ICN RECOMMENDED PRACTICES FOR MERGER ANALYSIS

I. <u>Coordinated Effects</u>

A. Merger enforcement is important to prevent the risk of coordination.

Comment 1: Merger enforcement plays an important *ex ante* role of preventing changes in market conditions that would make coordinated outcomes more likely or more effective and can be an effective tool to avert coordination. Mergers, in certain circumstances, can increase the likelihood that firms coordinate their behaviour or make existing coordination more stable or more effective.

B. Coordination can take place across any or all dimensions of competition and take many forms.

Comment 1: A merger can change market conditions to make coordination more attractive or more durable than it would be without the merger. If conditions allow, firms can coordinate on one or several dimensions of competition, such as: price; capacity; output; product features; delays in the introduction of new technologies or products; or reduced efforts on innovation or investment. Firms can also coordinate by dividing the market, for instance by geographic area or customer characteristics, or by allocating contracts in bidding markets. Such coordination effectively limits competitive interaction as if the firms had agreed not to compete. Coordination among competitors lessens competition when it occurs explicitly - through inherently unlawful collusive agreements not to compete or to compete less aggressively - or tacitly, through observation of and response to competitors' behaviour that otherwise might be lawful. Coordination among buyers for goods, services, wages, working conditions or other input factors may also in certain circumstances result in harm to competition.

Comment 2: Mergers of competitors or potential competitors ('horizontal' mergers) can increase the likelihood that the firms remaining in the market could coordinate their behaviour, by affecting their ability and/or incentive to coordinate or by making their existing coordination more stable or more effective. For example, mergers can reduce the number of market participants; increase the similarities among firms; eliminate a maverick (i.e., a firm with a disruptive presence); increase market observability of the strategies and the behaviour of market participants; create structural or commercial links between competitors such as minority shareholdings, cross-directorships or commercial agreements; reduce their incentives to innovate or invest in capacity expansion; or increase multi-market interaction.

Comment 3: Mergers between firms active in different product or geographic markets, including at different levels of the value chain ('non-horizontal' mergers), can also allow firms to coordinate their behaviour, increase possibilities to coordinate, or make their existing coordination more stable or more effective. For example, such mergers can increase similarity among firms; eliminate or materially change the incentives of a maverick; increase access to sensitive information; increase barriers to entry; increase multi-market interaction; or increase the ability to punish deviation from the coordination as a deterrent including through targeted foreclosure strategies to raise competitors' input prices.

Comment 4: In assessing whether the merger may increase the risk of coordination, agencies should conduct a holistic case-by-case assessment based on available evidence, considering that no single factor or group of few factors is determinative.

C. Agencies should assess whether conditions conducive to coordination are present.

Comment 1: A merger can raise concerns about coordinated effects even without explicit agreements among competitors or communications among them. In the case of tacit coordination, firm conduct does not rise to the level of an agreement but can still lessen competition in a particular market. Coordination need not involve all firms active in the market, include all products or customers in the market, relate to all dimensions of competition, nor lead to perfect alignment between the firms. Coordination can occur even with some degree of uncertainty about the exact terms of coordination. When assessing whether a merger changes the market conditions in a way that increases the likelihood of coordination, important factors to consider may include, but are not limited to:

- **The number of firms in a market** since it is easier to coordinate among a few firms than among many. Highly concentrated markets can be more susceptible to coordination and coordination becomes more likely when mergers increase concentration. An increase in concentration in the market may itself increase the risk of coordination. At the same time, the existence of more firms, such as a fringe of small firms, may not reduce the likelihood of coordination, for example if coordination is sustainable among a subset of firms or if small players face capacity constraints. A reduction in the number of significant players in the market may give rise to coordinated effects, particularly if other factors that make a market vulnerable to coordination are present.
- Whether the merger eliminates or changes the incentives of a **maverick**, i.e., a firm with a disruptive presence in the market that may hinder the remaining firms from coordinating. Accordingly, a merger involving a maverick or a merger that significantly changes the incentives of a remaining maverick may increase the likelihood of coordination.
- The **homogeneity of the products**, or increased homogeneity as a result of the merger, may increase the risk of coordination since the market observability is higher and it is easier to coordinate on terms such as price when competing products are substantially the same. However, firms may be able to reach a coordinated outcome even in markets with complex product characteristics or terms of trade. For instance, in a market with many differentiated products, firms may still be able to coordinate on prices by establishing simple pricing rules that reduce the complexity of coordination. Coordination can also be achieved using a homogenous input or product base as the focal point. Competitors may also use similar tools such as price algorithms or Artificial Intelligence ("AI") to support their commercial strategies, including on pricing, which may ease coordination. Moreover, if a firm's behaviour can easily be followed by competitors, it may be easier to coordinate even on a large number of prices or features.
- The **similarities of the firms** across key parameters, especially cost structures, degree of vertical integration, aligned incentives, activities in the same or other markets, or changes to similarities. However, there can be coordination between

competitors with asymmetries, including when the mechanism of coordination consists of following the market leader.

- The **degree of market observability** and access to commercially relevant information, including monitoring via public communication or common service providers, such as information concerning prices, output, capacity, identity of customers served, territories served, discounts, new product introductions, or any other competitive actions. Information exchange arrangements among market participants, such as public exchange of information through announcements or publications or private exchanges through trade associations, increase market observability. Firms may also simply follow the market leader for example by matching its prices, eliminating the need to exchange information or make public announcements.
- **Cross-shareholdings, minority interests and other structural or commercial links**, including via industry associations, that may make it easier for competitors to exchange competitively sensitive information, enhance firms' ability to coordinate or reduce their incentives to compete. Even if a transaction does not reduce the number of competitors, it may lead to coordinated effects if it creates links, such as by creating a joint venture, establishing cross-shareholdings, or resulting in common board members.
- The stability of **demand and supply conditions.** It is easier to coordinate on price when conditions are **stable and predictable** (e.g., because of frequent, regular orders) than when they are frequently changing (e.g., because of the ease of entry by new firms or frequent and significant product innovations, significant increases or decreases in demand). However, coordination may still exist including in growing or innovative markets, especially when barriers to entry are high, including coordination for example on delayed launch or reduced investments. The existence of frequent and regular orders, which increases predictability of demand and the frequency of interactions among competitors, may make it easier to coordinate.

Comment 2: Evidence that competitors have previously engaged in explicit or tacit coordination to lessen competition or that the conditions of coordination are met pre-merger, can serve as strong evidence that a market is susceptible to coordination. Even if previous attempts were not successful, a merger may tend to make coordination more likely, more stable or more effective, or remove the specific reason it failed. Past breakdowns in cooperation may also provide an indication of the firms' ability to coordinate, and these failures do not demonstrate that the merger will not increase the likelihood of more enduring cooperation in the future. However, evidence of previous coordination is not a necessary condition for finding coordinated effects.

Comment 3: Evidence of competition between some or all market participants, including in the assessment of the post-merger situation, is not inconsistent with also finding evidence of existing or likely coordination. Firms may not coordinate over all competitive parameters or in all regions, coordination may not include all firms in the market(s), and coordination may be characterised by periods during which the coordinating group competes.

Comment 4: The availability of large datasets and the use of automated algorithms, AI, and machine learning may make coordination easier, more efficient, or more prevalent.

Pricing algorithms, the use of AI and advanced analytical or surveillance tools that track or predict competitor prices or actions may significantly increase the risk of coordination between competitors and may facilitate coordination. AI or algorithms may substantially enhance market transparency and increase the frequency with which firms interact. Furthermore, the use of a common third-party advisor for algorithmic pricing may facilitate coordination.

Comment 5: The level of evidence required to show that a market is conducive to coordination post-merger depends on the legal framework. Some agencies use rebuttable structural presumptions, relying on the relationship between high market shares and concentration and the likely anticompetitive effects of a merger. For these agencies, the anticompetitive effects of a merger are presumed to follow from the change in market shares. Such agencies typically bear the burden of producing evidence that establishes a presumption that can then be rebutted by the merging firms, usually by a showing that the market shares give an inaccurate portrayal of the merger's likely effects on competition.

Comment 6: Multi-market interactions between firms increase transparency and insights into competitors' behaviour and may increase the risk of coordination. Multi-market interactions may also reduce asymmetries that arise in individual markets, when looking at the firms' aggregate activities over all different products and geographies concerned. Moreover, firms that compete in multiple markets might compete less aggressively in some markets in anticipation that others may reciprocate by competing less aggressively in other markets, thus allowing both to exchange gains from reduced competition in different markets. Rather than having to agree on a market-sharing agreement in one market that may not have obvious criteria on how to share it, the competitors have several separate markets for potential allocation among them. Therefore, agencies should understand not only whether the firms are active in the same or vertically related (geographic and product) markets, but also if they are active with the same products in different geographies, or in the same geographies with different products, as it may increase multi-market interaction and hence the risk of coordination.

Comment 7: Agencies may infer risk of coordinated behaviour from qualitative evidence, such as market characteristics, internal documents, past behaviours, or the deal rationale. The extent to which firms are or will be engaged in conduct that facilitates coordination may be discussed in a firm's internal communications (e.g. emails, collaborative spaces etc.) and strategic planning documents. For example, an executive may signal the firm's expectation of matching competitors' prices to avoid a price war. Documents justifying a price increase may disclose a price leadership strategy supported by pre-announcing prices in the expectation that others will follow. Agencies may also rely on empirical analyses, including modelling of possible price increases. Such analyses should be case-specific and may depend on the availability of relevant data and suitable methods. However, quantitative evidence is not a pre-requisite to find a risk of coordination, and any modelling can raise difficulties considering the many different methods that may be employed to reach coordinated outcomes.

D. Agencies may assess incentives of firms to follow rather than deviate from coordination, including whether participants may detect and deter deviations from coordination.

Comment 1: Although coordination may be in the collective economic interest of participants, it may be in a firm's individual interest to deviate from the terms of coordination in order to take advantage of the profit opportunity created when other firms raise their prices or otherwise coordinate their behaviour. Agencies may assess the extent to which firms would have the ability to monitor the terms of coordination and to detect and respond to deviations from the terms of coordination. A lack of explicit terms of coordination may not be determinative of a lack of coordinated effects. For some agencies the lack of the ability of firms to detect and respond to deviations may not be determinative of a lack of coordinated effects.

Comment 2: For some agencies, the assessment of whether participants may detect and deter deviations from the terms of coordination may be part of their legal framework of analysis and hence may be carried out in all cases where a coordinated effects theory of harm is assessed. Other agencies do not require an assessment of merging parties' ability to detect and deter deviations since tacit coordination can occur even when firms cannot detect and deter coordination. These agencies may assess these criteria only as necessary under their respective frameworks, e.g., when brought and substantiated by the merging parties.

Comment 3: When assessing the potential detection of deviations from the coordinated behaviour, important factors include, but are not limited to:

- The degree of **market observability** or access to information necessary to verify compliance by other firms with the terms of coordination, such as information concerning other firms' pricing, output levels, capacity, innovation, or individual transactions. The necessary information depends on the proposed terms of coordination. For example, information necessary for detecting deviation from price coordination is different from the information needed for detecting deviation from coordination based on market division. For instance, if orders for the relevant products are uniform both in terms of frequency and size, it may be difficult for a firm to deviate (by expanding its output) without being detected. Also, if there is little fluctuation in demand or costs, deviations may be easier to detect.
- If **orders for the relevant products are infrequent and large**, firms may have a greater incentive to deviate to secure orders as deviations may be very profitable and the threat of deferred punishment during the future procurement may not serve as effective deterrence.
- More **homogeneity** of products and firms may make monitoring of compliance with the terms of coordination and detection of deviations easier.

Comment 4: Coordination will be sustainable where the incentive to coordinate is higher than the incentive to deviate from the coordinated outcome for each coordinating firm. The size of the gain from deviation will depend on the characteristics of the markets. For example, the gains from deviating may be low where there is strong customer loyalty or where many customers are already committed to long-term contracts. However, in markets where customers are price sensitive, deviating with a small reduction in price could be sufficient to induce customers to switch. Anticipating the risk of a credible and effective retaliation can lower the incentive to deviate. It may take many forms, including temporary abandonment of the terms of coordination by other firms in the market reverting to competition, or targeted punishment of the deviating firm for example by offering discounts or better terms to their customers. Sanctions are especially effective if

they can harm the deviating competitor without causing high costs for the punishing firm. A targeted punishment may be more effective where contracts are not typically concluded on a long-term basis and there is little price transparency for customers. While targeted retaliation may be relatively more efficient to implement than a generalised price war, the latter can nonetheless be an effective retaliation strategy. In assessing whether firms may be able to punish a deviation by one of the firms when it is detected, and whether potential deviators can anticipate the punishment, important factors include, but are not limited to:

- The **timeliness** with which the deterrent mechanism can be implemented, given that reprisal that manifests itself after a significant time lag may be less likely to offset potential benefits from deviating.
- The **credibility and foreseeability of the deterrent mechanism**: e.g., the threat of expanding output to punish a deviating firm may not be credible or effective if coordinating firms have no or little excess capacity.

Comment 5: Some factors that increase the likelihood of strong or rapid responses to a deviation from the terms of coordination by competitors include low customer switching costs, use of algorithmic pricing, or use of meeting-competition clauses (also referred to as 'price matching' or 'most-favoured-nation (MFN) clauses'). The more predictable or observable competitors' responses to strategic actions or changing competitive conditions are, and the more interactions firms have across multiple markets, the greater the likelihood of coordination. For instance:

- The **availability of large datasets and the use of automated algorithms and AI** may increase the predictability of a competitor's responses, making it easier to infer a departure from tacit coordination.

- Retaliation need not necessarily take place in the same market as the deviation. If the coordinating firms have **multi-market interactions**, these may offer additional opportunities for retaliation and punishing deviations from a coordinated scheme, and thus make deviations less likely.

Comment 6: Agencies can infer the incentives not to deviate from coordination from qualitative evidence, such as market characteristics, internal documents, past behaviours, or the deal rationale. It is rarely possible to quantify the incentives of competitors to adhere to, rather than deviate from, the terms of coordination.

E. In conducting coordinated effects analysis, agencies may assess the extent to which existing competitive constraints and other factors may deter or disrupt coordination.

Comment 1: For some agencies, the assessment of whether existing competitive constraints or other factors may deter or disrupt coordination may be part of their legal framework of analysis and hence may be carried out in all cases where a coordinated effects theory of harm is assessed. Other agencies may assess these criteria only as necessary under their respective frameworks, e.g., when brought and substantiated by the merging parties. In making this assessment, agencies should consider all available evidence, including the pre-merger market conditions that may constrain or facilitate coordination, and the impact of the merger on these conditions

Comment 2: Agencies may consider evidence suggesting that competitive constraints or other market conditions that will remain in the post-merger market may prevent coordination. If the coordination does not concern all the market participants, agencies may consider the degree of market power exerted collectively by the firms that are part of the coordination. Given that coordination becomes more likely as concentration increases, it is rare for factors that deter or disrupt coordination to prevent coordination in concentrated markets that are prone to coordination.

Comment 3: Actions of competitors not expected to participate in the coordination, the presence of a remaining maverick with sufficient disruptive incentives, or of potential competitors whose entry or competitive constraints are sufficient in time, scope, and likelihood may jeopardise coordination. For instance, the existence of competitors with the ability to expand output to take sales from coordinating firms may deter or disrupt coordination. Detailed guidance on how to assess potential entry and expansion can be found in the Merger Analysis Recommended Practices [VII] on Entry and Expansion. The presence of competitors, mavericks, and potential competitors, however, only reduces the risk of coordination so long as these market participants retain incentives to deviate from coordination and the ability to effectively discipline other market participants after the merger is completed. A merger that eliminates a maverick, competitor, or potential competitors or significantly changes its incentives increases the susceptibility of a market to coordination.

Comment 4: Agencies may also consider efficiencies and conduct a failing firm assessment in line with the framework set out in the respective Recommended Practices related to these matters.