

ICN RECOMMENDED PRACTICES FOR MERGER ANALYSIS

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

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

I. The Legal Framework for Competition Merger Analysis

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

*WORKING GROUP COMMENTS
Original Comments (April 2008)*

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

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

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

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

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

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

WORKING GROUP COMMENTS
Original Comments (April 2008)

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

Comment 2: A merger review law should have broad application to transactions¹ that may raise significant competitive concerns, regardless of how the transaction is structured. The legal authority to analyze a merger should not be based on the form or technicalities of a merger agreement.

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

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

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

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

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

*WORKING GROUP COMMENTS
Original Comments (April 2008)*

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

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

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

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

II. Use of Market Shares: Thresholds & Presumptions

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

WORKING GROUP COMMENTS
Original Comments (April 2008)

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

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

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

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

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

*WORKING GROUP COMMENTS
Original Comments (April 2008)*

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

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

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

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

*WORKING GROUP COMMENTS
Original Comments (April 2008)*

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

Comment 2: In some jurisdictions, high market share or market concentration gives rise to a presumption of competitive harm, whereas in others they do not. When agencies use presumptions of competitive harm based on market shares or market concentration, the investigatory process should take into account evidence that may overcome or confirm the

presumption. Agencies should be transparent about the meaning and use of any presumptions, including any quantitative standards used to evaluate market shares or concentration.

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

III. Entry & Expansion

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

WORKING GROUP COMMENTS
Original Comments (April 2008)

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

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

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

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

WORKING GROUP COMMENTS
Original Comments (April 2008)

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

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

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

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

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

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

IV. Competitive Effects Analysis in Horizontal Merger Review: Overview

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

*WORKING GROUP COMMENTS
Original Comments (June 2009)*

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

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

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

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

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

WORKING GROUP COMMENTS
Original Comments (June 2009)

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

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

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

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

WORKING GROUP COMMENTS
Original Comments (June 2009)

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

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

be flexible enough to adapt over time to evolving markets, business practices, and economic learning.

V. Unilateral Effects

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

*WORKING GROUP COMMENTS
Original Comments (June 2009)*

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

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

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

*WORKING GROUP COMMENTS
Original Comments (June 2009)*

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

- *Merger to monopoly:* A merger that would combine the only two rivals in a properly defined market raises a high risk of significant anticompetitive unilateral effects. In examining a merger combining the only two rivals in a relevant market, agencies

should assess whether any competitive constraints exist, such as ease of entry, that would preclude the unilateral exercise of market power by the merged firm.

- *Merger of competitors in differentiated product markets:* A merger that would combine competing suppliers of differentiated products may raise the potential for significant anticompetitive unilateral effects if a sufficient proportion of consumers view the products combined by the merger as their first and second choices (or closest substitutes). Commonly used sources of evidence on the degree of substitutability among differentiated products include marketing surveys, analysis of purchasing patterns, cross-price elasticities, and information contained in normal course of business documents from market participants. Agencies should assess whether the merger would allow the merged firm profitably to increase price on one or more products after the merger, or whether sufficient customers would switch to products of other competitors so as to render such a price increase unprofitable for the merged firm. Agencies should also consider whether rival sellers likely would replace any loss of competition by repositioning or extending their product lines to compete more closely with the merged firm.
- *Merger of competitors in undifferentiated product markets:* In examining a merger that would combine competing suppliers of undifferentiated products in markets in which firms are distinguished primarily by capacity, agencies should consider whether the merged firm would find it profitable to raise price by reducing output below the level that would have prevailed absent the merger. The exercise of market power in such markets is likely only if competitors of the merged firm likely would not respond to the price increase and output reduction by the merged firm with increases in their own outputs sufficient in the aggregate to make the unilateral action of the merged firm unprofitable. This may occur if non-merging firms face binding capacity constraints that could not be economically relaxed in a timely manner, or if existing excess capacity is significantly more costly to operate than capacity currently in use. In such cases, competitors may find it more profitable to raise price than expand output, resulting in additional anticompetitive unilateral effects.
- *Merger of rivals in bidding or auction markets:* A merger that would combine rival bidders in bidding or auction markets may raise the potential for significant anticompetitive unilateral effects. There are a variety of models in the economic literature addressing a wide array of bidding and auction formats involving both differentiated and undifferentiated products. For example, some models focus on whether the merger would combine the two lowest-cost or otherwise closest competitors. Other models focus on whether the merger would result in a competitively significant reduction in the number of bidders. Agencies should determine the appropriate model depending upon the circumstances of the market, and each bid or auction market should be analyzed on its own facts.

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

exist to calibrate the model. The fit of a model should be based on the totality of the evidence.

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

WORKING GROUP COMMENTS
Original Comments (June 2009)

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

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

- *Availability and Responsiveness of Alternative Suppliers:* If alternative suppliers (offering adequate substitutes and with sufficient available capacity) will remain post-merger, and a significant number of customers are willing and able to turn to these alternative suppliers in the event of an anticompetitive increase in price, the threat of losing such customers may be enough to deter the exercise of market power by the merged firm.
- *Entry, Repositioning, or Expansion:* The prospect of entry by new competitors, or expansion or repositioning by existing competitors, may be sufficient in time, scope, and likelihood to deter or defeat any attempt by the merged firm to exercise market power.² In some cases, however, a merger may lessen the potential for entry, expansion or repositioning to act as a competitive constraint against the exercise of market power.

² Recommended Practice for Merger Analysis III addresses the analysis of entry and expansion.

- *Buyer Power:* In some circumstances, customers may have the incentive and ability to defeat the exercise of market power through their bargaining strength against the seller because of their size, commercial significance to the seller, or ability to switch to alternative sources of supply. Customers also may have the ability to encourage or sponsor competitive entry or expansion, or to produce the relevant product themselves. In such cases, even firms with very high market share may not be in a position to exercise market power post-merger. To prevent significant anticompetitive effects, however, buyer power must constrain the exercise of market power in the market and not merely protect certain individual customers.
- *Efficiencies:* Agencies should carefully assess any substantiated claims by the merging parties that a merger will generate efficiencies sufficient to prevent or mitigate anticompetitive unilateral effects from the merger. For instance, cost reductions may reduce a merged firm's incentive to raise price. Efficiencies may also result in benefits in the form of new or improved products, even when price is not immediately and directly affected. Agencies should consider the impact of substantiated efficiencies that are unlikely to be achieved in the absence of the merger on the merged firm's ability and incentives to compete, and whether such efficiencies may preserve or intensify competition, thereby benefiting consumers.

VI. Coordinated Effects

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

WORKING GROUP COMMENTS
Original Comments (June 2009)

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

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

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

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

WORKING GROUP COMMENTS
Original Comments (June 2009)

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

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

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

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

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

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

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

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

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

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

*WORKING GROUP COMMENTS
Original Comments (June 2009)*

Comment 1: Agencies should assess whether competitive constraints or other market conditions that will remain in the market following the merger are adequate to prevent the

creation or enhancement of coordinated interaction. Factors that are often relevant in making this assessment include, but are not limited to:

- *Past Coordination/Behaviour of Firms:* In assessing the likelihood of coordinated effects, agencies should take into account information on the pre-merger characteristics of the markets concerned, including the past behaviour of firms. Evidence of past coordination is important and may serve as strong evidence that all three conditions for successful coordination are present if the relevant market characteristics have not changed appreciably or are not likely to do so in the near future.
- *Entry or Expansion:* Agencies should also consider the actions of competitors not expected to participate in the coordination (“non-coordinating competitors”) and potential competitors, which may be sufficient in time, scope, and likelihood to jeopardise the outcome expected from coordination.³ For instance, the existence of non-coordinating competitors with the ability to expand capacity to take sales from coordinating firms may deter or disrupt coordination. Agencies should therefore consider the existence and significance of barriers to entry and expansion into the relevant market(s) since low barriers to entry and expansion may render successful coordination unlikely or impossible.
- *Maverick Firm:* Coordination may also be difficult to sustain in the presence of a maverick firm – a firm with a different competitive strategy and a greater economic incentive than its rivals to deviate from the terms of coordination. Particular care is needed in mergers involving the acquisition of a maverick firm because in some circumstances those mergers may eliminate a significant constraint to effective coordination and make coordinated interaction more likely, more successful, or more complete.
- *Buyer Power:* Agencies should consider whether the actions or characteristics of customers affect the likelihood of successful coordination. In some circumstances, buyers may be able to undermine coordinated behaviour, for example by sponsoring entry or expansion. Where large buyers likely would engage in long-term contracting, so that sales covered by such contracts would be large relative to a firm’s total output, firms may have a greater incentive to deviate from the terms of coordination.
- *Efficiencies:* Agencies should carefully assess any substantiated claims by the merging parties that a merger will generate efficiencies sufficient to prevent or mitigate coordinated effects from the merger. For instance, cost reductions may enhance a merged firm’s incentives to lower prices, thus reducing incentives to coordinate. Efficiencies may also result in benefits in the form of a new or improved product that could undermine coordination. Agencies should consider

³ Recommended Practice for Merger Analysis III addresses the analysis of entry and expansion.

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

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