Compecon – Competition Economics

Comments on Competition Authority Draft Merger Guidelines Consultation.

1st November 2013

EXECUTIVE SUMMARY.

This note outlines Compecon's comments regarding the Competition Authority's *Draft Merger Guidelines for Consultation* ("the 2013 Consultation") dated 13th September 2013. Compecon welcomes the opportunity to comment on the Authority's proposals for revisions to its Merger Guidelines ("the Guidelines").

The 2013 Consultation proposes some major changes to the Guidelines. In general the proposals in the 2013 Consultation are vague in a number of respects and would reduce clarity and certainty. For example, the Consultation document does not provide a clear definition of a substantial lessening of competition (SLC) and it is unclear whether it is proposed that the current consumer welfare standard should be retained. The structure of the section on horizontal mergers is confusing and lacks clarity. The section on efficiencies is also rather vague. Some of the proposals are inconsistent with one another while, in our view, there is no economic justification for some of the proposed changes. In our view substantial revisions would be required to the Consultation draft before it could be used as the basis for revised Guidelines.

Almost three years have elapsed since the Authority previously sought views from practitioners on possible revisions to the Guidelines in a 2010 Consultation. The 2010 Consultation indicated that the Guidelines should include more detailed explanations of certain issues such as the meaning of an SLC and "maverick firms" but the 2013 Consultation fails to do so. The 2013 Consultation also contains some proposals which were not flagged in the 2010 Consultation.

In our view a more detailed consultation process is required before any revisions are made to the existing Guidelines. This is necessary to permit a detailed exchange of views between the Authority and interested parties which cannot be achieved by simply requesting written comments on the 2013 Consultation. We would therefore suggest that, as a next step the Authority should organise a seminar to allow a discussion of its proposals with interested parties.

Compecon's views on specific issues are summarised below.

Key Elements in Merger Control.

- There is no clear statement in the 2013 Consultation that the SLC test is to be interpreted in terms of consumer welfare as is currently the case. In our view the merger guidelines should state explicitly that the SLC test is interpreted in terms of consumer welfare. If the Authority proposes to move away from a consumer welfare test, then there needs to be a clear explanation and justification for such a fundamental change in approach.
- The Guidelines should state clearly that the only counterfactual that will be considered is the most likely alternative outcome to a merger not proceeding.

Market Definition.

- Identifying the relevant market provides a framework for analysing competitive effects. There are numerous examples in the literature where the failure to define markets correctly has resulted in incorrect findings regarding the likely competitive effects of mergers. In many cases it is not necessary to precisely define the market because the merger in question is unlikely to result in an SLC on any possible market definition but this does not eliminate the need to define a relevant market entirely.
- The Guidelines should specify that for products to be regarded as supply side substitutes, capacity switching must occur within a relatively short period of time.

Market Concentration.

- The proposed revisions to the HHI thresholds are welcome as is the confirmation that the HHI thresholds are a screening device for identifying cases than may require closer scrutiny and that HHI values above the thresholds do not establish that a merger will result in an SLC is welcome. The Guidelines should provide that where the post-merger HHI is below 1,000 no anti-competitive effects are likely to arise and such mergers are presumed unlikely to result in any SLC.
- The relevance of paragraph 3.15 on concentration ratios is not clear.

Horizontal Mergers.

- In general chapter 4 of the 2013 Consultation is somewhat disjointed and confusing. A more logical sequence might be to address the two broad categories of anti-competitive effects, i.e. unilateral and coordinated effects first and then address some

of the more specialised examples. Similarly it is not clear why paragraph 4.15 on market shares and concentration is included where it is.

- It might also be helpful to set out certain broad messages more clearly. For example, as a general rule, cases of non-dominant unilateral effects are more likely to arise in the case of differentiated products than in the case of homogenous products and are more likely in consumer goods markets which are generally regarded as differentiated. In the absence of dominance, coordinated effects are more likely in the case of homogenous products, although unilateral effects may arise if the non-merging firms are capacity constrained. There may be exceptions to such general rules. For example coordinated effects can sometimes occur in differentiated product markets but nevertheless such rule of thumb guidance would be helpful.
- It is not clear why the 2013 Consultation refers only to monopoly and makes no reference to near-monopoly and single firm dominance as obvious examples of when a merger could lead to a unilateral price increase, as is the case in the current Guidelines.
- The 2013 Consultation states that the ability of firms to raise prices in the case of homogenous products would be reinforced if consumers were relatively price insensitive or if switching opportunities were limited." This point requires some clarification. For example, consumers cannot be price insensitive between homogenous products. Similarly it is not clear why switching opportunities might be limited in the case of homogenous products.
- A notable omission in the discussion on closeness of competition in the case of unilateral effects is that such an analysis needs to take into account the scope for the remaining non-merging firms to reposition their products post-merger to make them closer substitutes for the merging brands.
- It could be helpful if an appropriate theory of competitive harm could be identified at an early stage in the review process, possibly even at pre-notification stage, in order to facilitate a fruitful exchange between the Authority and the notifying parties.
- It is not clear what implications, if any, the discussion on bidding markets in paragraph 4.30 has for merger control.
- The discussion of maverick behaviour is also not very helpful. Clarification is required in light of the Authority's findings on maverick behaviour in *Heineken/Scottish & Newcastle*. The Authority's 2010 Consultation proposed that the

Guidelines could be amended to include a more complete discussion of the significance of maverick firms for merger review but the 2013 Consultation does not address this issue.

Entry.

- The current two year timeframe used to define timely entry should be maintained. Entry will take longer in some industries and markets than in others but the longer it takes for successful entry the more likely it is that consumers will be harmed in the meantime by an anti-competitive merger. If it takes longer to enter some markets then that indicates that they are subject to short-term barriers to entry. In addition the longer the time horizon used for assessing entry the more difficult it becomes to predict with any degree of certainty that entry is likely to occur.
- The statement that the sufficiency requirement may be satisfied by multiple entry and does not need to be satisfied by a single entrant is welcome.

Efficiencies.

- The section on efficiencies in the 2013 Consultation is highly problematic and lacks clarity. The section fails to clearly describe the test to be applied. This is particularly important in light of the analysis of efficiencies in the *Kerry/Breeo* case. The analysis of efficiencies depends upon whether the SLC test is based on consumer welfare or total welfare.
- The economic literature indicates that fixed cost savings may be passed on in the long-run and consequently they should not be totally discounted.
- The Authority also needs to clarify its understanding of fixed and variable costs. For example, if a firm outsources production, the price it pays to its suppliers is a variable cost to the firm regardless of whether this might include a contribution to supplier's fixed costs.
- The approach to the treatment of dynamic efficiencies is inconsistent with the treatment of timeliness of entry.
- Efficiencies should be merger specific but the fact that there might theoretically be alternative ways of achieving efficiencies without a merger is not the appropriate test for merger specificity. The onus should be on the Authority to show that suggested

alternatives are realistic options in the circumstances facing the merging parties rather than just theoretical possibilities.

- In defining efficiencies as non-merger specific the test should be whether they are likely to occur in the absence of the merger, not as suggested in paragraph 6.8, whether they could occur. A merger may lead to efficiencies being realised sooner than they would otherwise have been. Such efficiencies should not be discounted as consumers would not be harmed by taking such efficiencies into account.
- Paragraph 6.13 implies a very significant dilution of the efficiency defence. The issue is whether the effect of a potential diminution in competition might be offset by efficiencies. A reduction in marginal cost will increase the profit maximising level of output, other things equal, which will lead to a fall in price so the claim that efficiencies are more likely to be passed on if the market is competitive is not relevant. The economic literature recognises that a monopolist will pass on at least 50% of any cost reduction.

Countervailing Buyer Power.

- The 2013 Consultation fails to recognise that in some instances a buyer may be able to exercise countervailing buyer power provided it can delay or defer purchases for a period of time. It is also important to recognise that a buyer does not need to be able to permanently obtain supplies from an alternative source in order to exercise countervailing buyer power.
- The Consultation states that a customer’s ability to exercise buyer power may be limited if it resells the products by the willingness of its customers to buy alternative products. Past evidence of brand loyalty may not provide an accurate indicator of likely consumer responses to a post-merger price increase.
- Paragraph 7.8 states that where customers are also competitors of the merging parties, the incentives of both parties may become aligned leading to harm to competition. This fails to recognise that own brand is not a single entity but involves several competing own brands. It also assumes that the reseller has the power to raise prices of both products in the downstream market, which begs the question of why it would not raise prices of both products anyway.
- It makes sense to discount statements and other actions by the merging parties following the announcement of the merger for the obvious reason that they have a

vested interest in portraying the merger in a favourable light. Such arguments do not apply to third parties. In particular, evidence that customers do not expect the merger to alter their ability to exercise countervailing buyer power should not be discounted because it post-dates the announcement of the merger.

Non-Horizontal Mergers.

- The lack of any reference to portfolio effects in the section on non-horizontal mergers appears strange particularly given the reference to such effects at paragraph 2.4.

1: INTRODUCTION.

1. This note outlines Compecon's comments in respect of the Competition Authority's document entitled *Draft Merger Guidelines for Consultation* ("the 2013 Consultation") dated 13th September 2013. Compecon welcomes the publication of the 2013 Consultation and the opportunity to comment on the Authority's proposals for revisions to its Merger Guidelines ("the Guidelines").

2. Before commenting on the proposals included in the 2013 Consultation, Compecon wishes to address certain procedural matters.

3. The Authority's existing Merger Guidelines ("the Guidelines") were published in December 2002. The Authority published a consultation document on possible revisions to the Guidelines in December 2010 (Consultation on Competition Authority Guidelines for Merger Analysis, 3rd December 2010 – "The 2010 Consultation") and held a seminar for interested parties. At that time it indicated that the 2010 Consultation represented the first stage in the process of reviewing the Guidelines and that following the consultation it would publish new draft Guidelines and seek the views of interested parties. No further documents were issued by the Authority until the publication of the 2013 Consultation. The 2013 Consultation states:

> "After the consultation process the final version of these guidelines will replace the Authority's current guidelines." (Paragraph 1.3).

4. The 2013 Consultation includes proposals for some major changes to the Guidelines. Some of the proposals are vague in a number of respects and would reduce clarity and certainty. In our view a more detailed consultation process is required before any revisions are made to the existing Guidelines. This is necessary to permit a detailed exchange of views between the Authority and interested parties which cannot be achieved by simply requesting written comments on the 2013 Consultation. We would therefore suggest that, as a next step the Authority should organise a seminar/workshop to allow a discussion of its proposals with interested parties.

5. In particular, the 2013 Consultation document does not provide a clear definition of a substantial lessening of competition (SLC) and it is unclear whether it is proposed that the current consumer welfare standard should be retained. This is despite the fact that the 2010 Consultation indicated that the Guidelines should include a more detailed explanation of what is meant by an SLC. The structure of the section on horizontal mergers is confusing and lacks clarity. Similarly the section on efficiencies is also rather vague. The 2010 Consultation proposed that further clarification was required as to what constituted a "maverick" firm but again the 2013 Consultation does not really address this. Some of the proposals are inconsistent with one another, e.g. entry and dynamic efficiencies, while, in our view, there is no economic justification for some of the proposed changes. In our view substantial revisions would be required to the Consultation draft before it could be used as the basis for revised Guidelines. It is also relevant that almost three years have elapsed since the Authority previously sought views from practitioners on possible revisions to the Guidelines. The 2013 Consultation also includes some proposals which were not flagged in the 2010 Consultation. For all these reasons, Compecon submits that a process that is limited to seeking and considering written submissions is inadequate.

6. The balance of this submission addresses issues in the order in which they appear in the 2013 Consultation.

2: KEY ELEMENTS IN MERGER APPRAISAL.

2.1: Introduction.

7. Chapter 1 of the 2013 Consultation sets out key elements to the Authority's merger review function. These include:

   a. The relevant test;
   b. The relevant counterfactual; and
   c. The evidence necessary for the Authority to perform its merger review function.

2.2: The Relevant Test.

8. The Competition Act, 2002, provides that the Competition Authority is required to form a view as to whether or not a merger or acquisition which has been notified to it will result in a substantial lessening of competition (SLC). The 2002 Guidelines state:

> "The SLC test is interpreted in terms of consumer welfare." (Paragraph 1.3).

The 2013 Consultation contains no explicit statement that the SLC test is interpreted in terms of consumer welfare. Indeed there is no statement in the document as to how the SLC test is to be interpreted.

9. This is despite the fact that the 2010 Consultation stated:

> "2.8 The 2002 Merger Guidelines should be updated to provide more clearly the context for Competition Authority's use of the SLC test. For example, at present, there is no linkage to the Act, whereas a clearer link to the Act would highlight the purpose and meaning of the SLC test.
>
> 2.9 Also in addition to a technical description of the SLC test, there should be greater emphasis on its role as a theoretical concept. This would clarify how the SLC test is used by the Competition Authority in forming its opinion on whether or not a proposed transaction will substantially lessen competition."

10. The 2010 Consultation went on to state:

> "2.10 The 2002 Merger Guidelines could be amended to clearly:

• define what is meant conceptually by the term "substantial lessening of competition"; and

• describe the role of the SLC test in the Competition Authority's merger review function (for example, by reference to Sections 21 and 22 of the Competition Act 2002 and/or any analogous sections in subsequent legislation)."

The 2013 Consultation does not address these issues.

11. It could be argued that the consumer welfare test is implied. For example, paragraph 1.7 of the 2013 Consultation states:

> "Any Authority finding in relation to the presence or absence of an SLC will be based on all available information considered in the light of all possible theories of consumer harm arising from possible adverse competitive effects."

Similarly paragraph 1.9 states:

> "In applying the SLC test the Authority analyses not only the effect on the price of affected products but also other effects that can impact on consumers, such as changes to output (quantity), quality, consumer choice and innovation (e.g. development of new products or enhancements to existing products)."

12. In our view any revised merger guidelines should state explicitly that the SLC test is interpreted in terms of consumer welfare. If the Authority proposes to move away from a consumer welfare test, then there needs to be a clear explanation and justification for such a fundamental change in approach.

2.3: The Relevant Counterfactual.

13. The 2010 Consultation proposed that the Guidelines should be improved and updated to better describe the concept of the counterfactual which it described as "what will or might happen in the absence of the merger going ahead". It went on to suggest that the Guidelines could be amended to:

- describe the concept of the counterfactual;
- illustrate the importance of the counterfactual to the Competition Authority's merger review function, particularly for more complex cases (for example, failing firm cases); and,

- highlight the importance of identifying the relevant counterfactual in considering a proposed transaction.

14. The 2013 Consultation devotes just four paragraphs to the issue. It correctly acknowledges that in most cases the appropriate counter-factual will entail the continuation of the pre-merger situation. The issue of the counterfactual featured in the *Herald/AM* case where the Authority stated that the notifying parties had put forward two alternative counterfactuals. The Authority's Determination stated that it had identified a third possible counterfactual. It is not clear from the Determination which of these alternatives scenarios was considered to constitute the appropriate counterfactual.

15. The 2013 Consultation states that the Authority "will consider all available evidence to decide on the relevant counterfactual. In doing so the Authority will assess the credibility of a counterfactual proposed by the merging parties to ensure accurate identification of the relevant counterfactual." (Paragraph 1.15). The Consultation contains no mention of the fact that only the most likely counterfactual scenario should be considered. In other words assessment of the counterfactual is not a matter of considering various possible alternatives. Rather it involves identifying the most likely alternative scenario in the event that the merger does not proceed. Any amendment to the Guidelines should make clear that the only counterfactual that will be considered is the most likely alternative outcome to the merger not proceeding.

3.4: The Relevant Market.

16. The 2013 Consultation notes that under Section 22(3) of the Competition Act, the Authority is required to make a determination to either clear, clear with conditions or prohibit a merger depending on its effects on competition in a market or markets within the State. The Consultation goes on to state:

> "It does not, however, follow that market definition must precede and set the boundaries for identifying and analysing competitive effects. Rather, while market definition is a useful tool of analysis it cannot and should not restrict or limit the range of competitive effects to be addressed by the Authority in the course of its merger

> review. Many factors relevant to defining markets will also be relevant to analyzing competitive effects, and vice versa." (Paragraph 1.19)

17. The Consultation contains no further explanation or elaboration of this statement. It is not at all clear in what way market definition might restrict or limit the range of competitive effects to be addressed by the Authority. While the final sentence in the above quotation is correct, it is not at all clear why it removes the need to define the relevant market.

18. The Authority therefore needs to provide a detailed explanation of precisely what is meant by paragraph 1.19. In particular, it needs to explain how market definition can restrict or limit the range of competitive effects to be addressed by the Authority. Identifying the relevant market provides a framework for analysing competitive effects, e.g. whether there is a competitive overlap between the parties; which products exercise a competitive constraint on the merging brands; whether there is potential for entry and other factors that are relevant to the analysis of competitive effects. There are several examples in the literature where the failure to define markets co-rrectly has resulted in incorrect findings regarding the likely competitive effects of mergers.

19. It is accepted that it is often not necessary to define the relevant market precisely in order to come to a conclusion as to whether or not a merger will result in an SLC, because an SLC is unlikely to arise in any possible market. Both the Authority and EU Commission have cleared a large number of mergers on that basis. This point is recognised in the 2010 UK Merger Guidelines which note that it is not always necessary to *precisely* define the boundaries of the relevant market while the ACCC has also recognised that it is often possible to determine a merger's likely impact on competition without *precisely* defining the boundaries of the relevant market. The existing Guidelines clearly provide that market definition is neither necessary nor sufficient to establish the competitive impact of a merger.

> "It is not always necessary to reach a firm conclusion on market definition if more direct measures of market power are available. This may hold, for example, where it is clear that the merger does not raise competition concerns on any reasonable definition of the market. Alternatively, a market may not be defined if the transaction clearly gives rise to adverse competitive effects." (Guidelines, Paragraph 2.2). It is not clear therefore that any change is required and no justification has been advanced for doing

so. Recognising that a precise market definition is not necessary in every case does not mean that there is no need to define a relevant market at all.

20. The remainder of the 2013 Consultation contains numerous references to analysing competitive effects in specific markets which appears inconsistent with the statement at paragraph 1.19.

3: MARKET DEFINITION.

21. In spite of paragraph 1.19, the 2013 Consultation devotes a chapter to the issue of market definition. This begins by stating:

> "In assessing whether a merger will lead to an SLC, the Authority will examine the competitive impact in the part of the economy most likely to be affected by the merger. Whether or not the Authority precisely defines one or more markets, it will identify the products or services and geographic area in which competition may be harmed. The Authority will also identify those competitors that are most likely to provide a timely competitive constraint on the merging parties." (Paragraph 2.1).

Interestingly it states that the Authority *will* identify the products or services and geographic area in which competition may be harmed.

22. The 2013 Consultation also states:

> "Where there is significant horizontal and/or vertical overlap between the merging parties and competition concerns are likely to arise post-merger, market definition is likely to be an important part of the Authority's analysis." (Paragraph 2.5).

23. The 2013 Consultation restates the Authority's emphasis on demand side substitution and its limited reliance on evidence of supply side substitution in defining markets, although it advances no justification for this approach.

24. Paragraph 2.15 states:

> "A product is a supply-side substitute for another in cases where the capacity for producing that product could profitably be switched to supply the other product quickly and without significant investment in response to a small price increase by the hypothetical monopolist. The precise period for determining whether suppliers would switch to supplying the relevant products will vary from market to market."

This description is rather vague and unhelpful. It states capacity must switch from one product to the other quickly but then sates that the precise period will vary from market to market. In our view if capacity switching cannot take place within a short period of time, this would tend to indicate that supply side substitution is not possible or likely in a particular market. The Authority should specify that for products to be regarded as supply side

substitutes, capacity switching must occur within a relatively short period of time, while stating that any switching that would take longer would be considered in the context of rivals' responses to the merger.

25. Paragraph 2.22 details factors which the Authority says it will consider when defining the relevant geographic market. These include evidence that customers have previously switched or considered switching to suppliers in another location in response to relative changes in relative prices, although it states that evidence that customers considered switching will be given less weight. It is not clear why evidence that customers considered switching should automatically be given less weight. The fact that customers considered switching may have been sufficient to reverse any increase in relative prices without any actual switching having occurred. At the other extreme customers could have considered switching and concluded that it was not practical to do so. Clearly these two alternatives have very different implications for geographic market definition. Consequently evidence that customers considered switching should not automatically be given less weight than evidence of actual switching. The relevant issue is whether the threat of switching was sufficient to reduce prices or whether customers concluded that switching to a supplier in another geographic area was not a practical option.

4: MARKET CONCENTRATION.

4.1: Introduction.

26. The main point to note under this heading is that the 2013 Consultation proposes some changes in the market concentration thresholds used by the Authority to identify those cases requiring more detailed analysis.

27. The current HHI thresholds applied by the Authority are set out in Table 4.1.

Table 4.1: Competition Authority Merger Zones

Zone	HHI	Change
A	Less than 1000 Between 1000 and 1800 Above 1800	Any Less than 100 Less than 50
B	Between 1000 and 1800 Above 1800	Greater than 100 Between 50 and 100
C	Above 1800	Greater than 100

Source: Competition Authority, Merger Guidelines.

28. The thresholds divide mergers into three different categories or zones. Mergers in Zone A are considered less likely to have adverse competitive effects. Mergers falling in Zone B may raise competition concerns. Zone C mergers occur in already highly concentrated markets and are more usually those that raise competition concerns. While the Guidelines do not provide for a "safe harbour", transactions falling within Zone A are relatively unlikely to result in a detailed investigation. While understandably the Authority does not wish to restrict its discretion arguably the greatest benefit of a concentration measure such as the HHI is in providing a useful tool to identify mergers that are highly unlikely to raise competition concerns. This can assist the Authority in taking decisions as to which mergers require detailed scrutiny and which do not. It can also assist notifying parties by

reducing the requirement for expert analysis of cases where there is little likelihood that a merger would not result in an SLC.

29. The 2013 Consultation provides that:

"The Authority will have regard to the following thresholds:

any market with a post-merger HHI greater than 1,000 may be regarded as concentrated and highly concentrated if greater than 2,000; and

except as noted below, in a concentrated market a delta of less than 250 is unlikely to cause concern and in a highly concentrated market a delta of less than 150 is unlikely to cause concern." (Paragraph 3.11).

30. The proposed changes involve some simplification of the thresholds with a modest increase in the upper threshold definition of highly concentrated markets from 1,800 to 2,000. Compecon believes that the proposed threshold revisions are reasonable.

31. The 2013 Consultation states:

"The purpose of the HHI thresholds is not to provide a rigid screen in order to determine whether or not a merger is likely to result in an SLC. Rather, the HHI is a screening device for deciding whether the Authority should intensify its analysis of the competitive impact of a merger. The lower the post-merger HHI and the smaller the increase in the HHI, the less likely it is that the Authority will deepen its assessment of the competitive effects of a merger." (Paragraph 3.12).

The explicit confirmation that the HHI thresholds are a screening device for identifying cases than may require closer scrutiny and that HHI values above the thresholds do not establish that a merger will result in an SLC is welcome.

32. Paragraph 3.13 states:

"It should be noted, however, that a merger that falls below the HHI thresholds may still raise competition concerns in certain circumstances such as, for example, where one or more of the following factors are present:

- If the products of the merging parties are considered by customers to be close substitutes.

- Where one of the merging parties is a maverick firm or has recently experienced a rapid increase in market share, has driven innovation or has been charging lower prices than its competitors in the market under review.
- If a merger involves a potential entrant or recent entrant with a small market share.
- Where there are regulatory barriers to entry.
- Where there are high customer switching costs.
- Where indications of past or ongoing coordination are present.
- Where one of the merging parties has a pre-merger market share of 50% or more."

33. While the paragraph refers to mergers falling below the HHI thresholds but makes no distinction between them. For example, there is a very significant difference between a merger where the post-merger HHI would be below 1,000 and one where it would be above 2,000 but the delta would be lower than 150. A HHI of less than 1,000 implies a market with at least ten undertakings and it is difficult to see how any competitive harm would result from such a merger. In other words, the Guidelines should make clear that where the post-merger HHI is below 1,000 no anti-competitive effects are likely to arise and the exceptions listed in paragraph 3.13 are not relevant, i.e a post-merger HHI of less than 1,000 should be considered highly unlikely to result in any SLC.

34. An indication that mergers below certain thresholds are unlikely to pose any threat to competition is likely to increase predictability and reduce the burden on the notifying parties. For example, they are unlikely to have to devote time and resources to compiling evidence on entry barriers, efficiency gains and other factors. Provided they have defined the market correctly and the post merger HHI is below the level at which a merger might raise competition concerns, then the notifying parties and their advisors need not incur the unnecessary expense of further analysis and argumentation.

35. While concentration per se does not necessarily mean that a merger will reduce competition, it is worth noting that the HHI can provide some additional useful information about the likely competitive impact of a merger. In *Stena/P&O*, for example, the merger effectively involved the sale by one party of a business to another, thus leaving the number of competitors unchanged, although the Authority noted that the level of market concentration would decline as a result. If the number of competitors remains unchanged but the HHI declines this means that market shares have become more symmetric, which might increase

the risk of coordinated effects. In other words it may sometimes be necessary to look beyond simple numerical changes in the value of the HHI and to consider the implications of such changes.

36. Paragraph 3.15 refers to concentration ratios. It is not clear how what relevance if any this paragraph has to the Authority's merger analysis.

5: HORIZONTAL MERGERS.

5.1: Introduction.

37. Section 4 of the 2013 Consultation discusses possible anti-competitive effects of horizontal mergers, i.e. mergers between competitors.

5.2: Competitive Harm Theories.

38. The 2013 Consultation restates that horizontal mergers result in two broad categories of anti-competitive effects:

- Unilateral effects; and
- Coordinated effects.

39. The Consultation notes that unilateral effects occur when a merger results in the merged entity having the ability, the incentive and the opportunity to raise prices at its own initiative and without coordinating with its competitors. It states:

> "4.9 The ability [to] of a merged entity to set prices is most obvious in the instance of a merger to monopoly. In that case the merged entity sets both market price and market output. The ability to set market price and/or market output is not, however, limited to a monopoly situation. Rather the ability to set prices and/or output can arise in markets with a small number of firms (also referred to as oligopolistic markets) and/or markets where products or services are imperfect substitutes. In these types of markets firms, to varying degrees, can exert market power and set, or at least materially influence, market prices.
>
> 4.10 The incentive to increase prices arises whenever the merged entity can increase profits by doing so. In a merger to monopoly the merged entity will have the strongest possible incentive to maximise profit by increasing prices and/or reducing output."

40. The existing Guidelines provide that one scenario in which a merger can result in unilateral effects is where it results "in monopoly, near-monopoly or single-firm dominance by the merged firm." (Paragraph 4.1.3) Clearly where a merger results in near-monopoly or the creation of a dominant position, the merged entity will have the ability and incentive to unilaterally raise prices. It is not clear why the 2013 Consultation refers only to monopoly

and makes no reference to near-monopoly and single firm dominance as obvious examples of when a merger could lead to a unilateral price increase. There appears to be no good reason for referring only to the creation of a monopoly in paragraphs 4.9 and 4.10.

41. Paragraph 4.13 states:

> "In addition, competitive constraints will be weakened to the extent that customers are not willing and/or able to switch from one competitor to another. This might occur for example in the case of strong consumer preferences (including brand loyalty) and/or non-trivial switching costs."

Pre-merger the merging parties were constrained from raising their prices. One cannot conclude that customers would be unwilling to switch in response to a post-merger price increase due to past brand loyalty. The extent to which such brand loyalty could be sustained in the face of a unilateral price increase will not have been previously tested.

42. Paragraph 4.15 regarding market shares and market structure seems out of place.

43. Paragraph 4.17 correctly states that unilateral effects can occur in the case of homogenous products if the remaining firms in the market are capacity constrained. The paragraph goes on to state:

> "The ability to raise prices would be reinforced if consumers were relatively price insensitive or if switching opportunities were limited."

This point requires some clarification. If products are homogenous then what does it mean to refer to consumers as price insensitive? They cannot be price insensitive between the products of different suppliers if the products are homogenous. If it is referring to overall market demand being relatively price inelastic, it is not clear how this alters the merged firms ability to raise the price of homogenous products unilaterally unless other firms are capacity constrained. Similarly it is not clear why switching opportunities might be limited in the case of homogenous products.

44. Paragraph 4.18 then states that in a homogeneous product market, all things being equal, a merger involving firms with large market shares which would result in a significant increase in market concentration would be more likely to give rise to competition concerns than one involving firms with small market shares. In the absence of other firms being capacity constrained the mechanism by which a merger of firms with large market shares increases the likelihood of unilateral effects in the case of homogenous products is unclear,

unless it involves the creation of a dominant position. The paragraph then repeats the points made in the previous paragraph that unilateral effects are more likely if:

a. Other firms are capacity constrained;
b. Consumers are price insensitive; and
c. Switching costs are relatively high.

It also states that unilateral effects are more likely if the merged firm has a strong incentive to raise prices because of the potential for a significant increase in profits. Firms have an obvious incentive to raise prices when doing so is profitable but it will only be profitable to do so if it does not result in a significant loss in sales and in the case of homogenous products that requires other firms to be capacity constrained. In other words it is not clear that the incentive point constitutes a separate channel through which unilateral effects may occur in homogenous product markets.

45. The issue of unilateral effects in differentiated product markets is discussed in paragraphs 4.19 to 4.23. Much of this analysis follows the standard literature approach to unilateral effects, which depends on the closeness of substitution between the merging products. It is worth noting that the approach outlined in the current Guidelines of using a 3% price threshold to test for the degree of substitutability within the market and which the Authority relied upon in arguing that own labels were not close substitutes of the merging brands in *Kerry/Breeo* has been dropped, a move that was flagged in the 2010 Consultation. Compecon pointed out at that time that there was no theoretical justification for such an approach. The removal of this provision is therefore welcome.

46. A notable omission in the discussion on closeness of competition is that such an analysis needs to take into account the scope for the remaining non-merging firms to reposition their products to make them closer substitutes for the merging brands. In other words one must not only consider the closeness of competition between brands pre-merger but the scope for non-merging brands to reposition their products post-merger which may prevent any unilateral price increase. This point is recognised in the existing Guidelines at paragraph 4.7 which states:

> "Also relevant is the ability of other firms to reposition existing products or brands or otherwise develop substitutes of sufficient homogeneity, substitutability quality and status to overcome consumer-stasis."

This approach is consistent with the relevant economic literature. The Authority has not always followed this approach in past decisions, focusing solely on closeness of substitution pre-merger. In our view the correct analysis of unilateral effects must take account of possible brand repositioning by rivals of the merging firms.

47. Paragraph 4.23 states:

> "For example, where product A and B are close substitutes and are included in a merger, then the merged entity could have the ability and incentive to unilaterally increase prices to the detriment of consumers. This unilateral price effect will be stronger to the extent that consumers are relatively price insensitive (as might occur in the case of high switching costs and/or brand loyalty)."

The first sentence describes the situation where sales lost by one of the merging brands as a result of a post-merger price increase accrue to the other merging brand thus making a price increase that was previously unprofitable profitable post-merger. The reference to consumer price insensitivity is again confusing. Some explanation is required of how this enhances the ability of the merged firm to raise prices unilaterally.

48. Paragraphs 4.24-4.26 address the issue of a merger involving a potential competitor. 4.24 states that a reduction in competition would occur where either:

a. one or more of the merging parties would have entered the market in the absence of the merger, or
b. one or more of the merging parties posed a credible threat of entering the market at some un-specified time.

The latter point requires some clarification, particularly with respect to what is meant by entry at some unspecified time. If this is referring to some unspecified future time, it seems rather vague. Arguably if such an undertaking is to be considered a potential entrant and the merger therefore regarded as anti-competitive, the threat of entry should be relatively immediate. It is hard to see how it would have exercised any competitive constraint on the market otherwise. This is consistent with the view that entry must be timely to be regarded as effective in constraining any post-merger SLC.

49. The issue of monopsony is addressed in paragraphs 4.27-4.29. Paragraph 4.29 states:

> "It is possible also that a merged entity may increase both (i) its buyer power in relation to its suppliers and (ii) its market power in relation to its customers. In such situations

> the merged entity may have the ability and incentive to retain benefits from its monopsony power and not pass benefits though to its customers, in which case the Authority's merger review would include analysis of both monopsony and monopoly effects."

Monopsony is the opposite of monopoly. Just as a monopolist must reduce output in order to raise price, a monopsonist must reduce its purchases to drive prices down. If the monopsonist is reselling into a competitive downstream market, then reducing its purchases means it will lose sales and market share to rivals in the downstream market. If the downstream market is not competitive, however, then the exercise of monopsony power might be harmful. Consequently, it may be necessary to closely examine a merger that gives rise to a monopsony even if it does not increase the firms' downstream market power, if downstream competition is already weak.

50. Bidding markets are discussed in paragraph 4.30 which states:

> "In some markets, particularly bidding markets, the number of possible suppliers can influence the intensity of competition. For example, in tendering processes the greater the number of competitors able to supply the product or services, the more likely it is that there will be intense competition. A large number of suppliers will be particularly relevant to the intensity of competition if customers seek to have more than one supplier, e.g., a primary supplier and a secondary supplier, as might be the case if continuity of supply is important."

It is not at all clear what implications, if any, this has for merger control. The reference to the larger the number of competitors in tendering processes the more likely there will be intense competition might arguably suggest that mergers in bidding markets are generally undesirable. The paragraph certainly provides little guidance as to how the Authority will regard mergers in bidding markets for firms in such markets and their advisers.

51. Paragraph 4.32 discusses the issue of mergers involving maverick firms. It states:

> "So-called "maverick" behaviour involves competing more vigorously (e.g., in terms of price, quality, innovation etc.) relative to other firms."

The discussion of maverick behaviour again is not very helpful. The Authority rejected claims in *Heineken/Beamish & Crawford* that the target acted as a maverick firm. The evidence in that case indicated regular parallel price increases by the only two other suppliers in the market from which the target regularly deviated but the Authority decided that it was

not a maverick firm. Consequently some clarification is needed of the conditions required to be fulfilled for a firm to be considered a maverick.

52. The 2010 Consultation proposed that the existing Guidelines could be amended to include a more complete discussion of the significance of maverick firms for merger review including that the loss of a maverick firm is most relevant in the context of potential coordinated effects. The 2013 Consultation does not include a more detailed discussion.

53. The balance of Chapter 4 in the 2013 Consultation is devoted to the issue of coordinated effects. Much of this discussion is consistent with the relevant economic literature and the case law and so there is no need for comment.

5.3: Conclusions.

54. Chapter 4 of the 2012 Consultation is somewhat disjointed and confusing. For example, it begins with a discussion of unilateral effects but then goes on to discuss specialised cases such as potential entry, bidding markets, monopsony and maverick firms before addressing the issue of coordinated effects. A more logical sequence might be to address the two broad categories of anti-competitive effects, i.e. unilateral and coordinated effects first and then address some of the more specialised examples. Similarly it is not clear why paragraph 4.15 on market shares and concentration is included where it is.

55. It might also be helpful to identify certain broad messages more clearly. For example, as a general rule, cases of non-dominant unilateral effects are more likely to arise in the case of differentiated products than in the case of homogenous products and are more likely in consumer goods markets which are generally regarded as differentiated. In the absence of dominance coordinated effects are more likely in the case of homogenous products, unless the non-merging firms are capacity constrained in which case unilateral effects may arise in homogenous product markets. It is recognised that while such observations apply generally there may be exceptions to them. For example, it is accepted that coordinated effects can sometimes occur in differentiated product markets. Nevertheless, the inclusion of such general rules in the Guidelines could provide greater clarity and guidance for users.

56. The Authority may understandably be reluctant to restrict its freedom of action in terms of exploring possible competitive harm theories. Nevertheless, it could be helpful to both sides if an appropriate theory of competitive harm could be identified at an early stage in the process, possibly even at pre-notification stage. In one recent case, the Authority indicated at a relatively late stage that it had not ruled out possible coordinated effects even though this issue had not been raised previously.

6: BARRIERS TO ENTRY AND EXPANSION.

6.1: Introduction.

57. The current Merger Guidelines' recognise that a merger is unlikely to substantially lessen competition in a sustained manner if entry into the market is sufficiently easy as to prevent a post-merger price increase. This is consistent with the economic literature and international best practice. The Guidelines provide that entry must be sufficient, likely and timely.

6.2: Defining Entry Barriers.

58. There has been considerable debate in the economic literature on the question of what constitutes a barrier to entry and how entry should be assessed in merger cases. In the past entry barriers were considered to be pervasive in most industries. This is no longer the case although there are divergent views on how entry barriers should be defined.

59. One view of entry barriers focuses on factors that enable firms to enjoy supernormal profits in the long-run without attracting new entrants – long-run barriers to entry. This view is associated with the "Chicago" school which favours Stigler's definition of entry barriers as a cost which must be borne by firms seeking to enter an industry that is not or was not borne by incumbents.[1] It is now recognised by many economists, however, that incumbents can act strategically to discourage entry. This view of entry barriers therefore distinguishes between exogenous and endogenous entry barriers. The former are effectively determined independently of the firms in the industry. Endogenous, or artificial, entry barriers, are the result of strategic behaviour by incumbents that is designed to impede entry by exploiting some asymmetry between the incumbent and the new entrant, in order to raise the potential entrant's costs. Such barriers may enable firms to maintain prices above their competitive level for a time, i.e. they may constitute barriers to entry in the short-run but not in the long-run.

60. The Competition Authority's current Merger Guidelines state that entry must be:

[1] G. Stigler, *The Organization of Industry,* Richard D. Irwin, Homewood Il., 1968.

- Timely;
- Likely; and
- Sufficient.

Essentially these three requirements combine the divergent economic theories on entry barriers. The likelihood requirement reflects concerns with long-run barriers to entry while the timeliness condition addresses the issue of strategic behaviour designed to impede or delay entry.[2]

61. Paragraph 5.3 of the 2013 consultation states:

> "A barrier to entry is any factor that prevents or hinders effective new entry that might otherwise be capable of preventing an SLC arising from the merger. Barriers to entry are thus specific features of the market that give incumbents advantages over potential competitors. If the merger increases barriers to entry, the impact on competition is likely to be more severe since new entry that may have been possible pre-merger is likely to be prevented or impeded post-merger. (Paragraph 5.3)

Although not explicitly stated the above sentiments appear consistent with the Authority's existing approach as they implicitly seem to accept the existence of short-run strategic entry barriers.

6.3: Timeliness.

63. The current Guidelines specify that entry must be likely to occur within a two year time frame. This can be seen as addressing the problem of short-run strategic entry barriers. The 2013 Consultation, however, proposes a very significant change in the Authority's approach to entry and entry barriers. This can be in paragraph 5.3 of the Consultation which is worth quoting in full.

> "In order to prevent a merger from harming competition, entry must have a significant impact in a timely period. In general, the longer it takes for potential entrants to become effective competitors, the less likely it is that market participants will be deterred from causing harm to competition. The appropriate timeframe for effective new entry will depend on the characteristics and dynamics of the market under consideration, as well as on the specific capabilities of potential entrants."

[2] On this point, see, for example, M.B. Coate, Theory Meets Practice, Barriers to Entry in Merger Analysis, 4(1), *Review of Law & Economics*, 2008.

62. The opening sentence accepts that entry must be timely if it is to offset the risk of competitive harm. The second sentence correctly points out that the longer it takes for effective entry to occur the more likely it is that consumers will suffer harm as a result of the merger. The third sentence, however, introduces a complete *non sequiter* stating the appropriate time frame for new entry will depend on the characteristics and dynamics of the market under consideration. It is true that entry will take longer in some industries and markets than in others and as the second sentence in the above quote recognises the longer it takes to enter the more likely consumers will be harmed as a result of an anti-competitive merger. The fact that entry takes longer in some markets than others is not an argument for extending the definition of what constitutes timely entry. In fact it is for precisely this reason that the time-frame required for timely entry should be relatively short. Consequently the current two year timeframe used to define timely entry should be maintained. If it takes longer than this to enter some markets then that indicates that they exhibit short-term barriers to entry which is what the timeliness requirement is designed to address.

63. There is a second and more practical reason for maintaining a two year limit for entry. The longer the time horizon used for assessing entry the more difficult it becomes to predict with any degree of certainty that entry is likely to occur. In *Heineken/Beamish & Crawford* the Authority concluded that harmful effects would be offset by a proposed capacity expansion by the non-merging firm even though this was not predicted to come on stream for five years. In the event this development did not proceed.

6.4: Likelihood.

64. No comments on this point.

6.5: Sufficiency.

65. Paragraph 5.9 of the Consultation states:

> "Sufficiency does not require that one new entrant alone duplicates the size and scale of the merged entity. Timely and likely entry by multiple firms operating at a smaller scale may be sufficient if the combined effect of their entry would prevent harm to consumers."

The statement that the sufficiency requirement may be satisfied by multiple entry and does not need to be satisfied by a single entrant is welcome. This view is entirely consistent with the economic literature and with international best practice. Compecon notes that it represents a significant change in the approach adopted by the Authority in the *Kerry/Breeo* Determination which argued that, while multiple entry was likely, the entrants individually did not satisfy the sufficiency requirement.

6.6: Barriers to Entry.

66. The 2013 Consultation discussion of entry barriers follows the section on entry. It might flow more logically if entry barriers were addressed first. This section identifies three categorises of entry barriers legal/regulatory; structural; and strategic. At least some of the barriers included in the latter two categories could be regarded as short-run entry barriers. Logically therefore the two year requirement for timely entry should be retained.

6.7: Evidence for Assessing Entry.

67. Paragraph 5.18(a) states:

> "An absence of successful and effective entry in the past suggests that entry may be difficult; conversely, successful entry is evidence that entry may be easy, although entry may be more difficult post-merger than it was before."

The absence of entry may suggest that entry is difficult or it may reflect the fact that entry was unattractive in the past but that might change as the result of a merger.

68. Paragraph 5.13(b) refers to evidence of planned entry by firms in adjacent or complementary markets or by other firms outside the market. It states that it is not necessary for the merging parties to identify the names of potential entrants in order to demonstrate that entry is likely but that such evidence would be useful if available. This is a relatively minor point but it is difficult to envisage a situation in which one might have evidence of planned entry by a firm but not know its identify.

69. Evidence of entry of itself is not conclusive proof of the absence of entry barriers. Entry needs to be sustained over time and must not be confined to niche markets. This was an important issue in the Commission decision in the first *Ryanair/Aer Lingus* merger case.

6.8: Barriers to Expansion.

70. As in the case of entry a two year limit should apply with regard to the timeliness text for the same reasons as outlined previously.

7: EFFICIENCIES.

7.1: The Basic Test.

71. The section on efficiencies in the 2013 Consultation is highly problematic and lacks clarity. To begin with the Consultation does not clearly specific the appropriate test or standard that the Authority is proposing will be applied to the evaluation of efficiencies. This also relates back to an earlier point because the evaluation of efficiencies depends on what is the appropriate standard against which mergers are assessed. In particular the analysis of efficiencies depends upon whether the SLC test is based on consumer welfare or total welfare. As already pointed out, until now the Authority has applied a consumer welfare test but the 2013 Consultation does not specify whether or not the Authority is proposing to retain this test or adopt a different test.

72. If a consumer welfare standard applies then the efficiencies test is whether a merger will produce sufficient cost savings to prevent a post-merger price increase, i.e. any increase in price due to a diminution of competition will be exactly offset by a reduction in price due to a decline in costs. This is precisely the position as outlined in the existing Guidelines state:

> "If a merger gives rise to anti-competitive effects, it is possible that these could be compensated for by improvements in efficiencies resulting directly from the merger. An increase in the price-cost margin resulting from a merger may be compensated by a reduction in cost that leaves the eventual market price unchanged or lower (or output no lower in the case where output is used). In essence it uses a 'net-price test' by considering whether the price paid by consumers will rise or fall as a result of the merger." (Guidelines, Paragraph 5.9)

73. The 2013 Consultation contains rather different language.

> "A merger may generate various efficiencies for the merged entity. The Authority's analysis of efficiencies goes beyond the impact of efficiencies on the merged entity and focuses on whether verifiable efficiencies mitigate adverse competitive effects and the risk of an SLC." (Paragraph 6.1).

The above statement is rather vague. This is a concern in light of the analysis of efficiencies in *Kerry/Breeo* where the Authority's assessment suggested that the balance between social

costs and benefits had to be considered. Nowhere in the section on efficiencies is there any clear indication of the test to be applied.

74. Paragraphs 6.3 to 6.6 of the 2013 Consultation describe different kinds of efficiencies, i.e. demand-side; supply-side; dynamic etc. Paragraph 6.3 includes the statement that:

> "Reductions in fixed costs are less likely to be passed through to consumers, so less weight is given to them by the Authority."

In *Kerry/Breeo*, the only case to date where there was an extensive analysis of efficiencies, reductions in fixed costs were totally discounted. Assigning less weight to certain types of efficiencies is not the same as discounting such efficiencies entirely and consequently some clarification is required regarding the Authority's approach to fixed cost savings.

75. It is also important to define fixed and variable costs correctly. For example, in its Determination in *Kerry/Breeo* the Authority stated:

> "The €1.1 million saving from transferring production in-house appears to compare the average incremental costs of in-house production with the price currently paid to outside suppliers. To the extent that the price paid to the outside suppliers includes a contribution to their overheads this means that the saving would be overstated. This reflects the emphasis in the Authority's Merger Guidelines (paragraph 5.13) on variable as opposed to fixed cost savings."

This argument is simply incorrect. If a firm outsources production, the price it pays to its outside suppliers is a variable cost. Whether or not it includes a contribution to their overheads is irrelevant. Thus the Authority needs to clarify its understanding of which costs are fixed and which are variable.

76. More importantly the economic literature indicates that fixed cost savings may nevertheless be passed on in the long-run and consequently they should not be totally discounted. Agencies in other jurisdictions, notably the US, take fixed cost savings into account and so failing to take account of fixed cost savings is not consistent with international best practice.

77. In the case of dynamic efficiencies, paragraph 6.6 states:

> "Dynamic efficiencies generally have non-price impacts rather than necessarily reducing prices to consumers. Dynamic efficiencies may be less certain to occur and

may also take more time to occur than other efficiencies. Hence dynamic efficiency claims, by themselves, are not likely to outweigh a finding of an SLC."

Two points arise in respect of the above. First it states that dynamic efficiencies generally have non-price impacts and do not necessarily reduce prices to consumers. This implies a consumer welfare standard but that only begs the question of why there is no explicit statement that an SLC is based on a consumer welfare test as is the case in the current Guidelines. The second point is that the paragraph states that dynamic efficiencies are unlikely to outweigh a finding of an SLC because they are less certain to occur and may take more time to occur than other efficiencies. This approach to the treatment of dynamic efficiencies is inconsistent with the treatment of timeliness of entry.

7.2: Merger Specific.

78. The existing Guidelines and the 2013 Consultation include a requirement that efficiencies must be merger specific. In principle this raises no difficulty. The 2013 Consultation states that the Authority's analysis of efficiencies distinguishes between efficiencies that are:

- " merger-specific - those that would occur only as a result of the merger and would not be attained by *feasible alternative scenarios* that raised less serious competition concerns, and
- not merger-specific - those that could occur anyway in the absence of the merger." (Paragraph 6.8 emphasis added).

79. A key issue here is that to be considered merger specific efficiencies cannot be achieved through feasible alternative scenarios. The economic literature indicates that alternative ways for merging parties to achieve projected efficiencies must be reasonably practical options for the parties and not just theoretical. There may be very good pro-competitive reasons why firms choose to expand through acquisition rather than by increasing capacity.[3] While claims that efficiencies are merger-specific should be viewed sceptically, competition agencies must make realistic assumptions about what alternative

[3] Calvin Goldman et al., 'International Competition Network', Merger Guidelines Project, 2004, Ch. 6, p. 5, <www.internationalcompetitionnetwork.org/library.aspx?search¼&group¼4&type¼0&workshop¼0&page¼4> 6 Jan. 2010.

means of achieving efficiencies exist.[4] In the US, efficiencies are considered non-merger-specific only if the alternatives are 'practical in the business situation faced by the merging parties'. The Authority needs to recognise that it cannot advance purely theoretical alternative means of achieving efficiencies, the onus is on it to show that such alternatives are realistic options.

80. Again in defining efficiencies as non-merger specific, in our view, the test should be whether such efficiencies are likely to occur in the absence of the merger, not as suggested in paragraph 6.8 of the Consultation, whether they could occur. The issue of timing is also relevant here. Some efficiencies may occur in the absence of the merger but the merger may lead to their being realised sooner than they would have been in the absence of the merger. Since it is a requirement that efficiencies must be sufficient to offset any possible price increase, it is difficult to understand why efficiencies which would be achieved sooner as a result of a merger should not be included, even though they would ultimately be realised without it. By definition consumers will not suffer harm in such circumstances.

81. Paragraph 6.13 states:

> "Consumers are more likely to benefit from efficiencies when the merged entity faces effective actual and potential competition and consumers face low switching costs. Accordingly, the Authority's analysis of efficiencies takes place in conjunction with its analysis of competitive effects."

A reduction in marginal cost will increase the profit maximising level of output, other things equal, which will lead to a fall in price so the relevance of the suggestion that efficiencies are more likely to be passed on if the market is competitive is questionable. The economic literature recognises that a monopolist will pass on at least 50% of any cost reduction. Indeed paragraph 5.13 of the current Guidelines acknowledge that reductions in marginal cost are more likely to be passed on even in the case of a monopolist.

82. Paragraph 6.13 implies a significant shift in the Authority's treatment of efficiencies. As pointed out, previously the issue is whether the effect of a potential diminution in competition might be offset by efficiencies. The statement that consumers are more likely to benefit from efficiencies when the merged entity faces effective actual and potential

[4] James Farrell & Carl Shapiro, 'Scale Economies and Synergies in Horizontal Merger Analysis', Antitrust Law Journal 67, no. 3 (2001): 685–710.

competition and that the Authority's efficiency analysis is combined with its analysis of competitive effects essentially amounts to a very significant dilution of any efficiency defence. This requires further clarification as to what exactly is being proposed.

8: COUNTERVAILING BUYER POWER.

8.1: Introduction.

83. Countervailing buyer power arises where buyers, either because of their size or commercial significance to their suppliers, have the ability to prevent suppliers raising their prices. The key issue is not the relative size of the buyers and the merged entity but whether such buyers could effectively refuse to buy or defer purchases in the event of an attempted price increase. This means that they must be able to do without the product concerned, at least for a period of time. In effect this requires that there be other suppliers they can buy from or, at the very least, they must be able to delay making purchases in order to put pressure on the merged entity not to raise prices.

84. It is important to recognise that in some instances a buyer may be able to exercise countervailing buyer power provided it can delay or defer purchases for a period of time. The 2013 Consultation fails to recognise this. It is also important to recognise that a buyer does not need to be able to permanently obtain supplies from an alternative source in order to exercise countervailing buyer power as the Authority argued in *Kerry/Breeo.*

85. Paragraph 7.7 of the 2013 Consultation states that if the customer resells the products it purchases, its ability to exercise buyer power may be limited by the willingness of its customers to buy the products of alternative suppliers. "Even if a reseller is able to buy from alternative suppliers or engage in self-supply in response to an exercise of market power by its supplier, this may not be credible if the products of alternative suppliers are not considered by the reseller's customers as a suitable replacement. In product categories where end consumers display a high degree of loyalty to leading brands, the extent to which even the largest resellers can exercise buyer power over a supplier(s) may be limited. Thus, brand loyalty is an important factor when considering the role of buyer power in retail markets."

86. There are problems with the Authority's argument. Brand loyalty is more likely to be an issue in the case of consumer goods. Multiple retailers enjoy some scope to replace brands with alternatives at least in the short-term. Second as noted earlier, brand loyalty may be

weakened by post-merger price increases and past evidence of such loyalty may not provide an accurate indicator of likely consumer responses to such increases.

87. Paragraph 7.8 states that where customers are also competitors of the merging parties, the incentives of both parties may become aligned leading to harm to competition. "A customer with buyer power who is also a competitor may not have the same incentive to resist an exercise of market power (e.g., a price rise) by the merged entity since such a price rise may enable the customer to increase sales of its own private-label products." In a footnote the Consultation states:

> "For example, if the merged entity raises the price of its products, there may be an incentive for a customer to also raise the price of its private-label products but by less than the price increase of the merged entity. This may lead to a customer increasing sales of its private-label products at the expense of the merged entity's products."

It then goes on to state that a merger may lead to an SLC even when a customer(s) possess sufficient buyer power to resist an exercise of market power.

88. There are several problems with the analysis outlined in the previous paragraph. The supplier and reseller are engaged in different markets. The reseller operates in a downstream market. In that market the supplier's product competes with the resellers own-label brand but the reseller also competes with other resellers who may also have own brands. The assumption underlying the Authority argument is that the reseller has the power to raise prices of both products in the downstream market, i.e. the price of its own label brand is not constrained by other own brands. If that is the case then it begs the question why it would not raise prices of the two products anyway. If the own brand faces competitive constraints then the scenario outlined by the Authority would not arise. The Authority's analysis fails to recognise that own brand is not a single entity but involves several competing own brands. In the case of the grocery sector, it is also relevant that some resellers only sell their own brands which again militates against the sort of behaviour suggested by the Authority.

89. Paragraph 7.11 states:

> "The Authority will give much greater weight to evidence that pre-dates the announcement of the merger under review in comparison to post-merger announcement evidence, because the behaviour of the merging parties vis-à-vis each other and third

> parties (i.e., customers, competitors and suppliers) is likely to be heavily influenced by the announcement of the merger."

It is strange to find such a statement under the heading of countervailing buyer power. One would have thought that it would have more general application. It is also worth noting the rationale advanced by the Authority, namely that the behaviour of the merging parties vis a vis each other and third parties is likely to be heavily influenced by the announcement of the merger. In other words, this provides a justification for discounting statements and other actions by the merging parties following the announcement of the merger for the obvious reason that they have a vested interest in portraying the merger in a favourable light. Such arguments do not apply to third parties. In particular, evidence that customers do not expect the merger to alter their ability to exercise countervailing buyer power should not be discounted because it post-dates the announcement of the merger.

9: MISCELLANEOUS ISSUES.

9.1: Non-Horizontal Mergers.

90. The current Guidelines include a discussion of portfolio effects, although they suggest that such effects are likely to arise very rarely. The 2013 Consultation does not address the issue of portfolio effects in the context of non-horizontal mergers. Interestingly, however, paragraph 2.4 which is concerned with market definition states that expanding the relevant market may lead to a finding of competitive harm in the wider market and cites as an example the case of a conglomerate merger with portfolio effects. It is curious therefore that there is no subsequent discussion and indication of the Authority's likely approach to portfolio effects.