ICN Merger Working Group: Analytical Framework Sub-group

THE ANALYTICAL FRAMEWORK FOR MERGER CONTROL

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Office of Fair Trading[1], London

I. OUTLINE

1. This paper discusses the framework within which mergers are assessed. It begins by considering the purpose of merger control. Without clear objectives for merger control, it is difficult to formulate an appropriate analytical framework. The paper then briefly reviews the relationship between jurisdiction and the analytical framework, before exploring some of the issues relating to the analytical framework itself. The paper touches finally on links between merger control processes and remedies in the context of the analytical framework.

2. An important aim of the paper is to raise issues for discussion. This is done throughout the text. Some of the key questions are summarised in the conclusion. Appended to this paper are four exemplar papers from members of the ICN and a jurisdictional matrix of ICN members, which helps compare and contrast the existing analytical frameworks.

II. WHAT IS MERGER POLICY FOR?

3. Although merger policy can have several aims, it is generally thought that its core purpose is to ensure that mergers do not jeopardise conditions for competition. This section therefore examines:

   (a) how the core purpose of merger policy serves economic goals – notably consumer interests;
   (b) the possible wider public interest goals of merger policy; and
   (c) the place of merger policy in the broader public policy context.

(a) Economic goals

4. Mergers consolidate the ownership and control of business assets, including physical assets (e.g. plant) and intangibles (e.g. brand reputation). They can enhance corporate – and wider economic – performance by improving the efficiency with which business assets are used. On one view even the threat of take-over can be a spur to efficiency, but on another the managerial pursuit of mergers can be a distraction from it.

5. Empirical evidence on the overall performance of mergers in terms of profits and share values is mixed.[2] The extent to which mergers enhance

[1] The OFT has prepared this paper in consultation with the members of the Analytical Framework sub-group, who have commented on an initial outline and earlier drafts. We are most grateful for their helpful and thoughtful contributions.

profitability is therefore a subject of debate. So, moreover, is their aggregate contribution to efficiency: mergers can increase profitability by enhancing not only efficiency but also market power.

6. Most mergers raise no serious prospect of an increase in market power. In such cases, there is usually no reason for intervention unless, perhaps, public policy objectives (other than competition-oriented objectives) are jeopardised by the merger.

7. With some actual and proposed mergers, however, there is a serious prospect of a detriment to competition. If it were not for merger control laws, no doubt many more such mergers would happen. The core purpose of merger policy is to prevent the prospective anti-competitive effects of such mergers through appropriate remedies, including prohibition if necessary.

8. Ultimately, though, is preserving competition an end in itself, or is the aim to protect consumer (or "total") welfare? Provided that the core purpose is consumer-oriented, we suggest that policy should focus on those mergers where a weakening of competition means that producer interests (e.g. in pursuit of higher profits) lead to outcomes that are at odds with consumer benefit (which can be expressed in terms of lower prices, higher quality, greater choice etc.).

9. Should the focus of merger policy be on preserving competition, protecting consumers or preserving economic efficiency?[3] Are these objectives ever in conflict? One view is that they virtually always coincide, given that the competitive process generally promotes efficiency in resource allocation, incentives to achieve productive efficiency, and dynamic incentives to innovate – bringing new and better products to the marketplace – as firms compete to give customers better deals. If they coincide, need we concern ourselves explicitly with "economic efficiency",[4] or indeed consumer welfare, could we not focus only on protecting the process of competition?[5] On the other hand, are there situations where consumers benefit notwithstanding a reduction in competition? Is it ever possible that economic efficiency is enhanced despite a reduction in both competition and consumer benefits?

10. In light of these considerations, how should mergers that appear anti-competitive but which are claimed to be pro-consumer, or at least pro-efficiency, be treated? Two broad issues arise. Whether, and if so how,

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[2] For a recent summary of research see, Lars-Hendrik Roller, Johan Stennek and Frank Verboven (2000), "Efficiency Gains from Mergers", The Research Institute of Industrial Economics, Working Paper No. 543.

[3] Economic efficiency in terms of allocating resources to those goods and services most highly valued at least cost.

[4] In other words, the core purpose of merger policy may be described as protecting the process of competition, which ensures the efficient allocation of resources occurs when we produce the goods and services that people value most highly

[5] The German exemplar paper gives an example of an authority that has adopted this type of approach.

efficiency evidence should be considered: (i) in the analysis of whether the merger is indeed anti-competitive; and (ii) after it has been concluded that a merger is anti-competitive.

11. On the first point, efficiency evidence might be informative about whether a merger would be anti-competitive. It might be, for example, that a merger had implications for some *measures* of competition – say market shares – which other things being equal might raise concerns. But if the change in market structure was shown to improve competition (and hence be presumptively pro-efficiency and pro-consumer), then might concern be allayed?[6]

12. On the second point, if efficiency factors are taken into account as a countervailing justification for a merger that has been found to be anti-competitive, there is the question of which factors count. Is consideration limited to *consumer* benefits in the relevant market, consumer benefits more generally, or should some kinds of *producer* benefit also be allowed into the reckoning?[7] The answer to these questions will arguably turn on how broadly one defines the core purpose of merger policy.[8]

13. The discussion so far has focused on the economic *process* of competition and economic *goals* of efficiency and consumer benefit. However, there is a case for seeing merger policy in a broader context.

(b) Public interest goals

14. Economic goals are ultimately public interest goals, and arguably economic goals are the only ones that should matter for the purposes of merger policy. But is this the case? Non-competition public interest objectives apply in many jurisdictions' merger review to at least some industrial sectors.

15. So the place of merger policy in achieving wider public interest goals needs discussion. In so doing, it is useful to distinguish between non-competition criteria for merger appraisal that apply generally, and those that apply to particular sectors. The former include regional employment policy, restrictions on foreign ownership and control, promotion of 'national champions', and (in South Africa) black economic empowerment.[9] Sectors where non-competition considerations may apply include defence, media and utilities.

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[6] See, for example, a 4 to 3 merger where, as a result of a merger between the number three and four firms, the new third firm is able to compete more effectively with the number one and two firms in the market.
[7] The US exemplar paper gives an example of a consumer-focused efficiency analysis.
[8] These are not just questions of principle – or of welfare economics – but also of practicality. Efficiency claims are much easier to make than to test, and the proponents of mergers have every incentive to make them.
[9] The South African exemplar paper gives an interesting overview of how distinctly national issues can be important considerations in an analytical framework.

16. Usually, where non-competition factors come into play, they are more restrictive of mergers than pure competition considerations would be. In contrast, 'national champion' arguments seek to limit competition-based intervention.

17. To understand whether non-competition 'public interest' objectives should have weight in merger appraisal it is perhaps best to consider merger review in a wider context.

(c) <u>Merger policy in context</u>

18. Merger policy is part of competition policy, which is but part of broader public policy affecting business, markets and the economy. So, to put merger policy in context, we need to consider how merger policy relates to the achievement of competition policy objectives in general as well as to broader economic policy objectives?

19. Merger policy works *ex ante*: it seeks to restrain those mergers, which, if allowed to go forward, would likely reduce competition.[10] This contrasts with prohibitions on anti-competitive agreements and abuses of market power. Such prohibitions operate *ex post* inasmuch as they penalise unlawful past actions but also operate *ex ante* via their deterrent effect.

20. Without merger control, the risk of breach of competition law prohibitions would arguably be greater. But why is merger policy required? Why not rely on the laws against such breaches rather than intervening in mergers beforehand? There are two main points.

    (a) Mergers eliminate any competition that exists between the merging parties and reduce the number of firms competing in the market. Where this reduction has a substantial effect on overall market competition, the market will be less oriented to consumer and efficiency goals, even in the absence of breaches of competition law. Acquiring business through successful competition for custom in the marketplace is one thing; acquiring business through merger is another, at least when competition is jeopardised.

    (b) The enforcement of competition law prohibitions is imperfect. Detecting and proving infringements of the prohibitions is difficult. The need to rely on those laws is reduced by maintaining competitive conditions so that the incentive and opportunity for collusion, abuse of market dominance, and other infringements are prevented from arising, at least insofar as they result from mergers. Further, even where structural remedies are available *ex post*, there can be high economic costs of disentangling a transaction where the merged entity has subsequently been found to harm competition.

[10] For present purposes, we regard the prompt examination of completed mergers as enabling *ex ante* action, as there will rarely have been time for full integration or the exploitation of the resulting market position.

21. In short, merger policy aims to avert structural changes that would damage incentives to compete while competition law/antitrust prohibitions seek to combat particular kinds of anti-competitive agreement and conduct.[11]

22. Do these considerations suggest that the threshold justifying public policy intervention in mergers should be substantially lower than for finding violations of competition laws for anti-competitive agreements and abusive market conduct?

23. As noted, competition policy – including merger policy – does not operate in a vacuum. It is part of wider public policy towards business, markets and the economy. How do (or should) merger policy and broader public policy issues interrelate? Five practical points are particularly relevant here.

    (a) Should non-competition 'public interest' objectives have weight in merger (and other competition) policy decisions? Or can other policy instruments pursue those objectives better? Employment goals, for example, can usually if not always be better pursued by direct employment policies.

    (b) If non-competition objectives are given weight in merger analysis, who is to judge them? Is an independent competition authority likely to be better placed to judge competition issues than more general 'public interest' issues?

    (c) Concentration of economic power can have a wider impact on society, for example through its impact on the political process. The prevention of an increasing number of monopolies can thus be perceived to have more than economic benefits.

    (d) Are there types of organisations or firms where a different approach is required to take account of their non-commercial or public role? For example, should mergers involving not-for-profit organisations be analysed in the same way as mergers involving commercial businesses?

    (e) Competition goals and principles may have importance for public policy way beyond the sphere of competition policy decisions. This is a theme of the ICN Working Group on Competition Advocacy and so is not developed here.

24. Given an identified purpose and context of merger control, how selectively should these controls be applied? Should all mergers be subject to potential scrutiny or, given identified objectives of merger control, can we describe characteristics of mergers that preclude policy intervention? In other words, based on the consumer and efficiency goals described above, is there a class of mergers that should escape scrutiny? If so, how should any such exemption be implemented (e.g. as a matter of law, in reporting thresholds, or as a rebuttable presumption in guidelines)?

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[11] There do exist "grey areas" such as Joint Ventures, which could be considered as a form of merger or as an agreement.

III. WHICH MERGERS SHOULD BE REVIEWED?

25. Given that most mergers do not give rise to any concerns almost regardless of the goals of merger policy, how should attention be focused on those mergers that might raise concerns?

26. Jurisdictional criteria help determine which mergers may raise concerns.[12] If the chosen goals of mergers policy are consumer and efficiency-oriented, should jurisdictional criteria aim to select for investigation only those mergers that might jeopardise the achievement of those goals? Could overly broad criteria increase the financial cost to firms of merging and increase the risks of delay, thus discouraging legitimate business pursuit and undermining the achievement of consumer and efficiency goals?

27. The process of investigating mergers has three stages.

    (a) Is the transaction a merger?
    (b) Is that merger potentially a legitimate subject for review?
    (c) Does the merger raise sufficient concerns to be challenged?

28. The third stage is, in effect, the substantive test itself and is discussed in the next section. This section examines how the scope and formulation of the first two selection filters interrelates with the analytical framework.

(a) Is the transaction a merger?

29. For the majority of transactions, this is obvious. There are, however, more marginal transactions that can be characterised as mergers, but also possibly be reviewed under the competition law prohibition of anti-competitive agreements or even abuse of market power. These marginal deals include joint ventures, acquisitions of minority interests (covering minority shareholders active in management or passive minority shareholders that are investors alone), and the sale of distinct assets such as technology or customer lists. Whether such marginal transactions are characterised as mergers depends on, among other things, the view taken of the relationship between merger policy and competition policy more generally (see below).

(b) Is the merger potentially a legitimate subject for review?

30. The answer should be closely linked to the objectives of merger policy. Presumably, there should be no need to review mergers that do not jeopardise the goals of merger policy? Put differently, should jurisdictional criteria aim to screen out mergers that, for policy reasons, are not deemed relevant subjects for review?

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[12] Jurisdictional criteria include the types of transactions which qualify as mergers, any thresholds below which mergers are not reviewable, and legal or administrative "safe harbour" provisions conditioning when full notification is not required. The Notifications and Procedures Subgroup is examining these issues.

Competition objectives

31. There are two main types of jurisdictional screen: share-based and turnover-based. These are not discussed further as the Notification and Procedures Subgroup are considering them.

Public interest objectives

32. Selecting mergers for investigation is still more complex where broader public interest objectives are involved. In particular, unless the public interest considerations relevant to selection are clearly spelt out, it is difficult to know which considerations will be taken into account given a wide range of possible public interest issues. In some cases, merger regimes have provided that certain classes of merger – e.g. those in particular sectors – will be subject to automatic review to achieve broader public interest objectives, such as plurality of the media or the protection of national security.

(c) <u>Jurisdiction over international mergers</u>

33. Where mergers have cross-border effects, potentially difficult issues arise in selecting mergers for investigation by national competition authorities.

34. Different competition authorities can and do apply different analytical frameworks to the same merger. Does this raise legal and/or practical problems? Where the affected countries subscribe to the same objectives for merger policy, is it possible for even trans-national mergers to be assessed in essentially the same way in different countries? The EC Merger Regulation is an example of separate jurisdictions agreeing to analysis of certain mergers in one supra-national framework. Here a central body adjudicates on a merger that may otherwise be notifiable in several EC Member States. Even where a merger falls for examination by some of the Member States, they may well actively co-operate in the assessment of its competitive effects (within the limitations of national confidentiality laws). Alternatively, in Europe, Member States can choose to refer mergers to the EC for scrutiny due to the pan-European nature of the merger.[13]

35. Is the risk of differential merger analysis greater where other public interest issues are taken into account? This requires choices about the relative importance of competing policy objectives and about the utility of alternative policy instruments to achieve those objectives. Different countries do not necessarily agree on these choices, suggesting that non-competition public interest considerations can be used to select mergers for investigation (and assessment) only on a national basis.

[13] Article 22 of the ECMR allows EC Member States– collectively and individually – to refer a case to the Commission for investigation when the case in question would not normally meet the EC's jurisdictional criteria.

IV. HOW SHOULD QUALIFYING MERGERS BE ASSESSED?

36. Having determined which types of merger should be selected for investigation, against what standard should they be assessed? We have already observed that the prospective post-merger effects being examined vary according to the aims of merger policy. This section examines criteria for merger assessment.

(a) Competition-based assessment

37. If competition policy is consumer- and efficiency-oriented, how can the substantive test be designed to catch mergers that could jeopardise these objectives?

Substantive test

38. The two competition tests most commonly used to assess changes in competition are the "dominance" and "substantial lessening of competition" (SLC) tests. There is considerable debate as to whether these two standards have the same practical effect.

39. The two tests share a focus on increasing market power as the harm to be prevented. Market power, in the context of merger analysis, may be defined as the ability to increase prices profitably (or reduce quality, innovation, choice or other ways in which competition may be inhibited) from pre-merger levels for a significant period of time. This may arise through the individual decisions of the merged firms and their competitors or through co-ordinated behaviour.

40. Mergers which may give rise to market power can broadly be divided into three types (or combinations thereof).[14]

    (a) Horizontal: Mergers between parties that operate in the same relevant market can increase the market power of the merging firms so that they could unilaterally impose a profitable post-merger price increase. Other firms in the market might raise their prices in response, also unilaterally. In other words, and without any kind of collusion, rivalry might weaken. Moreover, a merger may increase the likelihood of (or stability of) collusion, either tacit or explicit, between the firms remaining in the market.

    (b) Vertical: Mergers between parties which operate at different levels of an industry, though often pro-competitive, may in some circumstances reduce competitive constraints faced by the merged firm as a result of increased barriers to entry, raising rivals costs, substantial market foreclosure or an increased likelihood of collusion. This risk is, however, unlikely to arise except in the presence of

[14] Market power may also derive from the exercise of monopsony, or buyer power. This may arise as a result of a merger where the merged entity attains such buyer power that it can reduce the price it pays to suppliers to a level below the competitive price, leading to an anti-competitive reduction in suppliers' output.

existing market power or in markets where there is already significant vertical integration/restraints.

(c) Conglomerate: Mergers between firms in apparently unrelated markets - so called conglomerate mergers - would rarely substantially lessen competition or create/strengthen dominance. However, in some jurisdictions, mergers of this type have been found to create competition problems, e.g. through the exercise of 'portfolio power'.

41. Do the SLC and dominance tests each cover these three types of merger in effectively the same way, or, are there possible gaps? Does the answer to this question vary according to the precise formulation of the SLC and dominance tests in different regimes?

42. Single-firm dominance requires that one party in the market be capable of exercising substantial market power. It is clear that market conditions favourable to tacit co-ordination can be the basis for a finding of collective dominance.[15] Against this background, we can ask two questions of economics and law respectively to establish whether SLC and dominance are the same:

(a) whether, short of creating single-firm dominance, increasing the likelihood of tacit co-ordination is the only important way that a merger can reduce competition; and

(b) whether, absent express co-ordination or explicit economic linkages between firms, tacit co-ordination is a necessary condition for collective dominance?

43. The concept of SLC allows for a situation where a merger may increase the market power of the merged firm and (some of) its remaining competitors, allowing each of them to increase prices unilaterally in the face of reduced competition. In other words, the conduct of the firms is not co-ordinated: they are simply competing less vigorously with one another. In sum, a merger in a concentrated market can substantially lessen competition other than through tacit co-ordination by blunting competition among the remaining competitors in the market (and of course, ending such rivalry as existed between the merged parties themselves). Does the concept of collective dominance cover more than just tacit or explicit co-ordination? Does the SLC concept, which may cover mergers that fall short of dominance, provide too low a threshold? Are there any clear examples of cases where the two tests would produce different results?[16]

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[15] See Case T-342/99, Airtours v Commission, judgment of the Court of First Instance, June 6, 2002.

[16] The Australian and German exemplar papers give contrasting views to this question. This may reflect that it is the legal interpretation of the tests by national courts which is of paramount importance. For example Australia had not adopted the concept of collective dominance at the time it was abandoned in favour of the SLC test.

Analytical steps involved

44. Is there wide consensus on the broad approach for evaluating whether a merger will increase market power? This seems to be the case. This approach examines the competitive constraints the firms are currently under, and whether these are direct (as assessed in the exercise of market definition and concentration) or longer-run (potential new entry). The question then is, by comparing the world with the merger and the world without,[17] whether the merger weakens the overall effect of these constraints?

45. **Market definition.** Does proper examination of the likely existence or otherwise of market power depend on accurate definition of the market or markets affected by a merger? The process of defining the relevant market generates a useful frame of reference within which to assess the immediate competitive constraints that affect a firm's commercial behaviour. It is a useful organisational discipline on the thinking of competition authorities. But is reliance on market definition always helpful? For example, is a precise market definition necessary if there is other evidence of market power? Is excluding or including a product from the market oversimplistic given the spectrum of substitution possibilities that tends to exist in reality, and does this ever cause problems?

46. Relevant economic markets have two basic dimensions: products (or services) and geographic scope. Certain markets might also have a temporal dimension. Geographic markets can range in scope from part of a single country to world-wide. In addition, markets characterised by a high rate of innovation will require analysis of competition at a different level, e.g. competing in the development of new technology which will become tomorrow's new products and services.

47. The scope of a relevant economic market is determined by establishing which products are demand-side substitutes for the products or services supplied by the merging firms, both in terms of the substitute products themselves (the product dimension) and the potential for customers to source their products from alternative locations (the geographic dimension).

48. The "hypothetical monopolist" test is generally used to assess which other products are in the same market as those of the merging firms.[18] This test asks whether, a hypothetical monopolist of a product group could profitably impose a small but significant and non-transitory increase in price (usually 5-10%). If a sufficient number of customers switch to the alternative products such that the price rise is unprofitable, the relevant market should be widened to include those products that have prevented the price rise being profitable. The boundaries of the relevant market are defined for the minimum set of products where the hypothetical monopolist can profitably

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[17] Note: the comparison is not with the past pre-merger world, but with the future world in the absence of the merger.

[18] For example, see G.J. Werden (2002), 'The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm', US Department of Justice.

increase price.[19] Is this the best test? Does the cellophane fallacy have any relevance to merger analysis?[20]

49. **Direct competitive constraints.** Market definition can be used to elucidate the direct competitive constraints represented by rival firms. Although measures of market concentration are not determinative, can we use them to draw preliminary conclusions as to whether a merger might raise concerns because direct competitive constraints are not sufficiently strong to discipline exercise of market power? Generally, the more concentrated the market, the weaker the direct competitive constraints on merging firms and their competitors are likely to be.[21] Key measures of concentration include market shares, concentration ratios, and the Herfindahl-Hirschmann Index.

50. Concentration measures may also provide "safe havens", where mergers that do not result in market concentration above a certain level will not be investigated. How reliable are concentration-based "safe havens" in screening out mergers that raise no competition concerns?

51. Where assessment of pre- and post-merger concentration levels suggests that the merger may weaken the competitive constraints faced by the merged entity, the direct competitive constraints must be examined in greater detail and in light of the competitive dynamics in the market concerned.[22] Central to this analysis is an evaluation of existing and likely future conditions of competition to determine the extent to which the merger might have anti-competitive effects.

52. As noted above, there are three broad types of merger that may give rise to market power concerns, against which the facts of each case must be tested to see whether they fit a cogent theory of anti-competitive effects. This may include quantifying the potential unilateral effects of a merger (e.g. through merger simulation or review of bidding patterns) or examining whether co-ordinated effects are plausible (e.g. through the elimination of a destabilising maverick).

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[19] Markets can also be defined through supply-side substitution, in which the reactions of competitors to the hypothetical price increase are assessed. If competitors would switch capacity quickly to make and sell the merging firms' product (or a substitute for it), then they may be included in the scope of the relevant market as a direct competitive constraint. There is a close relationship between supply-side substitution and new entry, since supply-side substitution attempts to factor in to the competition analysis the likelihood of new entry directly disciplining a price increase. Regardless of terminology, this competitive constraint must be counted in the analytical framework.

[20] Named after the US *Du Pont* cellophane case, this issue centres on whether the prevailing or competitive price of a product should be used in market definition. Some argue that the prevailing price of a product may already be excessive (say where the merging firm already has market power) and so defining the market around this price may result in a fallacious – and potentially wider than appropriate – market definition.

[21] But high post-merger concentration levels may be less important if competition takes the form of bidding for large contracts.

[22] Other quantitative measures of competitive constraints, such as diversion ratios, cross-price elasticity and measures of product differentiation, can provide useful insights.

53. If a potential detriment to competition is indicated, other factors need to be taken into account such as the potential for substantial new entry or buyer power, to examine whether less direct constraints might discipline behaviour after all.

54. **New entry and expansion.** Even where a merger seems likely to increase market concentration, it might not lead to competition concerns if it is relatively easy for other firms to enter the market or for existing competitors to expand production. How can this be assessed?

55. Firms might enter if: (i) changes in relative price levels create incentives for new entry; and (ii) barriers to entry are not high. In addition to structural barriers (e.g. incumbents' scale economies, or control of necessary assets/key technology), barriers to entry may be behavioural, for example if incumbent firms are expected to respond strategically to entry (or threats thereof) with very low prices or by investing in excess capacity to deter entry.

56. When will new entry be an effective constraint? New entry must be realistic in the event that incumbents seek to exploit their post-merger positions. Prospective new entry should also be sustainable and significant enough to provide lasting and effective post-merger competition. In this connection, customers' switching costs may be an important consideration.

57. New entry could include imports and/or supply-side substitution. Capacity expansion or product repositioning by incumbents must also be considered. Where the prospect of competition from these sources is immediate, such competitors will, where possible, be included in the market definition rather than treated as potential entry. Are these the best approaches to ensure that either way the competitive constraints are evaluated properly?

58. **Buyer power.** Where customers can themselves discipline post-merger behaviour through the exercise of countervailing buyer power, should this be sufficient to resolve merger competition concerns? However, buyer power does not result simply from the existence of large customers. Even large customers may be unable to exercise buyer power in the face of 'must-have' brands, a lack of alternative suppliers, or an inability to threaten credibly to set up alternative supply arrangements. How should buyer power be assessed rigorously in merger analysis?

59. **Failing firms.** The analytical framework requires a comparison of the competitive situation with and without the merger. Where one of the merging parties is truly failing, the appropriate comparison is with the expected market structure if the firm is allowed to fail or is acquired by a firm other than the party to the merger. In practice, mergers rarely satisfy the criteria to justify a failing firm analysis. Arguably, in certain failing firm situations, it is at the point that the firm exits the market that competition may become most intense as the remaining market participants fight for customers. How should failing firms be considered?

60. **Efficiencies.** As noted in section II above, demonstrable efficiency gains can help show that a merger is not problematic. In such cases, proven

efficiency gains may have a positive effect on competition in the market, such that there is no reduction in rivalry despite the combination of erstwhile competitors; for example, by lowering the merged entity's marginal costs or increasing its ability to innovate. In such cases, assessment of the merger's efficiency benefits is incorporated into the substantive test and there is no need to consider potential trade-offs between these benefits and the competitive detriment of the merger.

61. It is, however, possible for efficiency to increase while competition is lessened. If so efficiencies may be explicitly weighed against any competitive detriment and the combined effects assessed to see if, overall, consumers benefit (or total welfare increases). In such cases, the pass through of efficiencies to consumers and thus the extent of residual competition would seem important. Can such efficiencies ever outweigh a competitive detriment? Or is some degree of competitive pressure a prerequisite to an efficient outcome? Here, efficiency gains might also be relevant to the assessment of remedies, whereby remedies must be proportionate to the competitive harm but may also seek, as far as possible, not to eliminate any benefits from the merger.

62. Issues for consideration include: how to weigh efficiencies against an increase in market power; must efficiency benefits be passed on to consumers; must they be merger specific; and must they be in the same market? How to take into account potential trade-offs between different types of consumer benefit – for example greater choice and quality against higher prices - or between groups of consumers – some who benefit and some who do not – or between markets or between long-run and short-run effects?

63. Efficiency claims are often made, but how often are they realised? Should competition authorities be sceptical of efficiency claims? In this connection, does asymmetry of information between the parties and the authority raise significant problems?

64. **Timeframe.** Is the appropriate timeframe for merger analysis simply dependent on the form of competition within the market, such as in markets characterised by technology races or fixed-term government franchises? Or does the analytical framework depend on the relative importance attached to short-run versus long-run competition?

65. How should effects on future competition be weighed alongside the short-term effects of the merger? For example, if a merger increases rivalry (and reduces prices) in the short-term but might reduce rivalry (and increase prices) over the long-term (e.g. by foreclosing the market or reducing incentives to innovate), how are these effects to be weighed against each other? Do limitations on decision-makers' predictive powers diminish the weight that should be accorded to potential long-term effects and if so, how should future effects be weighed?

(b) Assessment of public interest issues

66. Does assessment of public interest issues require a different approach from pure competition considerations depending on the issue in question? The approach for analysing national security considerations is likely to differ from, say, analysis of media plurality issues. Hence, is there no common assessment framework for non-competition public interest issues?

67. First, if non-competition issues are taken into account, how should analysis of those issues relate to the analysis of competition issues? Is there a difference between merger policies that can use non-competition issues to "override" the competition analysis[23] and regimes that consider competition and non-competition issues in the round?

68. Second, as noted above, there are questions as to who should assess non-competition public interest issues. Are competition authorities generally better placed to judge competition than public interest issues, since that is where their expertise and accountability lie? Are merger policies that call for balancing of non-competition and competition issues best implemented by politicians?

69. Third, some merger policies do not clearly articulate which non-competition public interest issues are of potential interest to the merger control authority and which are not. As a result, firms do not necessarily know which non-competition goals their merger might jeopardise. This can lead to unpredictable results and – arguably – have an adverse effect on economic efficiency.

70. Fourth, so far as possible, the assessment of public interest issues should be transparent and predictable. How is this best achieved? It should reduce lobbying and rent-seeking behaviour by interest groups. It will also allow for scrutiny of decisions.

(c) Permissiveness of the regime

71. No merger regime is perfect, and all therefore need to trade off between Type I errors (where a merger is prohibited that should have been cleared) or Type II errors (where a merger is cleared that should have been prohibited). To what extent will the trade-off chosen reflect a choice between the core purpose of merger policy and other competition and non-competition goals?

72. Does a more stringent merger regime (more concerned about Type II errors) reflect a concern that *ex post* enforcement of competition-law prohibitions on anti-competitive agreements and abuses of market power can be less than wholly effective in respect of application and/or deterrent effect? This

[23] There is a further difference between regimes that allow non-competition issues to override the competition analysis regardless of the competition outcome, and regimes that allow non-competition issues to override the competition analysis only where an adverse competitive effect of the merger has been identified.

would be consistent with comments at paras 20 to 22 above on the relationship between merger policy and broader competition policy.

V. HOW DOES THE CHOSEN ANALYTICAL FRAMEWORK IMPACT ON REMEDIES AND PROCEDURE?

Remedies

73. First, is there a close connection between the substantive test and remedies? Remedies to address potential adverse effects of mergers should be consistent with both the jurisdictional underpinning of the merger regime and the substantive test. For example, should the "maximum" remedy that can be required in a merger case be restoration of the position before the merger, or reducing a share to the level of the jurisdictional threshold?[24] Where remedies fall short of restoring the level of competition to the pre-merger world, this can require defining the precise point at which dominance is created or a lessening of competition becomes substantial. Is this easier for dominance tests than for SLC tests? This might also reflect on whether structural or behavioural remedies are preferable.

Procedure

74. Second, there are important issues concerning the procedure for applying the analytical framework. The Investigative Techniques Sub-Group is looking into this subject. Three aspects of the interrelationship between the analytical framework and procedure warrant mention.

    (a) As noted, a pure competition-based test is consistent with enforcement by an independent competition authority or sector regulator focused on ensuring competition delivers benefits to consumers. In contrast, where wider public interest issues remain, is there a case for politicians judging potentially competing public policy objectives?

    (b) A competition-based appeal process may only be appropriate where the analytical framework is founded on competition issues alone. Where public policy objectives are at play, is a judicial review process limited to procedural aspects – rather than substantive analysis and the decision's merits – more likely?

    (c) Where the burden of proof is high for the competition authority to secure action against mergers in a jurisdiction (such as a requirement to challenge in court), does this develop pressure for a robust analytical framework? Where an administrative regime involves a

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[24] For example, where a country has a jurisdictional threshold catching any merger creating a market share over 25%, is the maximum remedy that can be imposed to reduce the merged entity's market share to 24.9% since the buyer could have acquired up to this level without giving rise to a justiciable merger? Similar questions arise in the context of cross-shareholdings in competitors.

relatively lower burden of proof, does this develop pressure for transparency to demonstrate robust analysis?

VI. CONCLUSIONS AND SUMMARY OF ISSUES

75. This paper on the analytical framework for merger control has discussed a series of issues ranging from the aims of merger policy to constitutional matters. Some of the key questions identified are as follows.

Section II: What is merger policy for?

- Should the aim of merger policy go beyond the core purpose of ensuring that mergers do not jeopardise conditions for competition? If so, in what circumstances and towards what public interest goals? Are different public decision-makers appropriate for different policy objectives?

- The economic objectives of competition, efficiency and consumer well-being coincide usually but not always. If conflicts between them are claimed, how should they be resolved? Should the welfare test be consumer or "total" welfare? How might conflicts between short-run and long-run effects of merger be traded off, if at all?

Section III: Which mergers should be reviewed?

- How is the merger review process best designed to focus attention efficiently on potentially problematic cases? Are there thresholds (e.g. of size) below which deals should not be scrutinised?

Section IV: How should qualifying mergers be assessed?

- Are the "dominance" and "substantial lessening of competition" standards effectively the same? If not, how do they differ?

- What role should market definition and measures of direct competitive constraints such as HHIs play in merger assessment?

- How should the merger review process evaluate factors such as whether a market is susceptible to co-ordination? Or whether competitors will unilaterally expand or reposition in response to any price increase by the merged parties?

- How should efficiency claims be assessed? When should this be part of the analysis of whether the merger is anti-competitive or; when should it be after it has been concluded that a merger is anti-competitive? If the latter, what extent or nature of efficiency gain is needed to overcome an increase in market power? Must the benefits be passed on to consumers, be merger specific and in the same market? How should this be evaluated in practice?

- How can the operation of any non-competition public interest objectives be made transparent and predictable?

- In view of commercial vested interests and the fact that public bodies are not immune from error, who should bear the burden of proof at what stages of merger appraisal?

- Do (or should) differences in the core purpose of merger policy lead to significant differences in the permissiveness of regimes?

Section V: How does the chosen analytical framework impact on remedies and procedure?

- Does the analytical framework employed set limitations on possible remedies? For example should they be limited to no more than the existing (pre-merger) situation? Does the substantive test affect the ease with which remedies can be sought which address the concerns but fall short of prohibition?

General

- To what extent is there already broad convergence of the analytical frameworks for merger control internationally? What are the costs of non-convergence?

ANNEXES

Annex 1: Exemplar Country Papers

- Australia
- Germany
- South Africa
- USA

Annex 2: Bibliography

Annex 3: ICN member jurisdiction matrix