SUBMISSION IN RESPONSE TO THE COMPETITION AUTHORITY CONSULTATION ON ITS DRAFT MERGER GUIDELINES

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EU, COMPETITION AND REGULATORY GROUP
MATHESON
70 Sir John Rogerson's Quay
Dublin 2

TEL + 353 1 232 2000
FAX + 353 1 232 3333

This submission on behalf of Matheson is in response to the Competition Authority ("**Authority**") consultation on its revised Draft Merger Guidelines (the "**Draft Merger Guidelines**") dated 13 September 2013.

Matheson is Ireland's largest law firm, with over 600 people. Our principal office is in Dublin and we also have offices in London, New York and Palo Alto, California. Matheson's EU, Competition and Regulatory Group comprises specialist lawyers with many years of experience in advising on all aspects of EU and Irish competition law and regulatory matters, including merger control, cartel and dominance cases, public procurement law, State aid rules, competition law audits and compliance, competition litigation and sectoral regulation.

We welcome the opportunity to comment on the issues raised in the consultation. We agree that it is important that the Authority take proper account of its own experience obtained in its examination of almost 600 merger notifications to date under the Competition Acts 2002 - 2012 (the "**Act**") as well as the views of leading practitioners and international best practice. We hope that, following this consultation exercise, the Authority will also consider a review of its other merger-related documents and guidance, including its *Notice in respect of certain terms used in Part 3 of the Act* (N/02/003), its *Revised procedures for the review of mergers and acquisitions* (February 2006) and the *Merger Notification Form*.

Our comments are made in light of our experience in advising on a significant number of mergers under the merger control provisions of the Act as well as other merger control regimes.

Our comments are set out below, for ease of reference in the order of the consultation paper.

1 Elements of Merger Review

Introduction

As a general comment, the Authority has made very few references to its previous determinations to support the principles set out in the Draft Merger Guidelines. It is respectfully submitted that many of the points made in the Draft Merger Guidelines could be helpfully illustrated with reference to previous cases. Assuming that one of the objectives of the Draft Merger Guidelines is to assist legal advisors in providing certain and practical advice to their clients, we believe it is also important that the final guidelines distinguish between those principles that summarise the Authority's existing practice and those principles that mark a departure from the Authority's existing practice.

We note that the focus of the Draft Merger Guidelines is to provide guidance on how the Authority decides whether or not a merger substantially lessens competition under the Act (ie, the test for prohibition of a merger). We would also welcome guidance from the Authority on the internal / working test it applies for referring a merger to a Phase II investigation, in particular given the apparently broad discretion afforded to the Authority under the Act in this regard.

Substantial Lessening of Competition ("**SLC**")

Paragraph 1.11 states that, in analysing whether a notified merger gives rise to a SLC the Authority will consider competitive effects that may arise where one or more of the merging parties have non-controlling minority shareholdings in relevant third parties. It would be helpful if the Authority could provide guidance on the particular circumstances in which it would consider such effects. For example, would this consideration be undertaken only where there is an ability to influence strategic behaviour in some way and / or to receive information about a third party that would not otherwise be available?

The Counterfactual

Paragraph 1.14 considers whether the pre-merger situation is necessarily the appropriate counterfactual. We do not agree with the statement in paragraph 1.14 that non-merger specific competitive effects are "unusual" and believe that such a depiction could result in too onerous a burden being placed on the merging parties in relevant cases. By way of example, even if a firm is not a "failing firm" within the meaning of the Draft Merger Guidelines, a merging party could decide to reduce investments and / or raise prices absent the merger (eg, where it believes that the level of profits currently earned do not justify continuing its investment at the same level as pre-merger) or to exit the Irish market and explore other more profitable opportunities. Another possibility is that a new generation of innovation could lead to huge market changes.

Similarly, the suggestion in paragraph 1.15 that the counterfactual should be substantiated with "concrete evidence" could set the bar too high. We are not clear on whether "concrete evidence" is different from "evidence" as used in paragraph 1.20. It is respectfully suggested that the views of the merging party, where credible and genuinely held (including based on internal documents), should be sufficient to merit Authority consideration in most cases.

Actual and Potential Competition

In relation to potential entry, the text in paragraphs 1.16 and 1.17 appears to us to be ambiguous. We respectfully suggest that the Authority provide clearer guidance, in particular, on the circumstances in which it believes that merger with a potential entrant discourages entry. The example provided is unclear.

Market Definition

We welcome and wholly agree with the acknowledgement in this section that, in the majority of cases, a merger control authority should not be overly focussed on market definition, where there are no competition issues irrespective of the market definition chosen.

2 Market Definition

Market Definition

We strongly support the comment in paragraph 2.2 that, in some markets, market shares may not be a good measure of market power. This is especially so in certain types of market, such as differentiated markets and bid markets, where the intensity and / or frequency of competition between certain players may tell a different and more accurate story.

In paragraph 2.4, the Authority states that there are situations where there is no need to choose as between alternative market definitions since it will be sufficient for the Authority to show that the merger will result in a SLC regardless of choice. We understand, however, that in such a case, the Authority must proceed to demonstrate its concerns as regards each potential market identified. The Authority might make this clearer.

Paragraph 2.6 notes that, as regards the question of market definition, decisions in previous merger investigations by the Authority *"may provide only limited guidance"*. We understand that the Authority should not feel under pressure to follow an earlier decision on market definition where it feels that the situation has changed in the interim. However, we believe that the Authority should seek to maximise the guidance value that its merger decisions can deliver - otherwise, what is the point of publishing merger determinations clearing a transaction? If merger determinations offer no real guidance, would it not be better to simply issue a clearance press release only, thereby reducing the burden on the Authority and the related expense for merging parties of merger determination review for confidentiality etc. We suggest that the Authority could also refer to the fact that the merger decisions of other regulators may be of guidance / persuasive value (albeit that this might be limited).

Demand-side Substitution

In paragraph 2.12, the Authority suggests that in *"cases where prevailing prices are not considered to be competitive …"* it may conduct the SSNIP test using lower than prevailing prices as a benchmark. Can the Authority clarify what markets it has in mind and, in particular, what criteria it would use in coming to the view that prevailing prices are not competitive? Can the Authority provide guidance on how it would seek to compute a benchmark in such circumstances?

Geographic Market Definition

Regarding paragraph 2.22(d), we do not agree that less consideration should be given to data showing that customers considered switching (but did not switch), over evidence that actually did switch. We believe that equal weight can be given to both categories such as in the following fairly typical example: Customer A buys a product from Supplier X in Ireland and is approached by Supplier Y in Northern Ireland which can provide a similar product at a lower price. When Customer A tells Supplier X that it intends to terminate its order in favour of Supplier Y, Supplier X agrees to reduce its price to the same level, which results in Customer

A staying. In our view, since Customer A would have switched absent the behaviour of Supplier X, equal weight should be given to this evidence.

Regarding paragraph 2.23, we agree that a 'buy local' campaign could potentially have an impact on willingness to switch in some markets. However, we would expect these markets to be limited.

3 Market Concentration

Market Concentration

As a minor / clarification comment, we suggest that the final sentence in paragraph 3.1 be amended to read "*… an unconcentrated market is one with a large number of firms, each with a small market share".* We would also suggest that the reference in paragraph 3.2 to concentration being an indicator of the "*likely* competitive impact" of a merger is too general and would suggest that "likely" be replaced with "potential" (we note that this is clarified in paragraph 3.3).

Market Shares

We would welcome specific examples of the type of markets in which the Authority might consider it appropriate to measure market shares by maximum capacity (paragraph 3.7).

The Herfindahl-Hirshman Index ("**HHI**")

We welcome the alignment of the Authority's guidance on HHIs with that of the European Commission and also the Authority's confirmation that use of HHIs remains "*only a screening device*". We submit that it would also be helpful for the Authority to confirm (as the European Commission does it its *Guidelines on the assessment of horizontal mergers* (2004/C 30/03), the "**Commission Horizontal Guidelines**" at paragraph 19) that horizontal competition concerns are unlikely to arise with a post-merger HHI below 1000.

Concentration Ratios

In paragraph 3.15, the Authority explains the concept of concentration ratios, without further comment. It would be helpful if the Authority could indicate its views on whether it finds these measures to be a useful / relevant indicator.

4 Horizontal Mergers

Horizontal Mergers

We respectfully suggest that the introduction to paragraph 4.2 (which begins: "*Not all mergers are harmful to consumers*" and goes on to note that "*some horizontal mergers*" are pro-competitive / benign) may be misleading, in particular to non-specialist readers. Given that the vast majority of mergers notified to the Authority are cleared, without remedies, at the end of

Phase I, we would suggest that the Authority could include a general statement to the effect that most mergers do not raise serious competition issues.

The Commission Horizontal Guidelines provide some helpful guidance on indicative market share assessment at paragraph 18, as follows: *"Concentrations which, by reason of the limited market share of the undertakings concerned, are not liable to impede effective competition may be presumed to be compatible with the common market. Without prejudice to Articles [101 and 102] of the Treaty, an indication to this effect exists, in particular, where the market share of the undertakings concerned does not exceed 25% either in the common market or in a substantial part of it".* The Authority might consider including a similar indicative threshold.

As a general comment, some of the references in this section of the Draft Merger Guidelines to coordinated effects make this concept difficult to distinguish from conduct which would breach section 4 of the Act (ie, deliberate communication or concerted practices between competitors). For example, in paragraph 4.6(b), we suggest that the reference to coordinated "interaction" is ambiguous and might better be replaced with "coordinated behaviour". We return to this comment below.

In relation to paragraph 4.11, we are confused by the reference to the merged entity having the "opportunity" to raise prices (ie, in addition to the ability / incentive). The reference to opportunity, in our view, suggests that this is somehow afforded or accommodated by competitor or consumer behaviour. In the case of competitors, this suggests coordinated effects, which is confusing in a unilateral effects analysis. We assume that part of the rationale is as set out in the example given in paragraph 4.17 - ie, market circumstances, such as a difficulty in investing quickly in new / additional capacity. In our view, this is a feature of the market structure / environment, rather than an opportunity afforded by the behaviour of a competitor. Given that the reference to an "ability" to raise price already encompasses both competitor and consumer reactions, we respectfully submit that the terms ability and incentive adequately cover the point.

Unilateral Effects

Paragraph 4.12 makes reference to situations in which the remaining non-merging firms in the market do not have an "*incentive to compete*" which the Authority refers to as "*price accommodation*". It is not clear to us whether such "price accommodation" is the same as or different to a coordinated effects theory. We would welcome clarification from the Authority as to whether "price accommodation" is a separate theory of harm. If not, we suggest that, for clarity and ease of reference, comments on coordinated effects should be kept with the separate discussion later in this section.

Homogenous Project Markets

We believe that further clarification should be made of the reference to customer price insensitivity in paragraph 4.17. It is unclear to us why customers would be price insensitive in a homogenous product market (as the Authority notes in paragraph 4.16, in homogenous markets, there is little reason for consumers to show a preference for one product over another, other than on grounds of price). As such, we suggest that this reference should be deleted. In relation to 4.18(iv), we would suggest that an incentive to increase price should not (alone) increase the sustainability of a price increase, in the absence of other barriers such as high switching costs.

Differentiated Product Markets

In relation to differentiated product markets, while we strongly support the emphasis placed on closeness of competition, we believe that paragraph 4.20 may give the misleading impression that other (less closely competing) firms do not impose *any* competitive constraint. We would suggest that “rather than” on the fourth line should be replaced with “as well as”.

Merger with a Potential Competitor

The question of a merger with a potential competitor is addressed at paragraph 4.24. It is submitted that, in order to be competitively relevant, entry by the potential competitor should be timely (as is required by the Authority in order for the merging parties to raise a defence of new entry) and not simply a possibility “*at some un-specified time*” in the future. The same comment applies to paragraph 4.25(b). As a minor amendment to paragraph 4.25, we would suggest that the reference to “would” in the first line be changed to “may”.

Monopsony

Given that competition issues arising from monopsony effects are likely to be relatively unusual, we would welcome the addition of some illustrative examples in this section.

Number of Competitors – Bidding Markets

We submit that it would be helpful to include a comment in paragraph 4.30 regarding the relevance / analysis of market shares in bid markets. The Authority has stated in previous decisions (eg, IBM Ireland / Schlumberger Business Continuity Services, M/04/032) that market shares in bidding markets “*can change relatively quickly and accordingly in such markets the Authority relies less on market shares and instead examines competitive effects directly*”.

Coordinated Effects

We believe it is important to clarify that coordinated effects do not (of themselves) constitute a breach of section 4 of the Act. We submit that some of the language used (eg, the reference to hardcore behaviours in paragraph 4.33 and the reference to exchange of information in paragraph 4.35(f)) is potentially misleading and should be separated from any discussion of tacit coordination.

Incentives for Coordination

The Draft Merger Guidelines appear to place a very strong emphasis on the incentives for firms to compete less intensively. While incentive is clearly an important factor in collective dominance, tacit coordination cannot arise unless the firms involved also have the *ability* to coordinate (and an incentive not to depart from the tacit common policy). Reflecting the test set down in Case T-342/99, *Airtours,* the Commission Horizontal Guidelines (at paragraph 42) refer to "*whether it would be possible to reach terms of coordination and whether the coordination is likely to be sustainable".* We would therefore respectfully suggest that the section beginning with paragraph 4.37 should include a reference to the ability (as well as the incentive) to reach a common policy on the terms of coordination (eg, price) and that an alternative heading might be more appropriate for this section.

Paragraph 4.40 appears to introduce a rebuttable presumption in relation to past behaviour. While previous coordinated behaviour (to the extent that it can be proved) is one factor in considering the potential for coordinated effects, as noted above, it is essential that the parties have the ability to reach a common understanding. There may therefore have been changes to the market in the interim which means that it is no longer possible for such an understanding to be reached, at least tacitly (again, we believe that the reference to both "overt" and tacit coordination here is confusing).

5 Barriers to Entry and Expansion

Entry

We respectfully submit that the reference in paragraph 5.2 to new entry having a constraining effect where it is "costless" suggests too high a burden of proof on the merging parties. As the Draft Merger Guidelines state later on (at paragraph 5.6), the question is whether the new entrant will make a sufficient return on its cost of entry over time.

Sufficiency of Entry

Paragraph 5.9 appears to suggest that, in order for the Authority to consider a new entrant (or entrants) to be sufficient, it / they would need to duplicate the size of the merged entity. Again, it is submitted that this sets too high a requirement for sufficiency.

Strategic Barriers

In relation to strategic barriers to entry, we respectfully suggest that paragraph 5.15(c) should be clarified. It is submitted that it is incorrect to assume that the prior / future acquisition of a potential competitor by an existing player was / is necessarily motivated by a desire to prevent a new competitor entering the market – see also paragraph 5.18(k). The scenario mentioned in paragraph 5.15(b) would also appear to us to be unusual, at least in the absence of pre-existing tacit coordination.

6 Efficiencies

Efficiencies

Paragraph 6.1 states that the Authority concentrates on efficiencies "*that would not occur in circumstances other than the merger*". We believe that the current wording could be interpreted as requiring a finding that the claimed efficiencies could never arise in any future situation not involving the merger. Such a finding would not be practicably possible to evidence or verify. For these reasons, we suggest that the Authority replace the above phrase with language such as "*that would occur as a direct consequence of the merger, judged relative to what would occur without it*". Similar language is used in the Office of Fair Trading / Competition Commission joint Merger Assessment Guidelines (dated September 2010).

Supply-Side Efficiencies

Paragraph 6.3 states that cost reductions *"include economies of scale and / or scope that involve reductions in marginal cost"* and that *"[r]eductions in fixed costs are less likely to be passed through to consumers so less weight is given to them by the Authority"*. Similarly, paragraph 6.6 states that *"[d]ynamic efficiencies may be less certain to occur…are not likely to outweigh a finding of a SLC"*. The decision to de-value these types of efficiencies, on the basis that pass-through is less probable, represents an unwelcome departure from the approach taken in the Authority's contribution to the 2007 OECD *Roundtable on Dynamic Efficiencies in Merger Analysis*[1]. That contribution indicated that dynamic efficiencies, such as efficiencies arising in the long-term due to fixed cost reductions, are acceptable to the Authority and there was no suggestion that marginal cost savings would be prioritised.

We believe that the inclusion of a presumption against relevant efficiencies arising from fixed cost savings / dynamic efficiencies is unnecessary and may lead to consumer welfare losses for a number of reasons. First, the evidence to support any type of efficiencies should be assessed on a case-by-case basis, at least until the Authority has developed a substantial body of case law on efficiencies. Second, creating a new obstacle to a successful efficiency claim is likely to further discourage merging parties from raising efficiency arguments. This would conflict with the following statement included in the Authority's contribution to the OECD Roundtable (referenced above): *"Going forward it might be argued that it would be appropriate for the Authority to consider in some way signalling to merging parties that the perception that the Authority would hold efficiencies against the merging parties is incorrect."* We agree strongly with this statement and we urge the Authority to include in Section 6 a signal that it will approach the assessment of any claimed efficiencies with an open mind and without a pre-conception that a strong claim supports the existence of a SLC based on unilateral effects (ie, an "efficiency offence", as opposed to an "efficiency defence"). Third, a decision to neglect dynamic efficiencies may lead to consumer welfare losses arising from the discouragement and / or abandonment of mergers that would lead to significant fixed cost savings and increased innovation to the ultimate benefit of customers. Given the importance to Irish

1. http://www.oecd.org/daf/competition/mergers/40623561.pdf

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consumers of high quality technology services, which cannot be delivered without significant investment in infrastructure, it is important that the Authority expresses a willingness to consider efficiency claims involving the pass-through of fixed cost savings over a longer period of time.

Evaluation of Efficiencies

We respectfully submit that the description in the Draft Merger Guidelines of the evidentiary standard for assessment of efficiency claims should be modified, so as to provide merging parties with certain, consistent and workable guidance. Paragraph 6.7 requires that efficiencies be evidenced "*to a high degree of certainty*". Paragraph 6.14 expresses the required standard as "*convincing evidence*". Finally, paragraph 6.10 adds that the parties must provide "*convincing evidence*" that any efficiencies "*cannot be accomplished by another <u>feasible</u> means less restrictive of competition*".

We believe that the appropriate evidentiary standard should be lower ie, on the balance of probabilities. This is the threshold applied under the EU Merger Regulation. The Commission Horizontal Guidelines (at paragraph 77) refer to "*<u>sufficient evidence</u> that the efficiencies generated by the merger <u>are likely to</u> enhance the ability and incentive of the merged entity to act pro-competitively…"*

Under the Act, the Authority's decision on whether a SLC arises must be based on its opinion. An opinion reflects a reasoned assessment of probabilities. Thus, merging parties should not be required to rebut a probability with a certainty. Further, we do not understand why a higher evidentiary standard should apply to efficiency claims when other forward-looking assessments, such as the likelihood of new entry / expansion / buyer power, are undertaken based on the standard of a balance of probabilities. Indeed, arguably the evidentiary standard for efficiency claims should be even lower in recognition of the fact that the ability of merging parties to gather detailed evidence on the relevant matters can be constrained greatly by the competition rules on information-sharing.

We also believe that it would be helpful for the Authority to provide examples of what quality of evidence would meet the relevant evidential standard. The examples currently included in paragraphs 6.12 and 6.15 merely identify the evidence types and the factors that are likely to be considered by the Authority, without reference to the relevant evidential standard.

Finally, it is respectfully submitted that the use of the word 'feasible' in paragraph 6.10 (underlined above) is ambiguous and might suggest that a theoretical alternative could be sufficient to rule out an efficiency defence. For clarity, we suggest that the Authority amend the above-quoted extract from paragraph 6.10 so that it states "*alternative means less restrictive of competition that are realistic in the business situation faced by the merging parties, having regard to current market practices*".

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Benefits to Consumers

Paragraph 6.15(e) states that "*[e]fficiencies that reduce prices in one market cannot compensate for price increases in another market and are not considered to be pro-competitive efficiencies*." In our view, such a blanket exclusion is too general and might lead to consumer welfare losses. For example, it is possible that a future merger may create a potential for consumer harm in a small relevant market, but that affected consumers would accept this risk in order to benefit from significant efficiencies in a related market. By virtue of the above-quoted statement, the Authority would effectively be bound to block any such merger to the detriment of overall consumer welfare. Therefore, we suggest that the Authority considers including alternative wording to recognise the above possibility, particularly in cases where a reduction in competition is identified in a very narrow market that is linked to a market that will become more efficient, so that the same consumers will suffer any competitive harm and enjoy the efficiency benefits.

Finally, we believe that the Authority should include a statement to clarify, for the avoidance of doubt, that the applicable standard(s) for the assessment of efficiency claims does not depend on the level of the Authority's competition concerns regarding the merger (ie, not a 'sliding scale').

7 Countervailing Buyer Power

Buyer Power

The references to "*all customers*" in paragraph 7.1 and "*some but all buyers*" in paragraph 7.4 could suggest that a claim of countervailing buyer power is likely to be successful only where there is evidence that all customers have negotiating power. While the third sentence of 7.6 clarifies that "*buyer power possessed by <u>one or more</u> customers may protect all customers*", we believe that this point should be expanded and the earlier references clarified.

Buyer Power and SLC

Regarding countervailing buyer power, paragraph 7.1 might also reference other important pressure points which are available to powerful buyers, such as the threat of awarding the supplier less prominent shelf space or offering it less attractive promotional opportunities. Paragraph 7.1 does not acknowledge that buyers of smaller quantities may actually be better placed to exercise buyer power through switching because their quantity of demand is lower and therefore can be adjusted more easily. We suggest inclusion of this point.

In the same way that paragraph 7.5 includes a description of the adverse "waterbed effect", we suggest that the Authority include a description of the positive "umbrella effect" whereby the price terms achieved by powerful buyers become publicly available and can be used by smaller buyers in negotiations with the merged entity.

Evidence for Assessing Countervailing Buyer Power

The assumption underlying the statement in paragraph 7.11 that "*the behaviour of the merging parties vis-à-vis each other and third parties (ie, customers, competitors, and suppliers) is likely to be heavily influenced by the announcement of the merger*" is troubling. In our experience, merging parties seek to ensure that business continues as normal pending determination of a merger investigation by the Authority.

8 Non-Horizontal Mergers

Non-Horizontal Mergers

We welcome the general principle stated in paragraph 8.5 that "*non-horizontal mergers are generally less likely than horizontal mergers to generate competitive concerns*" and that "*non-horizontal mergers are often pro-competitive….*" We believe that the Authority could consider strengthening the current reference to non-horizontal mergers being "*generally*" less likely to generate competition concerns, such that it is clearer that such mergers will rarely or only in specific circumstances give rise to competition concerns. We note that the Office of Fair Trading / Competition Commission joint Merger Assessment Guidelines provide that "*it is a well-established principle that <u>most</u> [non-horizontal mergers] are benign and do not raise competition concerns*…" (emphasis added). The Commission Horizontal Guidelines (paragraphs 23 – 27) also provide a general guideline that where the post-merger market share of the merged entity is under 30%, the European Commission is unlikely to find concerns in non-horizontal mergers. The Authority might consider the inclusion of a similar indicative threshold.

We would welcome the inclusion in paragraph 8.5 of additional examples of the pro-competitive benefits / efficiencies often generated by non-horizontal mergers. Additional examples would include product repositioning (where a merged entity may reposition some of its products, which may have the effect of increasing variety and choice for consumers) and / or reduced investment hold-up problems (these can occur where a distributor may be reluctant to invest in promotion because its investment may also benefit competing distributors / retailers, and accordingly can be alleviated by a vertical merger). We also note that the examples in paragraph 8.5 are primarily supply-side efficiencies, and we would welcome inclusion of examples of demand-side efficiencies also (eg, network effects, 'one-stop' shopping). We note that such an approach is adopted in the Office of Fair Trading / Competition Commission joint Merger Assessment Guidelines.

It would also be helpful for the Authority to confirm in this section whether the same standard for efficiencies set out in section 6 of the Draft Merger Guidelines applies (please see our comments on the appropriate standard above) or whether the Authority proposes to adopt a lower standard, taking into account the general principle that non-horizontal mergers do not tend to give rise to substantive competition concerns and very often give rise to efficiencies.

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Unilateral Effects

In relation to paragraph 8.9, it would be helpful to have further guidance around how the Authority will measure the "significance" of a maverick player. Will the standard applied be the same as in the context of horizontal mergers, or will recognition be given to the specific circumstances in which non-horizontal mergers occur?

Paragraph 8.10 describes input foreclosure as follows: "(a*) total input foreclosure, such as when a merged wholesaler-retailer entity refuses to supply a key product to a retail competitor, and (b) partial input foreclosure, such as when a merged wholesaler-retailer entity increases wholesale prices charged to, or otherwise offers less attractive terms to, a retail competitor*". As input foreclosure can take a number of forms, including eg, opting for a specific choice of technology which is not compatible with technologies chosen by rival forms, or degradation of quality of input supplied, the Authority might consider including a more expansive / wider list of examples of input foreclosure.

We consider that the Authority should specify in paragraph 8.11 that for input foreclosure to be a concern, the merged entity must have a significant degree of market power on the upstream market, which could be defined by way of indicative market shares.

The Authority states in paragraph 8.12 that *"there will be an incentive to input foreclosure if customers switch to the merged entity downstream such that increased downstream sales and profits <u>more than offset</u> any loss in upstream sales and profits*" (emphasis added). While we agree in principle with this statement, we would suggest that the reference to "<u>more than offset</u>" should be clarified.

While we agree in principle with the statements in paragraph 8.15 on customer foreclosure, the position adopted assumes that the merged entity can easily satisfy / internalise the additional vertical demand; it would be helpful to have the Authority's views where this is not the case.

We note the reference in paragraph 8.16 (similar to that in paragraph 8.12 for input foreclosure) to the balancing between potential benefits and costs to a merged entity no longer purchasing input from competitors. In this situation the balancing test would be carried out between the increased production costs incurred by the merged entity for the relevant input (ie, as the merged entity will have to self-supply), and "*increased profits from upstream and/or downstream transactions*". While we understand the reference to downstream transactions, it is not immediately clear to us what "upstream" transactions might be in this context (as the merged entity will be self-supplying) and the associated increased profits from these upstream transactions.

While we agree with the principle in paragraph 8.17 that effects on customers in the downstream market may take time to occur, it would be helpful for the Authority to provide guidance as to the likely temporal scope of its review eg, will the Authority confine itself to a timeframe of 1-2 years after the merger, recognising the difficulties in conducting an accurate forward-looking analysis?

Coordinated Effects

Although the Draft Merger Guidelines acknowledge that non-horizontal mergers are "*generally less likely to generate competitive concerns*" (see comments above concerning reference to 'generally'), it would be useful to reiterate this sentiment at the outset of the section on coordinated effects (paragraph 8.18) ie, that non-horizontal mergers are very rarely blocked due to co-ordinated effects concerns, and that these types of mergers are often more likely to disrupt and destabilise the market, rather than to increase co-ordination.

We note that the list of effects in paragraph 8.19 is stated not to be exhaustive. However, in respect to paragraph 8.19(c), it would be helpful to have additional guidance as to at what point the Authority might consider the level of vertical integration is such that "*actual or potential entrants <u>must</u> also be vertically integrated to compete effectively"* (emphasis added). For example, would this be when 50% of the market is served by vertically integrated entities?

Conglomerate Mergers

As above, it is important to reiterate at the outset of the section on conglomerate mergers (paragraph 8.21) that this type of merger very rarely gives rise competitive harm, and that tying / bundling may have pro-competitive effects. The current section does not recognise the fact that bundling is not necessarily bad for competition and that customers may in fact find benefit from one-stop shopping. In this regard, the Authority might consider the re-inserting some of the text on portfolio effects from its existing Merger Guidelines (see, paragraph 6.7 of the Authority's 2002 Merger Guidelines).

Additional detail on the factors that the Authority will take into account in analysing ability, incentive and effect of a tying / bundling strategy would be welcome. By way of example, the Office of Fair Trading / Competition Commission joint Merger Assessment Guidelines identify the following factors as relevant: (i) whether customers have a demand for more than one of the products, and whether the products are complements; (ii) customer preferences for variety and one-stop shopping; and (iii) the costs to rivals of providing variety and one-stop shopping at a scale to enable them to compete effectively with the merged firm.

For ease of reference it would be helpful for the Authority to indicate which factors listed in paragraph 8.19 in relation to vertical mergers also apply to conglomerate mergers and / or where these factors might warrant a different treatment / application in the context of conglomerate mergers and the Authority's views for this.

9 Failing Firms and Exiting Assets

Failing Firm Argument

We welcome the Authority's acknowledgement of the failing firm argument as a defence in principle. However, we have concerns regarding some aspects of the defence which may make it unduly difficult for the parties to avail of it in practice (see below).

Failing Firm Test

In relation to the four criteria for the defence set out in paragraph 9.5, we note the following:

- Subparagraph (c) requires the assets of the failing firm "would" exit the relevant market in the absence of a merger transaction. It would be helpful for the Authority to clarify its views on the timeframe / imminence of such exit.
- Subparagraph (d) requires "*there is no* <u>*credible*</u> *less anti-competitive alternative outcome than the merger in question*" (emphasis added). The reference to 'credible' appears to us to be a welcome clarification of the Authority's previous guidance (which required the firm to have made verifiable efforts to elicit reasonable alternative offers of acquisition – paragraph 5.17(c) of the Authority's 2002 Merger Guidelines).

Evidence and Analysis

We note that paragraph 9.10 requires the parties to show that the merger will not leave consumers "worse off" than if the firm and its assets had left the market. We consider the reference to "worse off" to be ambiguous, and the test should be clearly linked to the likely effects on competition eg, in terms of creation of SLC.

Paragraph 9.12 addresses the situation whether both acquirer and target wish to benefit from the failing firm defence. Although we welcome the Authority's acknowledgement that the failing firm defence could apply to this situation as a matter of principle, given the practical difficulties associated with the defence, and lack of cases to date where the defence has been successfully invoked and applied, we query how realistic this situation will be. It would be helpful to have some examples of situations where the Authority considers this would be appropriate.

Finally, we note that the Authority has tended in the past to expedite its decision-making in circumstances where one of the merging parties is in financial difficulties . It would be helpful for the Authority to confirm its intended practice in this respect in the Draft Merger Guidelines, and in any event, we would urge the Authority to continue to deal with such cases expeditiously.

10 Other Comments

We would strongly support the provision of guidance by the Authority on its approach to remedies and would respectfully suggest that the Draft Merger Guidelines should include an explanation of the Authority's approach to remedies (both structural and behavioural) at both Phase I and Phase II. In particular, we suggest that the Authority should explain any preferences it might have for structural over behavioural remedies and the reason for such preferences including, where applicable, whether the monitoring of behavioural remedies has proved problematic and the nature of those problems.

As suggested above, we believe that the Authority should use actual cases to explain its views where possible.

One other important omission in the consultation is that it makes no reference (other than in paragraph 3.14) to the appropriate analysis to be adopted in respect of voluntary notifications (which is currently addressed in Part 7 of the 2002 Merger Guidelines), how the new guidelines should be interpreted as regards voluntary notifications and what effect if any they will have on the *Notice in respect of the review of non-notifiable mergers and acquisitions* (N/03/001). Currently, the 2002 Merger Guidelines provide some indication of the Authority's views as to when a voluntary notification is appropriate and we think it is important that the new guidelines provide clarity on the Authority's approach to voluntary mergers.

11 Concluding Remarks

We are grateful to the Authority for this opportunity to comment on the issues raised in the Consultation. If the Authority has any queries on the commentary set out above and / or wishes to discuss in more detail, please contact Helen Kelly or Bonnie Costelloe of this office.