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## Horizontal Combination (M & A) Analysis - A Comparative Competition Law Perspective

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**Horizontal combinations are significant source of pricing power and market dominance. The market impacts of horizontal combinations may adversely affect the market structure and the diffused interest of the consumers therein. This paper attempts to present a basic picture about the need for combination control and how competition authorities regulate horizontal combinations in light of the above notion.**

*“Economic power manifests itself in obtaining control of large areas of economic activity, by few industrialists by diverse means. Apart from affecting the economy of the country, this often results in the creation of industrial empires, tending to cast their shadows over political democracy and social values”*

– Monopolies Inquiry Commission (MIC).<sup>1</sup>

### I. COMBINATION REGULATION

#### Corporate Combinations

Corporate Combinations are arrangements between entities either to acquire or merge. For the purpose of competition law, Jurisdictions use the terms combination, merger and acquisition interchangeably. Generally combinations are classified into three types, (i) Horizontal combinations – combination between entities at the same stage of the market, i.e. whose business are either identical or similar, in other words the goods/services of the entities are identical or considered as substitutes to each other. (ii) Vertical combinations – combination between entities related at different stages of the market, for instance combination between two entities, one providing raw materials to other for

production. (iii) Conglomerate combinations – combination between entities in different markets. Among the three, horizontal combinations give rise to higher competitive concerns. A horizontal combination leads to two consequences in the market. Firstly, it results in a larger player and secondly, it reduces the number of participants. These impacts on the market structure may, place the resultant in a dominant position or better enable the market participants to collude. Thus, probabilities of horizontal combinations leading to adverse changes in the market structure are high.

#### Need for Regulation

The object of competition law is to sustain competition thereby promote internal efficiencies and lower prices generated out of rivalry between producers. Competition promotes consumer welfare and competition law works to prevent unfair transfer of wealth from consumers to producers.<sup>2</sup> Ensuring effective competition is presumed to be a constraint for any individual firm or firms acting in concert to opt profits by controlling supply.<sup>3</sup> Competition Agencies work to ensure that markets are driven by competition between the participants and to prevent activities having adverse effects on competition.

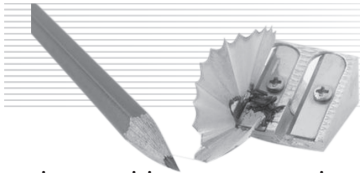
Attempts by market participants to discipline competition to their advantage are market abuses and attracts conduct provisions of competition law i.e. provisions prohibiting abuse of dominance and anticompetitive agreements. Abuse of dominance connotes unilateral exercise of market power and

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1. Report of the Monopolies Inquiry Commission, 1965, p.1. The observation also ponders the spirit and purport of Article 39 (b) and (c) of The Indian Constitution, 1950 (Constitution). The said provisions of the Constitution obligates the state to ensure that (i) the ownership and control of the material resources of the community are so distributed as best to subserve the common good and (ii) the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

2. Read generally, Robert H. Lande, “Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged”, 34 Hastings L.J. 65.

3. Australian Competition and Consumer Commission, “Merger Guidelines”, June 1999, para 5.4, p. 22.



anticompetitive agreement implies the coordinated exercise of market power by few firms acting in concert. Every market abuse presupposes the existence of market power and its exercise. Universally the concept of market power is understood as the “ability of a firm or group of firms acting jointly to profitably maintain prices above the competition level for a significant period of time”.<sup>4</sup> High market share, healthy finance and concentrated market structure are some of the significant attributes of market power.

Horizontal Combination (hereinafter the term combination shall exclusively mean horizontal combination) is a significant mode for firms to increase their market power. Thus firms may use combination as a strategy to gain market power thereby discipline competitors/competition. In the absence of regulatory supervision over combinations, a combination may be devised to achieve the following consequences<sup>5</sup>

- (i) firms may enter into combination to increase the market power of their resultant entity which may reduce the scope of competition in the relevant market. In these situations the combination may lead to abuse of dominance in particular when the motives of the parties are to control the relevant market; and
- (ii) two firms intending to enter into an anticompetitive agreement may enter into combination thereby avoid the operation of the provision prohibiting anticompetitive agreement, at the same time achieve the objectives of such anticompetitive agreement. Here the combination makes a pre-combination bilateral anticompetitive arrangement as a unilateral policy of the resultant.<sup>6</sup>

These consequences clearly picture the importance of combination control for the effective enforcement of conduct provisions of competition law. A competition law without efficient combination control could make its conduct provisions meaningless. It is also pertinent to note that though enforcement area of competition legislation is generally classified into three i.e. anticompetitive agreements, abuse of dominance and combinations, they are not mutually exclusive.<sup>7</sup>

4. WTO, “The Fundamental Principles of Competition Policy”, 7th June 1999 (WT/WGTC/W/127), p.7.

5. D.G. Goyder, “EC Competition Law”, 4th ed., Oxford University Press, United States, 2003, p. 335.

6. Also see para 25, 26 and 27 of the decision in *Europemballage Corporation and Continental Can Company Inc. v. Commission of the European Communities*, Case 6-72 (ECR 1973 p. 215), wherein the European Court of Justice elaborated the need for merger control and held that merger control is implied within the provisions prohibiting anticompetitive agreements and abuse of dominance.

7. Report of the High Level Committee on Competition Policy and Law, 2000, para 4.2 – 1.

### Ex-ante Regulation

Unlike the conduct provisions, combination control provisions are *ex-ante* and require absolute expertise on the part of the competition authority to determine the probable anticompetitive effects in a timely manner. Experience from other Jurisdictions shows that only five to ten percent of combinations alone have adverse effect on competition.<sup>8</sup> These arguments put together questions the need for *ex-ante* control particularly when the conduct provisions are there to regulate the probable anticompetitive conduct of the resultant of a combination.

Apparently it is true that *ex-ante* control is an unnecessary and a costly exercise in the presence of conduct provisions but the existing literature presents the following types of errors that may occur in the absence of *ex-ante* control<sup>9</sup> (i) it is a fact that all type of anticompetitive consequences are not covered by conduct provisions. For instance, in concentrated markets, combinations would further increase the concentration and enable the combining as well as other participants to function with lesser competitive constraints. Here the combination may not lead to any market abuse, still may adversely affect the competition that could not be remedied by the conduct provisions; and (ii) forfeiture of opportunity for structural remedies i.e. preserving combining entities as competing entities which may not be a possible exercise post the combination. In simple terms combination control aims at the prevention of adverse changes in market structure. Further, absence of effective combination control at an early stage in developing economies could necessitate market restructuring at a latter stage which may not be feasible on account of the huge cost involved.<sup>10</sup>

### Forward-looking Counterfactual Analysis

Combination assessment is a *counterfactual analysis*<sup>11</sup> wherein the task of competition agency is to compare two opposite scenarios of the market i.e. a fact and its counter-fact. Combination analysis is also an assessment of near future

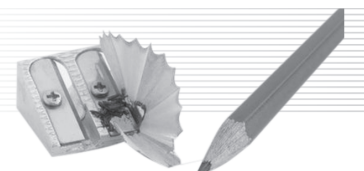
8. Even in a developed economy like U.S, 95% of the mergers notified to the competition authority are found not to have adverse effects on competition. See, U.S. Department of Justice and Federal Trade Commission “Commentary on the Horizontal Merger Guidelines” March 2006, Available at <http://www.usdoj.gov/atr/public/guidelines/215247.htm> (accessed on 16/08/2008).

9. ICN “Analytical Framework for Merger Control”, final paper prepared for ICN annual conference, Office of Fair Trading, London. Available at [http://www.internationalcompetitionnetwork.org/media/library/conference\\_1st\\_naples\\_2002/afsguk.pdf](http://www.internationalcompetitionnetwork.org/media/library/conference_1st_naples_2002/afsguk.pdf) (Accessed on 07/06/2009)

10. Also see, WTO, “Synthesis Paper on the Relationship of Trade and Competition Policy to Development and Economic Growth” (WT/WGTC/W/80), September, 1998, p.5.

11. Also referred as with and without analysis.

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(forward-looking) market wherein the counterfactual aspect does not mean a comparison between pre-combination and post-combination market structure but a comparison between two near future market situations one *with* combination and other *without* combination. The outcome of such a comparison is the effect of the combination. The present market scenario and the factors that had contributed to the past market fluctuations forms the basis for ascertaining the near future market condition. Exact delineation of near future market scenario also depends on the consideration of near future entries, exit and other probable structural fluctuations.<sup>12</sup>

## II. SUBSTANTIVE ASSESSMENT OF HORIZONTAL COMBINATIONS

### Assessment Criterion

The gist of combination analysis is that combinations that would jeopardize competition should be blocked. Competition legislations prescribe the substantive criterion (standard) in light of which respective competition authorities analyze combinations reported to them. *Substantial Lessening of Competition* (SLC) and *Market Dominance* (MD) are the two well known standards in this regard. Both the standards aim at the prevention of creation or strengthening of market power, leading to its probable exercise. Presently, majority of the Jurisdictions adopt/follow SLC since MD is considered to be a traditional standard that is not effective as SLC.<sup>13</sup>

SLC is basically the standard developed by US and latter adopted by other Jurisdictions with subtle variations in their underlying approach and nomenclature.<sup>14</sup> At present, among

the major Jurisdictions, EU's standard alone has reference to dominance which reads as "*significant impediment to effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position likely.*"<sup>15</sup> EU's standard is also essentially SLC with particular reference to dominance.<sup>16</sup>

### Framework for Assessment

Market-based resources allocation being the object of competition law, competition authorities should not act as roadblock to efficient corporate transactions. Also, as earlier mentioned only a miniscule of combinations has adverse effect on competition. Thus the assessment process should ensure a pro-competitive assessment that does not delay consummation of combinations that has no adverse effect on competition. Any rigid and time consuming assessment process would deny the society, the benefits/efficiencies of pro-competitive combinations. Competition authorities of Australia<sup>17</sup>, Canada<sup>18</sup> and U.S.<sup>19</sup> have come up with assessment guidelines that establish pre-determined analytical framework to determine the competitive effects of combinations in a timely manner. These frameworks incorporate various steps in a serialized manner that makes the assessment systematic and more comprehensive.<sup>20</sup> Though these frameworks serialize the

12. Change in regulatory structure, failing nature of one of the parties to the combination and such other factors contributing to the dynamics of the market are relevant in ascertaining the near future market scenario. See, ICN Merger Working Group, "ICN Merger Guidelines Work Book" April, 2006, p.8.

13. There is a big debate on the similarities and differences between both the standards. However, it is an admitted fact that though MD is said to include assessment of collective dominance, it does not give significance to non-coordinated (other than unilateral effects) effects as SLC. A combination subject to assessment under both the standard may give different result because of the above said difference and MD's particular focus on dominance. For further information, see OECD, "Substantive Criteria used for the Assessment of Mergers" February, 2003 (DAFFE/COMP (2003) 5), pp. 19 - 70.

14. Some of the illustrative nomenclature similar to SLC are,

- Australia – "effect, or be likely to have the effect, of substantially lessening competition in a market" (See, S. 50 of Trade Practice Act, 1974),
- Canada – "prevents or lessens, or is likely to prevent or lessen, competition substantially" (See, S. 92, Competition Act, 1985)
- India – "Appreciable adverse effect on competition" (See, S. 6 of Competition Act, 2002).

15. See Art. 2 (2) of Council Regulation (EC) No 139/2004 of 20 January, 2004.

16. Before 2004, EU followed MD standard wherein the relevant provision of the regulation applicable then (Council Regulation (EEC) No 4064/89 of 21 December 1989) provided that a merger "which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market."

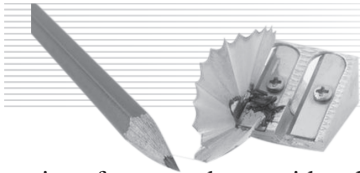
17. Australian Competition and Consumer Commission (ACCC) "Merger Guidelines, June 1999" (Australian guidelines), Available at [www.accc.gov.au](http://www.accc.gov.au) (accessed on 29/01/2008).

18. Competition Bureau, "Merger enforcement Guidelines, 2004" (Canadian guidelines) Available at <http://www.competitionbureau.gc.ca> (accessed on 3/02/2008).

19. U.S. Dep't of Justice (DoJ) & Federal Trade Commission (FTC) "1992, Horizontal Merger Guidelines (with April 8, 1997, revisions to section 4 on efficiencies)" (U.S. guidelines), available at <http://www.ftc.gov/bc/docs/horizmer.htm> (accessed on 17/01/2008).

20. For instance the analytical framework of US guidelines is as follows :

"First, the Agency assesses whether the merger would significantly increase concentration and result in a concentrated market, properly defined and measured. Second, the Agency assesses whether the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects. Third, the Agency assesses whether entry would be timely, likely and sufficient either to deter or to counteract the competitive effects of concern. Fourth, the Agency assesses any efficiency gains that reasonably cannot be achieved by the parties through other means. Finally the Agency assesses whether, but for the merger, either party to the transaction would be likely to fail, causing its assets to exit the market." See para 0.2 of U.S guidelines.



various factors to be considered, they are flexible and are not binding on the respective authority.<sup>21</sup>

### A. Delineation of Relevant Market

Since the purpose of combination assessment is to determine the probable exercise of market power, competition authorities have to identify the constraints on market power and see whether the proposed combination leads to the elimination of any of such constraints. Market Delineation is the usual preliminary step in any combination assessment which helps in identifying the competitive constraints prevailing among the competitors. Practically, market delineation ensures a focused approach by fixing the periphery within which the assessment would be carried out.

Though markets have different dimensions, product and geographic dimensions are the usual aspects delineated for the purpose of competition law.<sup>22</sup> SSNIP test as developed by U.S authorities is the universally accepted tool for relevant market delineation. Under SSNIP “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* (SSNIP), assuming the terms of sale of all other products are held constant”.<sup>23</sup> SSNIP is also called as the *hypothetical monopolist test* wherein the resultant market essentially addresses the competitive constraints that exist between products and areas.

Under SSNIP methodology, the endeavor of competition authorities is to identify the products and geographic areas in which the combining entities operate and for each such identified product and the respective area in which it is sold or distributed, pose themselves a question as to what would happen if a hypothetical monopolist producing that product makes a ‘small but significant and non-transitory increase in price’ (provided the sale of the other products remains constant). The purpose of the question is to find out the behavior of buyers and other suppliers in response to the price raise. If the price rise leads to the use of substitutes by buyers

or supply of substitutes by other suppliers or shifts in the area of purchase, leaving no room for the hypothetical firm to yield profit, such substitutes and areas are also included in the relevant market. These considerations on buyer and suppliers behavior are called as Demand (buyer/consumer) and supply (producer) side factors. 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.

### B. Dynamics of Relevant Market

As a corollary of forward-looking analysis, competition authority has to delineate the near future market for the purpose of analysis. It is to be noted that the present market situation need not be the same in future also. To predict the future market one has to understand the history and present scenario of the market. In this process, the focus is on the stability of market structure.<sup>24</sup> In this regard one has to look into the forces that had acted on the market structure and its future prospectus. The significant factors that influences market structure are.<sup>25</sup>

- (i) *Rivalry*: Rivalry implies the nature of competition in the market, in particular, between the combining entities. Pricing strategies, discounting, distribution and marketing methods, prevalent in the market are of great use to assess rivalry. In case the combination results in elimination of active competition, then it implies the resulting entity’s gain in pricing power.

In rivalry consideration, authorities should also give credence to the presence of *maverick firms* in the market. “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”.<sup>26</sup> These firms pressurize the other participants to extend the perils of competition. The presence of maverick firm makes it difficult for the other participants to exercise market power.

- (ii) *Innovation*: Innovative markets are less conducive to exercise of market power, since little innovation gives a huge benefit to the innovator over the other participants.

21. The guidelines and frameworks established do not bind the competition authority. For instance, the Australian guidelines at p.1 read that “The guidelines do not have any legal force in determining breaches of the Act.” Also see para 0 of the US guidelines and p.1 of the Canadian guidelines wherein the phrases used suggests that the guidelines are not binding and mechanical application of the guidelines is highly improbable.

22. Australian guidelines have reference to functional and time dimensions also, see para 5.40 and paras 5.64 to 5.81 of the Australian guidelines.

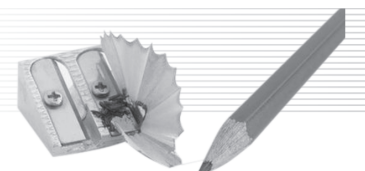
23. Para 1.0 of U.S. guidelines

24. See, 4.17 of Canadian guidelines.

25. See, para 5.161 to para 5.165 of Australian guidelines.

26. ICN Merger Working Group: Analytical Framework Sub-group, “Project on Merger Guidelines” 2004, Chapter IV, Pg.20. available at <http://www.internationalcompetitionnetwork.org> (Accessed on 04/03/2009)

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Thus market leaders often change in innovative markets. Innovation includes both production (product and process) as well as functional (marketing and distribution) aspects. A combination may increase the innovative ability of the resulting entity; it may also enable the resultant to compete well with market leader. On the other hand, combination between two innovators may reduce innovation and monopolize scarce intellectual property resources of the market.

Upon the determination of dynamics, the market as defined in the earlier step has to be altered in the light of the consequences of the identified dynamics.<sup>27</sup> The out come of this process would be the near future market for the purpose of the analysis.

### C. Market Concentration

Market concentrations are economic measurements that represent the size and number of participants in a market. Combination guidelines fix thresholds<sup>28</sup> based on these measurements that are used by competition authorities as a preliminary screen to challenge combinations. Concentration thresholds are derived from the market share of the participants and are considered as good proxies of market power. However breach of the prescribed thresholds is not conclusive as to the existence or probable exercise of market power but indicates the need for further analysis. Competition authorities also make rebuttable presumption of market power on the basis of market concentration levels.<sup>29</sup>

It should be noted that combinations that are not in breach of the fixed threshold are presumed not to have any adverse effect on competition and are cleared in the preliminary stage itself. Computing concentration involves the following three steps

- (i) *Identification of participants*: Once the market is delineated, actual participants of the market could be easily identified. Since combination analysis is forward-looking, participants list should include potential suppliers also.<sup>30</sup> Potential participants are called as participants through supply response or uncommitted entrants.<sup>31</sup> These are participants who find the market profitable in

response to SSNIP and participate without any sunk cost.<sup>32</sup>

- (ii) *Computation of market share*: Market share of a particular participant refers to its stake in the market. Market share by itself is considered as a good indicator of unilateral dominance and it forms the basis for computing concentration. Though market share details are readily available in concentrated markets, one should know the basis of its quantification to ensure the authenticity of such readymade data or to compute in the absence of such data.

Generally, revenue of the participants is considered as the basis for measuring market share. However, capacities, units of production and units of sale of the participants are also used as the basis for computing market share. Depending upon the circumstance,<sup>33</sup> appropriateness of a particular basis is decided. For instance, in a homogeneous product market where all the participants operate with their full capacity, market share computed any of the above mentioned basis would give similar result.

- (iii) *Measures of concentration*: Industrial Concentration Ratio (CRs) and Hirfindal-Hirshmen Index (HHI) are the usual concentration measures on which safe harbor limits are established.

- (a) **CRs** : CRs is the aggregate of market shares of few leading market players. CR4 (aggregate of market share of first four leading participant) and CR3 (aggregate of market share of first three leading participant) are the commonly used CR measure.

**CR 3** =  $A+B+C$  [A, B, C are the market shares of the first three leading participants].

- (b) **HHI** : HHI is the aggregate of squares of market shares of all the participants in the market and delta ( $\Delta$ ) refers to the difference between post-combination and pre-combination HHI.

**HHI** =  $\sum |A^2+B^2+C^2+\dots+N^2|$  [A, B... N are the participants in market]

27. For instance, in European Union, significance is given to alteration of market share in the light of near future exit, entry or expansion. See "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)" at para 15, Available at <http://europa.eu> (accessed on 2/02/2009)

28. Also called as safe harbor limits.

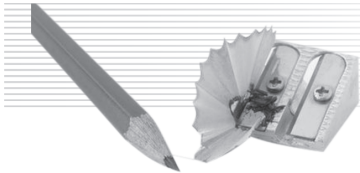
29. See, para 1.51 of U.S. guidelines.

30. See, para 4.2 to para 4.4 of Canadian guidelines.

31. See, para 1.0 and footnote 7 of US guidelines.

32. Those parts of the costs of an enterprise that can not be recovered if it ceases operations, even in the long run. It includes those investments that can not be deployed anywhere other than in the business, such as regulatory cost construction cost in mines etc. The existence of sunk cost tends to produce hysteresis in the economy, and helps to explain the rarity of contestable markets. See John Black, "A Dictionary of Economics", Oxford University Press, at p. 452, [2005].

33. See para 4.5 to 4.10 of Canadian guidelines



▲ = post-combination - pre-combination  
HHI

HHI is considered to be a better measure of market concentration since it takes into account all the participants whereas CRs consider only the market share of few participants.

Competition authorities claim that their CR and HHI thresholds are fixed on the basis of their experience and combinations falling below the thresholds generally do not involve any adverse effects on competition.

### D. Adverse Effects on Competition

The core of combination analysis is to assess the adverse effects on competition i.e. the probable exercise of market power. Exercise of market power may be unilateral or coordinated; perspective of analysis also differs for each of the instance.

Among the three jurisdictions, U.S. and Canada<sup>34</sup> have different concentration threshold for probable unilateral and coordinated exercise of market power. For example, the Canadian guidelines use market share threshold in respect of probable unilateral effects and CR4 for probable coordinated effects. Breach of threshold fixed for coordinated effects need not lead to the breach of threshold fixed for unilateral effects and *vice-versa*.

- (i) *Unilateral effects*<sup>35</sup>: In a homogeneous product market<sup>36</sup> a dominant entity finds it profitable to increase price with reduction in supply (out-put). The sale loss that might occur due to increased price is overlooked by the profit yielded through price raise and artificial demand created.

If combination is in differentiated product market, where products of the combining entities are first and second choice of the consumers, the combination may internalize substitution. In the absence of combination, price raise in one product makes the consumers to switch to the other, but the combination internalizes such substitution with in the resulting entity. Here the sale loss in one product due to price raise is compensated by the increased sales in other product.<sup>37</sup>

34. Australian guidelines establishes common threshold, breach of which leads to two parallel analyses separately for unilateral and coordinated effects.

35. See, para 2.2 of U.S guidelines and para 5.11 to para 5.17 of Canadian guidelines.

36. Homogeneity refers to the identicalness of the product of different suppliers. Here the price is the concern of the consumers based on which the consumer selects the supplier.

37. For better understanding of economics of unilateral behavior, one may refer to 'Bertrand' and 'Cournot' theories of oligopoly which explains multilateral price raise and capacity constraints of rivals, respectively.

- (ii) *Coordinated effects*: Anti-competitive effects are also generated by the collective action (coordination) of few participants in the market. Possibilities of coordination are high in oligopoly. The coordination may be overt or tacit. The general Characteristics of collusive markets are<sup>38</sup>
  - (i) market conditions are conducive to coordination, (ii) if any participant deviates from the terms of coordination, it can be detected and (iii) possibility of retaliation of deviants. Openness in pricing, higher degree of market homogeneity, presence of industrial association and excess capacity of the participants are some of the factors that show the existence of the above market conditions.

### E. Entry

Before going to the substance of entry analysis, it would be better if we appreciate the difference between supply response participation (uncommitted entry) and committed entry. Such a differentiation is clearly made under U.S. guidelines by defining uncommitted and committed entrant separately.<sup>39</sup> Uncommitted entrants participate in the market without significant investment and are assessed in participant identification stage but committed entries involve sunk investments and are considered in entry analysis.

If entries in the market are highly probable then such entries or their threat acts as a constraint to adverse competitive effects. An entry to be effective should be timely, likely and sufficient.

- (i) *Timeliness* of entry implies the ability of the entrant to become an effective competitor within reasonable time.
- (ii) An entry is said to be *likely* if the entrant finds the industry profitable within reasonable time. Entry is unlikely unless the sale opportunity available to the entrant is higher than the minimum viable sales at which he is profitable. Canadian competition authorities follow a different test for likeliness, for them the presence of 'entry advantaged firms' shows the likeliness of entry.<sup>40</sup>
- (iii) *Sufficiency* of entry needs the entries to bring/preserve the competition prevalent before the combination. In sufficiency, the focuses is on the ability of the entrant(s) to bring back the competition within reasonable time.

All the above three components of effective entry refers to reasonable time which is usually two years.<sup>41</sup>

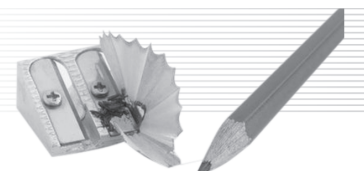
38. See, para 2.1 of U.S guidelines, para 5.20 of Canadian guidelines and para 5.168 of Australian guidelines.

39. See, para 1.32 and para 3 of US guidelines and para 5.53 of Australian guidelines.

40. Para 6.4 of Canadian guidelines list the entry advantage firms.

41. See, para 3.2 of US, para 6.3 of Canadian, and para 5.126 of Australian guidelines.

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While speaking about entry probabilities, entry barriers also count. Entry barriers are usually of three types, structural, regulatory, and functional. Structural barriers are unique to the particular market which includes huge sunk cost, scarce intellectual property resources, technical expertise and other entrepreneurial difficulties. Regulatory barriers are prescribed under law which includes licensing, permitting, approval and other quality and price standards to be maintained by a participant. Functional barriers are those difficulties that are present in marketing and distribution. Besides these, strategies of existing participants in response to potential entry are also significant barriers.

Entry may also happen through imports. In such instance, in addition to the above aspects, competition authorities consider import specific tariff and non-tariff barriers.<sup>42</sup>

### **F. Countervailing Bargaining Power**

If the buyers' concentration is dense, it may have the potential to constrain the ill-effects of a combination. Mere buyer concentration does not constitute power to constrain anti-competitiveness, it is the buyers concentration coupled with their ability which matters. Majority of the jurisdictions have a passing reference about this factor, U.S. guidelines does not have reference to this factor at all. Some of the instances where countervailing power of buyers exist are,<sup>43</sup>

- (a) buyer's ability to switch to suitable alternatives within reasonable time. This aspect is similar to product substitution analysis at market definition stage.
- (b) Presence of sophisticated buyers who are likely to foster or sponsor entrants in response to price rise. Again this factor depends on someone entering the market.
- (c) If there is a heavy competition in vertically related downstream market. Competition in downstream market demands its producer to minimize costs and these producers will stop buying raw materials, if the particular supplier raise price.

### **G. Efficiencies Gains**

Efficiencies are the benefits that arise out of the combination. "Efficiencies include cost savings, more intensive use of existing capacity, economies of scale or scope, or demand-side efficiencies such as increased network size or product quality. They might also encompass pro-competitive changes in the merged entity's incentives, for example by capturing

42. Para 5.112 of Australian guidelines deal regarding the factors that are significant in import analysis.

43. See, para 7.2 of Canadian guidelines and para 5.129 of Australian guidelines.

complementarities in R&D activity, which in turn might increase incentives to invest in product development in innovation markets".<sup>44</sup> If the generated efficiencies off-sets its ill-effects then such benefits becomes a valid ground to approve the combination.

Jurisdictions differ in their approach in considering efficiencies. In U.S., they form part of SLC determination whereas Canadian authorities use efficiencies as a defense<sup>45</sup> to approve anticompetitive combinations. Australian authorities consider efficiencies in authorization which is a separate process for approving anti-competitive combination.

The usual conditions for recognizing efficiencies are (i) specificity - claimed efficiency is the direct consequence of the combination and the same can not be achieved in any manner other than the combination;<sup>46</sup> and (ii) pass-on – the benefits achieved should be passed on to the consumer either in terms of lower price or better quality of products/service.<sup>47</sup>

### **H. Failing Firm Defense**

Failing firm is an entity which by reason of its financial distress is about to exit the market. Combination of such firms is presumed not to have adverse effect on competition.<sup>48</sup> The basic rationale underlying the failing firm defense is that the future market concentration would be equally detrimental to competition irrespective of whether the combination is cleared or blocked.

Failing firm analysis is usually based on two factors firstly, the failure of the firm and secondly, whether the alternatives to the combination results in greater competition than that of the combination. The usual requirements for recognition of the defense are<sup>49</sup>

- (i) In the absence of combination the alleged firm would not be able to meet its financial obligations in the near future.
- (ii) There is no other alternative available to the failing firm that is less anticompetitive than the proposed combination.
- (iii) Absent the combinations, the assets of the failing firm would exit the market.

44. ICN Merger Working Group: *Investigation and Analysis Subgroup, "Merger Guidelines Work Book" [2006], at p. 62.*

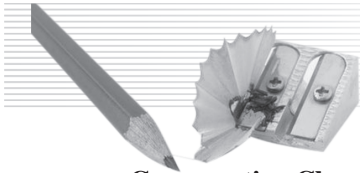
45. See, Section 96 of Canadian Competition Act, 1985.

46. See, para 8.17 Canadian guidelines. Also, para 4 and footnote 35 of U.S. guidelines.

47. Canadian guidelines have no reference to pass-on requirement.

48. In Australia failing firm aspect is considered as a part of elimination of vigorous and effective competitor. See para 5.138 to 5.147 of Australian guidelines

49. See, para 5.1 of U.S. guidelines and part 9 of Canadian guidelines.

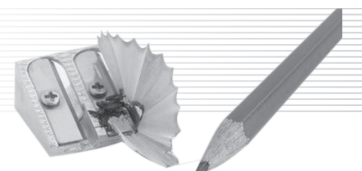


## Comparative Chart – Combination Assessment practice in Australia, Canada and United States

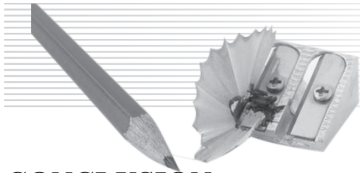
Element		Australia	Canada	United States
Law	Statute	S. 50, Trade Practice Act, 1974.	S. 92, Competition Act, 1950.	S. 7, Clayton, Act, S. 1, Sherman, Act and S. 5 of the Federal Trade Commission, Act.
	Guidelines	Merger Guidelines, June 1999.	Merger enforcement Guidelines, 2004.	1992, Horizontal Merger Guidelines (with April 8, 1997, revisions to section 4 on efficiencies).
	Authority	Australian Competition and Consumer Commission (ACCC).	Competition Bureau.	U.S. Dep't of Justice & Federal Trade Commission.
Substantive Assessment	Criterion	Combination has the effect, or be likely to have the effect, of substantially lessening competition in a market	Combination prevents or lessens, or is likely to prevent or lessen, competition substantially	Combination has the effect substantially to lessen competition
	Market power	Market power is the ability of a firm or firms profitably to divert prices, quality, variety, service or innovation from their competitive levels for a significant period of time.	Market power of sellers means the ability of a single firm or group of firms to profitably maintain prices above the competitive level for a significant period of time.	Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.
Market Definition	SSNIP benchmarks	5% price raise and 1 year is considered as non-transitory.	No explicit benchmarks specified.	Usually 5% but the Agency at times may use a price increase that is larger or smaller than 5% percent.
	Demand side Substitution	Considered.	Considered.	Considered.
	Supply side Substitution	Considered.	Considered in supply response and entry assessments.	No explicit reference in market definition stage.
Market Concentration	Uncommitted entry (supply responses)	No explicit reference.	Addressed as participants through supply response and are considered in supply response stage.	Considered in participant identification stage.
	Threshold	<i>Common threshold:</i> MS >15% & CR4>75% or MS > 40%.	<i>Unilateral:</i> >35% combined share <i>Coordinated:</i> CR4 >65%, unless combined share is <10% (use of HHI is optional).	<i>Unilateral:</i> >35% combined share <i>Coordinated:</i> HHIs (i) >1800/>100 (strong inference) (ii) >1800/>50 (moderate inference) 1000 to 1800/>100 (moderate inference).
	Inference of market power	No explicit inference from concentration.	No inferences of market power from concentration.	Rebuttable inferences of market power.
Anti-competitive effects		No explicit reference about demarcated analysis for unilateral and coordinated effects.	Unilateral and coordinated effects are separately analysed.	Unilateral and coordinated effects are separately analysed.

# Articles

## Horizontal Combination (M & A) Analysis – A Comparative Competition Law Perspective



Entry	Timeliness	No explicit reference	2 years.	2 years (with exceptions).
	Likelihood	No explicit reference	Entry advantage firms test is used	SO (sale opportunity) is greater than MVS (minimum viable scale) at which an entrant is profitable
	Sufficiency	No explicit reference	Entry is likely to be on a scale and scope that would be sufficient to eliminate a material price increase	Entry is sufficient in maintaining pre-combination competition.
	Barriers	Sunk costs, regulatory barriers, access to scarce resources enjoyed by incumbent firms, economies of scale and scope, product differentiation and brand loyalty and the threat of retaliatory action by incumbents.	Regulatory, sunk cost and other entry – deterring factors.	Barriers in Different phases include pre-entry, regulatory and post entry difficulties.
	Import	Given more emphasis than other two jurisdictions. Import specific tariff and non-tariff barrier are considered.	Not formally recognized but while identifying participants, foreign participants are considered.	No explicit reference
Countervailing Buyer Power		Buyer's ability to constrain price raise.	Buyer's ability, to shift to substitutes, vertically integrate their activity to upstream market or to foster or sponsor entrants.	No explicit reference
Efficiencies	Approach	Considered in authorization, a separate procedure to approve anticompetitive combination.	Considered as a defense and forms part of the assessment.	Efficiencies are part of SLC determination.
	Specificity	Benefits should be specific to the combination.	Gains that are likely to be attained by modes other than combination are not considered.	Should be specific to the combination (Cognizable efficiencies)
	Consumer Pass-on	Benefit to public is the terminology used (see S. 90 of Trade practice, Act, 1974, on authorization). Apparently the benefits should pass-on to consumers.	No explicit reference	Though not expressed it's an essential informal requirement.
Failing firm		Not considered as a separate step but considered when the fact of elimination of vigorous competitor is assessed.	The claimant should prove that (i) no other competitively preferable purchaser exist; (ii) the firm can not revive in any manner;& (iii) liquidation of the firm would not result in higher degree of competition than combination.	It should be demonstrated that (i) absent the combination, the assets of the firm would exit the market; (ii) the firm can not be restructured under Chapter XI of bankruptcy code; & (iii) the firm has taken unsuccessful good-faith efforts to elicit less anticompetitive alternative.



### CONCLUSION

A fair reading of the combination guidelines issued by Australia, Canada and U.S. authorities ponder their rich and organized experience in antitrust jurisprudence. Further these guidelines are not the guidance for the respective authorities but an explanation to other as to how they deal with combinations. The non-binding integrated approach established by these guidelines allows the competition authorities to adopt market specific strategies on case to case basis and decide the potential issues in a timely manner. Thus, it is always rational to have a comprehensive pre-determined approach for combination analysis. However, guidelines and frameworks can be drafted by a competition authority only after attaining sufficient experience in combination control.<sup>54</sup>

Indian combination control regime seems to be on the verge of enforcement<sup>55</sup>. Though it is early for our commission to think about guidelines this is the right time to give some guidance on market definition and market concentration guidelines since they are the indispensable preliminary aspect of combination analysis. □

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54. See also "ICN's Recommended Practice for Merger Notification Procedures, 2002" Even Recommend Practice VIII, C, comment 3, p. 23.

55. In terms of our Competition Act, 2002, combinations reported to CCI are suspended for 210 days unless expressly approved earlier. CCI is also trying to limit the said period by fixing time frame for prima-facie opinion (see proviso to Reg. 27 of the draft Regulations on Combinations issued by CCI). Thus CCI has to make a time-bound assessment within which it has to consider the factors mentioned in S. 20(4). The 14 factor factors mentioned under S. 20(4) are nothing but an extensive expression of the steps A to H discussed in this paper. However CCI's approach and understanding of 20(4) factors need not be the same as discussed in this paper or to that of a particular jurisdiction since application/enforcement of competition law is highly influenced by the underlying purpose and objectives of the relevant legislation that are unique to jurisdictions and economies.