrative and not exhaustive. From these examples we can understand that it is highly difficult to predetermine market situation. It is because of this reason majority of the guidelines makes it clear that the framework and factors suggested by them are not rigid but amenable to the needs of competition authority. Thus what is required is an integrated approach with flexibility to the competition commission. The flexibility given should enable the commission to adopt market specific strategy on case to case basis.

[43] See ¶2.2 of Irish notice in respect of guidelines for merger analysis 2002, at pg.4.
[44] See ¶3.2 of New Zealand Merger and acquisition Guidelines 2004 at pg.17.

MODEL FRAMEWORK:

The model guidelines are totally flexible and not binding on the commission. The rationale behind the formulation of this framework is to show the general approach that shall be followed by the Competition Commission, in respect combination review. Nothing in these guidelines restricts the Commission from adopting a different strategy, if the peculiarity of the market situation warrants. In case the commission adopts an approach different from the general methodology suggested, it shall reasonably explain the same to the parties to the merger with due reasons. The Commission shall as far as be transparent to the parties about the procedure adopted by it for review.

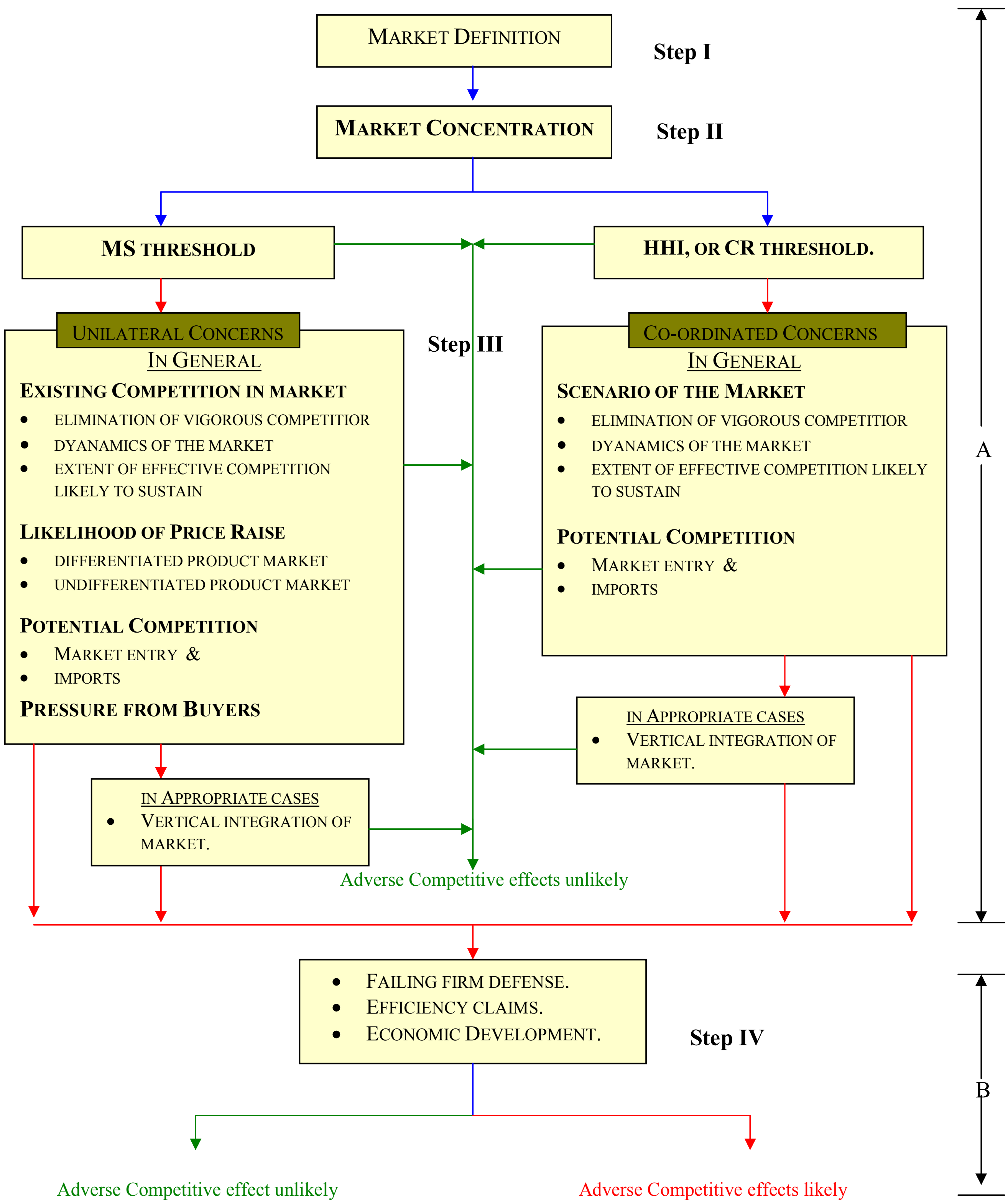
The model framework suggested below incorporates all the factors specified under section 20(4) within a four step analysis. Though the whole analysis is a four step process the commission may at any point of time during the review process, dispose of the proceeding on the ground that the combination is unlikely to have adverse impact on competition.

The model suggested below is an integrated approach in which the first three steps constitutes preliminary review i.e., to form prima-facie opinion on the combination. In the final assessment stage, the commission firstly adjudicates the disputes regarding its findings in preliminary assessment, and secondly it considers the various defenses available to the parties. In the final stage, the burden of proving the factors is placed on the parties to the merger.

FOUR STEP INTEGRATED APPROACH FOR COMBINATION ASSESSMENT

Step I	Market Delineation.	Preliminary Assessment for prima-facie Anti-competitive determination.	A
Step II	Market Concentration		
Step III	Analysis of adverse competitive effects		
Step IV	Defenses	Final assessment stage for conclusive decision.	B

PICTORIAL CHART OF THE MODEL FRAMEWORK



As per the suggested model the relevant product and geographic market is delineated first. In case the commission is of prima-facie opinion that the market is significantly related to a vertical market, then functional dimension of the market is also delineated.

After market delineation, concentration of the market is computed. Separate thresholds are fixed for probable unilateral and coordinated concerns and based on the concentration level the probable adverse competitive effect are dealt in third step. The process till this stage constitutes the preliminary assessment. If the commission after this process is of the opinion that the merger gives raise to adverse anticompetitive effect, it will issue notice to the parties under section 29 to show cause why competition investigation of such merger should not be ordered.

In the final assessment stage the commission considers the various defenses available to the merging firms. At this stage the burden of proving the existence of defenses is placed on the incumbent firms. Before considering the defenses, the commission adjudicates the conflicts between its prima-facie findings and averments of the incumbents.

The discussion in below paragraphs focuses on the nature of information the commission looking for, in preliminary assessment. The discussion does not elucidate the concepts any were, since it will be a repetition of chapter II. Thus for conceptual clarity one may refer to the second chapter which gives a brief idea about concepts involved in combination assessment.

The narration below is not exhaustive, further it is not based on any of the information relating to Indian market. The structuring of this exercise is based on guidelines of other jurisdiction.

NATURE OF INFORMATION THE COMMISSION WOULD BE LOOKING AT EACH STEP

STEP I: MARKET DEFINITION

Market definition delineation much requires the information about the history of the market. Evidence about the past behavior of the consumers and producers are the best tools to delineate market.

(i) Product market

Product

1. Product Identification : All the products produced by the merging firms

2. Functional aspects of each products : Utility
Price (base price),
Character (physical and technical)

Substitutes

For identifying substitutes firstly the probable substitutes are taken into account, secondly the functional interchangeability of the probable substitute is assessed. Finally the barriers to substitution are identified.

1. Probable substitute identification : products disclosed as substitutes by merging firm, identification by comparing the utility of the main product.

Identification of probable substitutes is a trial and error exercise. The commission should try for the assessment of following information to find out the substitutes

- Evidence of substitution in recent past
- Comparison of price patterns in the recent past between the products.

- Features of products influencing substitution
- Chain of substitution
- Other existing classification
- Customers loyalty for the product
- Views of customers and competitors
- If Trademark is registered in respect of main product then the classification under Trademarks act 1999.

2. <u>Functional interchangeability</u> : meticulous comparison of utility, price and features of probable substitute and main product

Existence of functional interchangeability alone is not sufficient to include a product as substitute. After this the authorities must look at the various barriers to substitution.

3. <u>Barriers of substitution</u> : (i) *Barriers on demand side substitution:*

- Switching cost
- Consumer preference (doubts about other product's quality, utility, etc.)
- Transaction issues in case of cluster market
- Special concerns of down stream producers.

(ii) *Barriers on supply side substitution*

- Regulatory barriers and state interventions
- Sunk cost investment
- Loss in current output in order to switch to alternative inputs
- Learning and human capital investment
- Constraints arising in downstream markets

- Uncertainty about quality and reputation of unknown suppliers (aspects of loyalty also)
- Retooling costs
- Marketing and distribution difficulties

The purpose of assessing supply side substitution under this stage is to identify substitutes and not participants.

(ii) Geographic market

Geographic market should be delineated from the buyer's perspective. Firstly determination of the territorial area in which merging firms conducts business. Secondly the potential areas to which the buyers will shift their purchase in response to price rise. The commission should keep in mind that geographic market is a territorial area in which price discrimination between two locations results in loss to the producer due to arbitrage.

1. <u>Delineation area in which the company presently conducts its business</u> : information obtained from merging firms.

2. <u>Delineation of potential area</u> :
    - Nature of the product (fragility, perishability, etc…)
    - Customers' convenience in accessing alternative source of supply
    - Transport costs
    - Regulatory barriers
    - Trade flows/shipment patterns
    - Frequency of delivery
    - Reliability of service or delivery.

- Demand characteristics like brand, nationality, culture etc...
- Views of consumers and competitors

The existing market studies, industrial surveys, classification of goods done under statutes, ministries and other private organizations are of great use to the commission in delineating market.

Assessing barriers to supply side substitution should be differentiated from entry analysis. Supply side substitution is a market expansion activity it does not require large range of investment. Short term profitability should also be there for such supply.

II. MARKET CONCENTRATION

Market concentration is computed on the basis of present market shares of the market participants. For the purpose of competition analysis should be adjusted in such a manner to reflect near future. The EU guidelines clearly says that concentration calculation should consider the near future entry, exit and expansion in market[45].

In market concentration stage

1. Firstly the commission should look for already existing materials about market concentration.
2. Secondly the commission identifies the market participants. In this stage the participants through supply response are also included in the participants list.
3. Thirdly the respective share of participants in the market is assessed.
4. Finally the concentration level is computed.

[45] See ¶ 15 of EC guidelines.

1. Existing materials about market share : Authenticity of the data should be high. For the purpose of such data the commission can look for

- Market studies done by research institutes.
- Previous case material decided by the commission
- Information from industrial association
- Reports of ministries and other government organizations

If such data is available then the commission should consider its relevance to the proceedings keeping in mind the authenticity and data of such material.

2. Identification of market participants : information from the merging parties

Participants through supply response:

- Switching costs
- Commitment of the participant
- Excess capacity of the participant
- Intellectual property rights
- Regulatory barriers
- Marketing and distribution difficulties.

In identifying the response participants the commission should differentiate it analysis from entry analysis. For a participant through supply response the impediments should be very minimal but for a committed entrant even a higher impediment is immaterial. In case were imports are probable then additional barriers like tariff barriers, non-tariff barriers, exchange rates, etc… should be considered.

3. Market share computation: Nature of product and supply share will be calculated on the basis of sale revenue, capacity, and units of production or sale. Depending on the circumstance the basis of calculation differs.

Factors of focus are :

- Homogeneous product market
- Differentiated product market
- Excess capacity possessed by any of the participant and its likely use
- Business expansion plans of market leaders
- significant purchase orders placed to participants

To know the appropriate basis of calculation refer to market concentration part in chapter II.

4. Measurement of concentration: Based on the computed market share, the HHI and levels are measured.

STEP III (1) UNILATERAL COMPETITVE CONSTRAINTS

The assessment of unilateral effects consists of four steps were the following are assessed in order

1. Extent of competition in market

(i) Rivalry :

- Discounting, pricing, distribution and marketing strategies between competitors
- Competition between the merging firms (market share difference between firms)

- Past litigations and conflicts between participants
- Stability of market shares over a period of time
- Presence of maverick firm

(ii) *Innovation in the market*:

- Technological developments in production (product and process)
- Marketing and distribution strategies
- Intellectual properties held by merging firms (more number of patents, designs, trademarks implies innovation in production and marketing)

2. **Likelihood of price rise** :

- In case of *differentiated product market* level of product differentiation and choices of the consumer (is the products of merging firms 1st and 2nd choice of consumers)
- In case of *homogeneous product market* what is the capacity of the merging and non merging firms

3. **Potential competition**

(i) Entry : *firms with entry advantage as in Canadian style:*

- fringe firms already in the market
- firms that sell the relevant product in adjacent geographic areas
- firms that produce products with machinery or technology that is similar to that used to produce the relevant product

- firms that sell in related upstream or downstream markets
- firms that sell through similar distribution channels
- firms that employ similar marketing and promotion methods

Sale opportunities:

- Own price elasticity
- Cross price elasticity
- Minimum viable sale
- Decline in market demand
- Vertical integration and forward contracting by incumbents
- Incumbents sale promotion act in response to entry

Entry barriers

a. Pre-entry barriers:

- Sunk Cost investment
- Planning, design, construction and
- Management

b. Regulatory barriers:

- Permitting
- Approval
- Licensing
- Clearance

c. post-entry barriers

- Marketing and distribution

(ii) Imports : In addition to the above aspects of entry the following information becomes essential:

- The extent of imports independence from supply from domestic suppliers
- Information about the influence of imports on pricing in the domestic market
- Degree of substitutability
- Tariff and non-tariff barriers
- Anticipated regulations and deregulations (within reasonable time)
- Manifest plans of overseas corporation to enter domestic market
- Nature of the product and possibilities of import
- Exchange rate fluctuation

4. Countervailing bargaining power :

- Buyers concentration
- Vertical relation of buyers
- Sophistication of buyers
- Economic alternatives available to buyers

STEP III (2) COORDINATED COMPETITIVE CONSTRAINTS

Analysis of coordinated effects involves two step processes in which first the existing scenario of trade is understood and then the pressure of potential competition is assessed. Potential competition analysis will be similar to the approach specified under unilateral effects part. Understanding of existing scenario of trade involves analysis of existing competition as specified in unilateral effects part but the commission in addition should focus on the following issues punctiliously

- Heavy market concentration

- Stability of market share over a period of time
- Low range of market dynamics
- High level of entry barriers
- Homogeneous or differentiated product market (degree of substitutability)
- Presence of Industrial associations
- Openness of pricing patterns
- Territorial reservations among producers

The commission may at any point of time in the above procedure form an opinion that adverse effect on competition is unlikely and may dispose of the proceeding then and there. Further as emphasized right from the beginning noting said in the procedure is sacrosanct, depending on the circumstance of the case the commission may well deviate from this model.

Since this research is concerned with preliminary assessment explanation about defenses are not done as a part of the study.

4.6. CONCLUSION

It is easy for any one to look at the guidelines of other jurisdiction and suggest a model for combination assessment. But the credibility and practicality of such model under Indian market situation is highly questionable. A careful reading of U.S., Australian, and EU's guidelines shows their rich experience in merger control. Further these guidelines are not the guide for the respective authorities, but an explanation to others as to what the commissions do in merger analysis. Thus, it is too early for this commission to think about combination guidelines[46].

The Competition Act seems to be on the threshold of enforcement. Though it is early to think about combination guidelines, the Competition commission should consider about Market definition and Concentration threshold guidelines, which are the indispensable preliminary aspects of any combination analysis.

For the guidance of this commission the lessons and materials of other jurisdictions is far sufficient. But one of the main purposes of having combination guidelines is to make the purpose of combination regulation more clear. It is incumbent on this Commission to educate the legal fraternity about the basic issues of combination assessment, which in turn helps in better enforcement of the law relating to combination.

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[46] Even the "ICN's Recommended Practice for Merger Notification Procedures" says that jurisdictions come up with Merger Guidelines only after acquiring sufficient experience [see R.P VIII, C, comment 3 at P.g. 23].