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**The headings that are both centred and in italics are by Val Korah, the others are part of the guidelines, I have also italicised key words in various paragraphs and deleted footnotes for ease of reading.**

## **Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings**

(2004/C 31/03)

### **I. INTRODUCTION**

#### *Merger regulation*

1. *Article 2 of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings*<sup>1</sup> (hereinafter: the ‘Merger Regulation’) provides that the *Commission has to appraise concentrations* within the scope of the Merger Regulation with a view to establishing whether or not they are compatible with the common market. For that purpose, the *Commission must assess, pursuant to Article 2(2) and (3), whether or not a concentration would significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position*, in the common market or a substantial part of it.

#### *Creation of dominant position under former regulation*

2. Accordingly, the Commission must take into account any *significant impediment to effective competition* likely to be caused by a concentration. The *creation or the strengthening of a dominant position is a primary form of such competitive harm*. The

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<sup>1</sup> Council Regulation (EC) No 139/2004 of 20 January 2004 (OJ L 24, 29.1.2004, p. 1).

concept of dominance was defined in the context of Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (hereinafter ‘Regulation No 4064/89’) as:

‘a situation where one or more undertakings wield economic power which would enable them to prevent effective competition from being maintained in the relevant market by giving them the opportunity to act to a considerable extent independently of their competitors, their customers and, ultimately, of consumers’<sup>2</sup>.

*Dominance under current regulation*

3. For the purpose of interpreting the concept of dominance in the context of Regulation No 4064/89, the Court of Justice referred to the fact that it ‘is intended to apply to all concentrations with a Community dimension insofar as they are likely, because of *their effect on the structure of competition* within the Community, to prove incompatible with the *system of undistorted competition* envisaged by the Treaty’<sup>3</sup>.

*Indication of competitive harm – single or collective dominance*

4. The creation or strengthening of a dominant position held by *a single firm* as a result of a merger has been the *most common basis* for finding that a concentration would result in a significant impediment to effective competition. Furthermore, the concept of dominance *has also been applied in an oligopolistic setting to cases of collective dominance*. As a consequence, it is expected that most cases of incompatibility of a concentration with the common market will continue to be based upon a finding of *dominance*. That concept therefore provides *an important indication as to the standard of competitive harm* that is applicable when determining whether a concentration is likely to impede effective competition to a significant degree, and hence, as to the likelihood of intervention<sup>4</sup>. To that effect, the present notice is intended to preserve the guidance that can be drawn from past decisional practice and to take full account of past case-law of the Community Courts

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<sup>2</sup> Case T-102/96, Gencor v Commission, [1999] ECR II-753, paragraph 200. See Joined Cases C-68/94 and C-30/95, France and others v Commission (hereinafter ‘Kali and Salz’), [1998] ECR I-1375, paragraph 221. In exceptional circumstances, a merger may give rise to the creation or the strengthening of a dominant position on the part of an undertaking which is not a party to the notified transaction (see Case IV/M.1383 — Exxon/Mobil, points 225-229; Case COMP/M.2434 — Grupo Villar MIR/EnBW/Hidroeléctrica del Cantabrico, points 67-71).

<sup>3</sup> See also Joined Cases C-68/94 and C-30/95, Kali and Salz, paragraph 170.

<sup>4</sup> See Recitals 25 and 26 of the Merger Regulation.

*Actual or potential competitors*

5. The purpose of this notice is to provide guidance as to *how the Commission assesses concentrations*<sup>5</sup> when the undertakings concerned are actual or potential competitors on the same relevant market<sup>6</sup>. In this notice such mergers will be denoted '*horizontal mergers*'. While *the notice presents the analytical approach* used by the Commission in its appraisal of horizontal mergers it cannot provide details of all possible applications of this approach. The Commission applies the approach described in the notice to the particular facts and circumstances of each case.

*Commission's evolving experience and judgments of ECJ and CFI*

6. The guidance set out in this notice draws and elaborates on *the Commission's evolving experience with the appraisal of horizontal mergers* under Regulation No 4064/89 since its entry into force on 21 September 1990 as well as on the case-law of the Court of Justice and the Court of First Instance of the European Communities. The principles contained here will be applied and further developed and refined by the Commission in individual cases. The *Commission may revise this notice* from time to time in the light of future developments.

*Subject to ECJ and CFI*

7. The Commission's interpretation of the Merger Regulation as regards the appraisal of horizontal mergers is without prejudice to the interpretation which may be given by the Court of Justice or the Court of First Instance of the European Communities.

**II. OVERVIEW***Benefits of competition*

8. Effective competition brings *benefits to consumers*, such as low prices, high quality products, a wide selection of goods and services, and innovation. Through its control of mergers, the *Commission prevents mergers* that would be *likely to deprive customers of these benefits by significantly increasing the market power of firms*. By

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<sup>5</sup> The term 'concentration' used in the Merger Regulation covers various types of transactions such as mergers, acquisitions, takeovers, and certain types of joint ventures. In the remainder of this notice, unless otherwise specified, the term 'merger' will be used as a synonym for concentration and therefore cover all the above types of transactions.

<sup>6</sup> The notice does not cover the assessment of the effects of competition that a merger has in other markets, including vertical and conglomerate effects. Nor does it cover the assessment of the effects of a joint venture as referred to in Article 2(4) of the Merger Regulation.

*‘increased market power’ is meant the ability of one or more firms to profitably increase prices, reduce output, choice or quality of goods and services, diminish innovation, or otherwise influence parameters of competition. In this notice, the expression ‘increased prices’ is often used as shorthand for these various ways in which a merger may result in competitive harm<sup>7</sup>. Both suppliers and buyers can have market power. However, for clarity, market power will usually refer here to a supplier's market power. Where a buyer's market power is the issue, the term ‘buyer power’ is employed.*

#### *Counterfactual*

9. In assessing the competitive effects of a merger, the *Commission compares the competitive conditions that would result from the notified merger with the conditions that would have prevailed without the merger*<sup>8</sup>. In most cases the competitive conditions existing at the time of the merger constitute the relevant comparison for evaluating the effects of a merger. However, in some circumstances, the Commission may take into account future changes to the market that can reasonably be predicted<sup>9</sup>. It may, in particular, *take account of the likely entry or exit of firms if the merger did not take place when considering what constitutes the relevant comparison*<sup>10</sup>.

#### *Assessment – market definition*

10. The Commission's assessment of mergers normally entails:

- (a) *Definition of the relevant product and geographic markets;*
- (b) *Competitive assessment of the merger.*

*The main purpose of market definition is to identify in a systematic way the immediate competitive constraints facing the merged entity. Guidance on this issue can be found in the Commission's Notice on the definition of the relevant market for the purposes of*

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<sup>7</sup> The expression should be understood to also cover situations where, for instance, prices are decreased less, or are less likely to decrease, than they otherwise would have without the merger and where prices are increased more, or are more likely to increase, than they otherwise would have without the merger.

<sup>8</sup> By analogy, in the case of a merger that has been implemented without having been notified, the Commission would assess the merger in the light of the competitive conditions that would have prevailed without the implemented merger.

<sup>9</sup> See, e.g. Commission Decision 98/526/EC in Case IV/M.950 — Hoffmann La Roche/Boehringer Mannheim, OJ L 234, 21.8.1998, p. 14, point 13; Case IV/M.1846 — Glaxo Wellcome/SmithKline Beecham, points 70-72; Case COMP/M.2547 — Bayer/Aventis Crop Science, points 324 et seq.

<sup>10</sup> See, e.g. Case T-102/96, Gencor v Commission, [1999] ECR II-753, paragraphs 247-263.

Community competition law (CB 98)<sup>11</sup>. Various considerations leading to the delineation of the relevant markets may also be of importance for the competitive assessment of the merger.

*Elements of appraisal considered in notice*

11. This notice is structured around the following elements:
  - (a) The approach of the Commission to *market shares and concentration thresholds* (Section III).
  - (b) The likelihood that a merger would have *anticompetitive effects* in the relevant markets, in the *absence of countervailing factors* (Section IV).
  - (c) The likelihood that *buyer power* would act as a countervailing factor to an increase in market power resulting from the merger (Section V).
  - (d) The likelihood that *entry* would maintain effective competition in the relevant markets (Section VI).
  - (e) The likelihood that *efficiencies* would act as a factor counteracting the harmful effects on competition which might otherwise result from the merger (Section VII).
  - (f) The conditions for a *failing firm defence* (Section VIII).

*Possible anti-competitive effects – countervailing factors*

12. In order to assess the foreseeable impact<sup>12</sup> of a merger on the relevant markets, the Commission analyses its possible anti-competitive effects and the relevant countervailing factors such as *buyer power*, the extent of *entry barriers* and *possible efficiencies* put forward by the parties. In exceptional circumstances, the Commission considers whether the conditions for a *failing firm defence* are met.
13. In the light of these elements, the Commission determines, pursuant to Article 2 of the Merger Regulation, whether the merger would significantly impede effective competition, in particular through the creation or the strengthening of a dominant

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<sup>11</sup> OJ C 372, 9.12.1997, p. 5.

<sup>12</sup> See Case T-102/96, *Gencor v Commission*, [1999] ECR II-753, paragraph 262, and Case T-342/99, *Airtours v Commission*, [2002] ECR II-2585, paragraph 280.

position, and should therefore be declared incompatible with the common market. It should be stressed that *these factors are not a 'checklist' to be mechanically applied in each and every case*. Rather, the competitive analysis in a particular case will be based on an overall assessment of the foreseeable impact of the merger in the light of the relevant factors and conditions. Not all the elements will always be relevant to each and every horizontal merger, and it may not be necessary to analyse all the elements of a case in the same detail.

### III. MARKET SHARE AND CONCENTRATION LEVELS

#### *First indication*

14. Market shares and concentration levels provide useful first indications of the market structure and of the *competitive importance of both the merging parties and their competitors*.

#### Market shares

15. *Normally, the Commission uses current market shares in its competitive analysis*<sup>13</sup>. However, *current market shares may be adjusted to reflect reasonably certain future changes, for instance in the light of exit, entry or expansion*<sup>14</sup>. *Post-merger market shares are calculated on the assumption that the post-merger combined market share of the merging parties is the sum of their pre-merger market shares*<sup>15</sup>. *Historic data may be used if market shares have been volatile, for instance when the market is characterised by large, lumpy orders*. Changes in historic market shares may provide useful information about the competitive process and the likely future importance of the various competitors, for instance, by indicating whether firms have been gaining or losing market shares. In any event, the *Commission interprets market shares in the*

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<sup>13</sup> As to the calculation of market shares, see also Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997, p. 3, paragraphs 54-55.

<sup>14</sup> See, e.g. Case COMP/M.1806 — Astra Zeneca/Novartis, points 150 and 415.

<sup>15</sup> When relevant, market shares may be adjusted, in particular, to account for controlling interests in other firms (See, e.g. Case IV/M.1383 — Exxon/Mobil, points 446-458; Case COMP/M.1879 — Boeing/Hughes, points 60-79; Case COMP/JV 55 — Hutchison/RCPM/ECT, points 66-75), or for other arrangements with third parties (See, for instance, as regards sub-contractors, Commission Decision 2001/769/EC in Case COMP/M.1940 — Framatome/Siemens/Cogema, OJ L 289, 6.11.2001, p. 8, point 142).

*light of likely market conditions, for instance, if the market is highly dynamic in character and if the market structure is unstable due to innovation or growth*<sup>16</sup>.

### *HHI concentration ratios*

16. *The overall concentration level in a market may also provide useful information about the competitive situation. In order to measure concentration levels, the Commission often applies the Herfindahl-Hirschman Index (HHI)*<sup>17</sup>. The HHI is calculated by summing the squares of the individual market shares of all the firms in the market<sup>18</sup>. The HHI gives proportionately greater weight to the market shares of the larger firms. Although it is best to include all firms in the calculation, lack of information about very small firms may not be important because such firms do not affect the HHI significantly. While the absolute level of the HHI can give an initial indication of the competitive pressure in the market post-merger, the change in the HHI (known as the ‘delta’) is a useful proxy for the change in concentration directly brought about by the merger<sup>19</sup>.

### **Market share levels**

17. According to well-established case law, *very large market shares — 50 % or more — may in themselves be evidence of the existence of a dominant market position*<sup>20</sup>. However, smaller competitors may act as a sufficient constraining influence if, for example, they have the ability and incentive to increase their supplies. A merger involving a firm whose market share will remain below 50 % after the merger may also raise competition concerns in view of other factors such as the strength and

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<sup>16</sup> See, e.g. Case COMP/M.2256 — Philips/Agilent Health Care Technologies, points 31-32, and Case COMP/M.2609 — HP/Compaq, point 39.

<sup>17</sup> See, e.g. Case IV/M.1365 — FCC/Vivendi, point 40; Case COMP/JV 55 — Hutchison/RCPM/ECT, point 50. If appropriate, the Commission may also use other concentration measures such as, for instance, concentration ratios, which measure the aggregate market share of a small number (usually three or four) of the leading firms in a market.

<sup>18</sup> For example, a market containing five firms with market shares of 40 %, 20 %, 15 %, 15 %, and 10 %, respectively, has an HHI of 2 550 ( $40^2 + 20^2 + 15^2 + 15^2 + 10^2 = 2 550$ ). The HHI ranges from close to zero (in an atomistic market) to 10 000 (in the case of a pure monopoly).

<sup>19</sup> The increase in concentration as measured by the HHI can be calculated independently of the overall market concentration by doubling the product of the market shares of the merging firms. For example, a merger of two firms with market shares of 30 % and 15 % respectively would increase the HHI by 900 ( $30 \times 15 \times 2 = 900$ ). The explanation for this technique is as follows: Before the merger, the market shares of the merging firms contribute to the HHI by their squares individually:  $(a)^2 + (b)^2$ . After the merger, the contribution is the square of their sum:  $(a + b)^2$ , which equals  $(a)^2 + (b)^2 + 2ab$ . The increase in the HHI is therefore represented by  $2ab$ .

<sup>20</sup> Case T-221/95, Endemol v Commission, [1999] ECR II-1299, paragraph 134, and Case T-102/96, Gencor v Commission, [1999] ECR II-753, paragraph 205. It is a distinct question whether a dominant position is created or strengthened as a result of the merger.

number of competitors, the presence of capacity constraints or the extent to which the products of the merging parties are close substitutes. The Commission has thus in several cases considered mergers resulting in firms holding market shares between 40 % and 50 %<sup>21</sup>, and in some cases below 40 %<sup>22</sup>, to lead to the creation or the strengthening of a dominant position.

*Fairly safe harbour up to 25%*

18. 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 81 and 82 of the Treaty, an indication to this effect exists, in particular, where the market share of the undertakings concerned does not exceed 25 %<sup>23</sup> either in the common market or in a substantial part of it<sup>24</sup>.

**HHI levels**

*Post merger HHI under 1000*

19. The Commission is unlikely to identify horizontal competition concerns in a market with a post-merger HHI below 1 000. Such markets normally do not require extensive analysis.

*Special circumstances*

20. The Commission is also *unlikely to identify horizontal competition concerns* in a merger with a *post-merger HHI between 1 000 and 2 000 and a delta below 250*, or a merger with a post-merger HHI above 2 000 and a delta below 150, except where special circumstances such as, for instance, one or more of the following factors are present:

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<sup>21</sup> See, e.g. Case COMP/M.2337 — Nestlé/Ralston Purina, points 48-50.

<sup>22</sup> See, e.g. Commission Decision 1999/674/EC in Case IV/M.1221 — Rewe/Meinl, OJ L 274, 23.10.1999, p. 1, points 98-114; Case COMP/M.2337 — Nestlé/Ralston Purina, points 44-47.

<sup>23</sup> The calculation of market shares depends critically on market definition. It must be emphasised that the Commission does not necessarily accept the parties' proposed market definition.

<sup>24</sup> Recital 32 of the Merger Regulation. However, such an indication does not apply to cases where the proposed merger creates or strengthens a collective dominant position involving the 'undertakings concerned' and other third parties (see Joined Cases C-68/94 and C-30/95, Kali and Salz, [1998] ECR I-1375, paragraphs 171 et seq.; and Case T-102/96, Gencor v Commission, [1999] ECR II-753, paragraphs 134 et seq.).

- (a) A merger involves *a potential entrant or a recent entrant with a small market share*;
- (b) One or more merging parties are *important innovators* in ways not reflected in market shares;
- (c) There are significant *cross-shareholdings* among the market participants<sup>25</sup>;
- (d) One of the merging firms is *a maverick* firm with a high likelihood of disrupting coordinated conduct;
- (e) Indications of past or *ongoing coordination, or facilitating practices*, are present;
- (f) *One* of the merging parties has a pre-merger *market share of 50 % or more*<sup>26</sup>.

*Use HHI only as initial indicator*

21. Each of these HHI levels, in combination with the relevant deltas, may be used as an initial indicator of the absence of competition concerns. However, they do *not give rise to a presumption* of either the existence or the absence of such concerns.

#### IV. POSSIBLE ANTI-COMPETITIVE EFFECTS OF HORIZONTAL MERGERS

22. There are two main ways in which horizontal mergers may significantly impede effective competition, in particular by creating or strengthening a dominant position:

*Unilateral effects*

- (a) *by eliminating important competitive constraints* on one or more firms, which consequently would have increased market power, without resorting to coordinated behaviour (non-coordinated effects);

*Co-ordinated effects = Tacit collusion*

- (b) *by changing the nature of competition* in such a way that firms that previously were not coordinating their behaviour, are *now significantly more likely to coordinate and raise prices or otherwise harm effective competition*. A merger

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<sup>25</sup> In markets with cross-shareholdings or joint ventures the Commission may use a modified HHI, which takes into account such share-holdings (see, e.g. Case IV/M.1383 — Exxon/Mobil, point 256).

<sup>26</sup> See paragraph 17.

*may also make coordination easier, more stable or more effective for firms which were coordinating prior to the merger (coordinated effects).*

*Unilateral and co-ordinated effects both relevant*

23. The Commission assesses whether the changes brought about by the merger would result in any of these effects. Both instances mentioned above may be relevant when assessing a particular transaction.

**Non-coordinated effects<sup>27</sup>**

24. A merger may significantly impede effective competition in a market by removing important competitive constraints on one or more sellers, who consequently have increased market power. The most direct effect of the merger will be the *loss of competition between the merging firms*. For example, if prior to the merger one of the merging firms had raised its price, it would have lost some sales to the other merging firm. The merger removes this particular constraint. *Non-merging firms in the same market can also benefit from the reduction of competitive pressure* that results from the merger, since the merging firms' price increase may switch some demand to the rival firms, which, in turn, may find it profitable to increase their prices<sup>28</sup>. The reduction in these competitive constraints *could lead to significant price increases* in the relevant market.

*Unilateral effects*

25. *Generally*, a merger giving rise to such non-coordinated effects would *significantly impede effective competition by creating or strengthening the dominant position of a single firm*, one which, *typically*, would have an *appreciably* larger market share than the next competitor post-merger. Furthermore, *mergers in oligopolistic markets<sup>29</sup> involving the elimination of important competitive constraints that the merging*

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<sup>27</sup> Also often called 'unilateral' effects.

<sup>28</sup> Such expected reactions by competitors may be a relevant factor influencing the merged entity's incentives to increase prices.

<sup>29</sup> An oligopolistic market refers to a market structure with a limited number of sizeable firms. Because the behaviour of one firm has an appreciable impact on the overall market conditions, and thus indirectly on the situation of each of the other firms, oligopolistic firms are interdependent.

*parties previously exerted upon each other together with a reduction of competitive pressure on the remaining competitors may, even where there is little likelihood of coordination between the members of the oligopoly, also result in a significant impediment to competition.* The Merger Regulation clarifies that all mergers giving rise to such non-coordinated effects shall also be declared incompatible with the common market<sup>30</sup>.

#### *Multiple effects*

26. *A number of factors, which taken separately are not necessarily decisive, may influence whether significant non-coordinated effects are likely to result from a merger. Not all of these factors need to be present for such effects to be likely. Nor should this be considered an exhaustive list.*

#### Merging firms have large market shares

27. *The larger the market share, the more likely a firm is to possess market power. And the larger the addition of market share, the more likely it is that a merger will lead to a significant increase in market power. The larger the increase in the sales base on which to enjoy higher margins after a price increase, the more likely it is that the merging firms will find such a price increase profitable despite the accompanying reduction in output. Although market shares and additions of market shares only provide first indications of market power and increases in market power, they are normally important factors in the assessment<sup>31</sup>.*

#### Merging firms are close competitors

28. *Products may be differentiated<sup>32</sup> within a relevant market such that some products are closer substitutes than others<sup>33</sup>. The higher the degree of substitutability between the merging firms' products, the more likely it is that the merging firms will raise prices*

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<sup>30</sup> Recital 25 of the Merger Regulation.

<sup>31</sup> See, in particular, paragraphs 17 and 18.

<sup>32</sup> Products may be differentiated in various ways. There may, for example, be differentiation in terms of geographic location, based on branch or stores location; location matters for retail distribution, banks, travel agencies, or petrol stations. Likewise, differentiation may be based on brand image, technical specifications, quality or level of service. The level of advertising in a market may be an indicator of the firms' effort to differentiate their products. For other products, buyers may have to incur switching costs to use a competitor's product.

<sup>33</sup> For the definition of the relevant market, see the Commission's Notice on the definition of the relevant market for the purposes of Community competition law, cited above.

*significantly*<sup>34</sup>. For example, a merger between two producers offering products which a substantial number of customers regard as their first and second choices could generate a significant price increase. Thus, the fact that rivalry between the parties has been an important source of competition on the market may be a central factor in the analysis<sup>35</sup>. High pre-merger margins<sup>36</sup> may also make significant price increases more likely. The merging firms' incentive to raise prices is more likely to be constrained when rival firms produce close substitutes to the products of the merging firms than when they offer less close substitutes<sup>37</sup>. It is therefore less likely that a merger will significantly impede effective competition, in particular through the creation or strengthening of a dominant position, when there is a high degree of substitutability between the products of the merging firms and those supplied by rival producers.

#### *Degree of substitutability*

29. *When data are available, the degree of substitutability may be evaluated through customer preference surveys, analysis of purchasing patterns, estimation of the cross-price elasticities of the products involved*<sup>38</sup>, *or diversion ratios*<sup>39</sup>. *In bidding markets it may be possible to measure whether historically the submitted bids by one of the merging parties have been constrained by the presence of the other merging party*<sup>40</sup>.

#### *Possibility of repositioning or extending product line*

30. In some markets it may be relatively easy and not too costly for the active firms to reposition their products or extend their product portfolio. In particular, the

<sup>34</sup> See for example Case COMP/M.2817 — Barilla/BPS/Kamps, point 34; Commission Decision 2001/403/EC in Case COMP/M.1672 — Volvo/ Scania, OJ L 143, 29.5.2001, p. 74, points 107-148.

<sup>35</sup> See, e.g. Commission Decision 94/893/EC in Case IV/M.430 — Procter & Gamble/VP Schickedanz (II), OJ L 354, 21.6.1994, p. 32, Case T-290/94, Kaysersberg v Commission, [1997] II-2137, paragraph 153; Commission Decision 97/610/EC in Case IV/M.774 — Saint-Gobain/ Wacker-Chemie/NOM, OJ L 247, 10.9.1997, p. 1, point 179; Commission Decision 2002/156/EC in Case COMP/M.2097 — SCA/Metsä Tissue, OJ L 57, 27.2.2002, p. 1, points 94-108; Case T-310/01, Schneider v Commission, [2002] II-4071, paragraph 418.

<sup>36</sup> Typically, the relevant margin (m) is the difference between price (p) and the incremental cost (c) of supplying one more unit of output expressed as a percentage of price ( $m = (p - c)/p$ ).

<sup>37</sup> See, e.g. Case IV/M.1980 — Volvo/Renault VI, point 34; Case COMP/M.2256 — Philips Agilent/Health Care Solutions, points 33-35; Case COMP/M.2537 — Philips/Marconi Medical Systems, points 31-34.

<sup>38</sup> The cross-price elasticity of demand measures the extent to which the quantity of a product demanded changes in response to a change in the price of some other product, all other things remaining equal. The own-price elasticity measures the extent to which demand for a product changes in response to the change in the price of the product itself.

<sup>39</sup> The diversion ratio from product A to product B measures the proportion of the sales of product A lost due to a price increase of A that are captured by product B.

<sup>40</sup> Commission Decision 97/816/EC in Case IV/M.877 — Boeing/McDonnell Douglas, OJ L 336, 8.12.1997, p. 16, points 58 et seq.; Case COMP/M.3083 — GE/Instrumentarium, points 125 et seq.

Commission examines whether the possibility of repositioning or product line extension by competitors or the merging parties may influence the incentive of the merged entity to raise prices. However, product repositioning or product line extension often entails risks and large sunk costs<sup>41</sup> and may be less profitable than the current line.

Customers have limited possibilities of switching supplier

31. Customers of the merging parties may have difficulties switching to other suppliers because there are *few alternative suppliers*<sup>42</sup> or because they *face substantial switching costs*<sup>43</sup>. Such customers are particularly vulnerable to price increases. The merger may affect these customers' ability to protect themselves against price increases. In particular, this may be the case *for customers that have used dual sourcing from the two merging firms as a means of obtaining competitive prices. Evidence of past customer switching patterns and reactions to price changes may provide important information in this respect.*

Competitors are unlikely to increase supply if prices increase

32. When market conditions are such that the competitors of the merging parties are unlikely to increase their supply substantially if prices increase, the *merging firms may have an incentive to reduce output below the combined pre-merger levels, thereby raising market prices*<sup>44</sup>. The merger increases the incentive to reduce output by giving the merged firm a larger base of sales on which to enjoy the higher margins resulting from an increase in prices induced by the output reduction.

*Rivals' capacity to expand when prices rise*

33. Conversely, when market conditions are such that rival firms have enough capacity and find it profitable to expand output sufficiently, the *Commission is unlikely to find that the merger will create or strengthen a dominant position or otherwise significantly impede effective competition.*

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<sup>41</sup> Sunk costs are costs which are unrecoverable upon exit from the market.

<sup>42</sup> See e.g. Commission Decision 2002/156/EC in Case IV/M.877 — Boeing/McDonnell Douglas, OJ L 336, 8.12.1997, p. 16, point 70.

<sup>43</sup> See, e.g. Case IV/M. 986 — Agfa Gevaert/DuPont, OJ L 211, 29.7.1998, p. 22, points 63-71.

<sup>44</sup> See, e.g. Case COMP/M.2187 — CVC/Lenzing, points 162-170.

*Rivals' capacity constraints*

34. Such output expansion is, in particular, unlikely when *competitors face binding capacity constraints and the expansion of capacity is costly*<sup>45</sup> or if existing excess capacity is significantly more costly to operate than capacity currently in use.

*Homogenous and differentiated products*

35. Although capacity constraints are *more likely to be important when goods are relatively homogeneous*, they may also be important where firms offer differentiated products.

## Merged entity able to hinder expansion by competitors

36. Some proposed mergers would, if allowed to proceed, *significantly impede effective competition* by leaving the merged firm in a position where it would have *the ability and incentive to make the expansion of smaller firms and potential competitors more difficult* or *otherwise restrict the ability of rival firms to compete*. In such a case, competitors may not, either individually or in the aggregate, be in a position to constrain the merged entity to such a degree that it would not increase prices or take other actions detrimental to competition. For instance, the *merged entity may have such a degree of control, or influence over, the supply of inputs*<sup>46</sup> or *distribution possibilities*<sup>47</sup> that expansion or entry by rival firms may be more costly. Similarly, the merged entity's *control over patents*<sup>48</sup> or *other types of intellectual property (e.g. brands*<sup>49</sup>) may make expansion or entry by rivals more difficult. In markets where interoperability between different infrastructures or platforms is important<sup>50</sup>, a merger may give the merged entity the ability and incentive to raise the costs or decrease the

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<sup>45</sup> When analysing the possible expansion of capacity by rivals, the Commission considers factors similar to those described in Section VI on entry. See, e.g. Case COMP/M.2187 — CVC/Lenzing, points 162-173.

<sup>46</sup> See, e.g. Case T-221/95, Endemol v Commission, [1999] ECR II-1299, paragraph 167.

<sup>47</sup> See, e.g. Case T-22/97, Kesko v Commission, [1999], ECR II-3775, paragraphs 141 et seq.

<sup>48</sup> See, e.g. Commission Decision 2001/684/EC in Case M.1671 — Dow Chemical/Union Carbide OJ L 245, 14.9.2001, p. 1, points 107-114.

<sup>49</sup> See, e.g. Commission Decision 96/435/EC in Case IV/M.623 — Kimberly-Clark/Scott, OJ L 183, 23.7.1996, p. 1; Case T-114/02, BabyliSS SA v Commission ('Seb/Moulinex'), [2003] ECR II-000, paragraphs 343 et seq.

<sup>50</sup> This is, for example, the case in network industries such as energy, telecommunications and other communication industries.

quality of service of its rivals<sup>51</sup>. In making this assessment the Commission may take into account, *inter alia*, the financial strength of the merged entity relative to its rivals<sup>52</sup>.

Merger eliminates an important competitive force

37. Some firms have more of an influence on the competitive process than their market shares or similar measures would suggest. A merger involving such a firm may change the competitive dynamics in a significant, anticompetitive way, in particular when the market is already concentrated<sup>53</sup>. For instance, a firm may be a recent entrant that is expected to exert significant competitive pressure in the future on the other firms in the market.

#### *Innovation*

38. In markets where innovation is an important competitive force, a merger may increase the *firms' ability and incentive to bring new innovations* to the market and, thereby, the *competitive pressure on rivals to innovate* in that market. Alternatively, effective competition may be significantly impeded by a *merger between two important innovators*, for instance between two companies with 'pipeline' products related to a specific product market. Similarly, a firm with a relatively small market share may nevertheless be an important competitive force if it has promising pipeline products<sup>54</sup>.

#### **Coordinated effects**

##### *Collective dominant position – tacit collusion*

39. *In some markets the structure may be such that firms would consider it possible, economically rational, and hence preferable, to adopt on a sustainable basis a course of action on the market aimed at selling at increased prices. A merger in a concentrated market may significantly impede effective competition, through the*

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<sup>51</sup> Commission Decision 99/287/EC in Case IV/M.1069 — Worldcom/MCI, OJ L 116, 4.5.1999, p. 1, points 117 et seq.; Case IV/M.1741 — MCI Worldcom/Sprint, points 145 et seq.; Case IV/M.1795 — Vodafone Airtouch/Mannesmann, points 44 et seq.

<sup>52</sup> Case T-156/98 RJB Mining v Commission [2001] ECR II-337.

<sup>53</sup> Commission Decision 2002/156/EC in Case IV/M.877 — Boeing/McDonnell Douglas, OJ L 336, 8.12.1997, p. 16, point 58; Case COMP/M.2568 — Haniel/Ytong, point 126.

<sup>54</sup> For an example of pipeline products of one merging party likely to compete with the other party's pipeline or existing products, see, e.g. Case IV/M.1846 — Glaxo Wellcome/SmithKline Beecham, point 188.

*creation or the strengthening of a collective dominant position*, because it increases the likelihood that firms are able to coordinate their behaviour in this way and raise prices, even without entering into an agreement or resorting to a concerted practice within the meaning of Article 81 of the Treaty<sup>55</sup>. A merger may also make coordination easier, more stable or more effective for firms that were already coordinating before the merger, either by making the coordination more robust or by permitting firms to coordinate on even higher prices.

#### *Forms of coordination*

40. Coordination may take various forms. In some markets, *the most likely coordination may involve keeping prices above the competitive level*. In other markets, *coordination may aim at limiting production or the amount of new capacity brought to the market*. Firms may also *coordinate by dividing the market*, for instance by geographic area<sup>56</sup> or other customer characteristics, or by *allocating contracts in bidding markets*.

#### *Conditions for coordination*

41. *Coordination is more likely to emerge in markets where it is relatively simple to reach a common understanding on the terms of coordination*. In addition, *three conditions are necessary for coordination to be sustainable*. First, the coordinating firms must be *able to monitor* to a sufficient degree whether the terms of coordination are being adhered to. Second, *discipline requires that there is some form of credible deterrent mechanism that can be activated if deviation is detected*. Third, the *reactions of outsiders*, such as current and future competitors not participating in the coordination, as well as customers, should not be able to jeopardise the results expected from the coordination<sup>57</sup>.

#### *Whether parties can agree on terms of coordination & sustain it*

42. The Commission examines *whether it would be possible to reach terms of coordination and whether the coordination is likely to be sustainable*. In this respect,

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<sup>55</sup> Case T-102/96, *Gencor v Commission*, [1999] ECR II-753, paragraph 277; Case T-342/99, *Airtours v Commission*, [2002] ECR II-2585, paragraph 61.

<sup>56</sup> This may be the case if the oligopolists have tended to concentrate their sales in different areas for historic reasons.

<sup>57</sup> Case T-342/99, *Airtours v Commission*, [2002] ECR II-2585, paragraph 62.

the Commission considers the changes that the merger brings about. The *reduction in the number of firms in a market* may, in itself, be a *factor that facilitates coordination*. However, a merger *may also increase the likelihood or significance of coordinated effects in other ways*. For instance, a merger *may involve a 'maverick' firm* that has a history of preventing or disrupting coordination, for example by failing to follow price increases by its competitors, or has characteristics that gives it an incentive to favour different strategic choices than its coordinating competitors would prefer. If the merged firm were to adopt strategies similar to those of other competitors, the remaining firms would find it easier to coordinate, and the merger would increase the likelihood, stability or effectiveness of coordination.

#### *Structure of market and past behaviour of firms*

43. In *assessing the likelihood of coordinated effects*, the Commission takes into account all available relevant information on the characteristics of the markets concerned, *including both structural features and the past behaviour of firms*<sup>58</sup>. Evidence of past coordination is important if the relevant market characteristics have not changed appreciably or are not likely to do so in the near future<sup>59</sup>. Likewise, evidence of coordination in similar markets may be useful information.

#### Reaching terms of coordination

44. Coordination is more likely to emerge *if competitors can easily arrive at a common perception* as to how the coordination should work. Coordinating firms should have *similar views regarding which actions would be considered to be in accordance with the aligned behaviour and which actions would not*.

#### *Relevant factors*

45. Generally, *the less complex and the more stable the economic environment, the easier it is* for the firms to reach a common understanding on the terms of coordination. For instance, it is easier to coordinate among a few players than among many. It is also easier to coordinate on a price for a single, homogeneous product, than on hundreds of prices in a market with many differentiated products. Similarly, it is *easier to*

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<sup>58</sup> See Commission Decision 92/553/EC in Case IV/M.190 — Nestlé/Perrier, OJ L 356, 5.12.1992, p. 1, points 117-118.

<sup>59</sup> See, e.g. Case IV/M.580 — ABB/Daimler-Benz, point 95.

*coordinate on a price when demand and supply conditions are relatively stable* than when they are continuously changing<sup>60</sup>. In this context volatile demand, substantial internal growth by some firms in the market or frequent entry by new firms may indicate that the current situation is not sufficiently stable to make coordination likely<sup>61</sup>. In markets *where innovation is important*, coordination may be more difficult since innovations, particularly significant ones, may allow one firm to gain a major advantage over its rivals.

#### *Market allocation*

46. *Coordination by way of market division* will be easier if customers have simple characteristics that allow the coordinating firms to readily allocate them. Such characteristics may be based on geography; on customer type or simply on the existence of customers who typically buy from one specific firm. Coordination by way of market division may be relatively straightforward if it is easy to identify each customer's supplier and the coordination device is the allocation of existing customers to their incumbent supplier.

#### *Ways of simplifying coordination*

47. Coordinating firms may, however, *find other ways to overcome problems stemming from complex economic environments short of market division*. They may, for instance, establish *simple pricing rules that reduce the complexity of coordinating on a large number of prices*. One example of such a rule is *establishing a small number of pricing points*, thus reducing the coordination problem. Another example is having a *fixed relationship between certain base prices and a number of other prices*, such that prices basically move in parallel. *Publicly available key information, exchange of information through trade associations, or information received through cross-shareholdings or participation in joint ventures* may also help firms reach terms of coordination. The more complex the market situation is, the more transparency or communication is likely to be needed to reach a common understanding on the terms of coordination.

#### *Symmetry, cross-share holding and joint ventures*

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<sup>60</sup> See, e.g. Commission Decision 2002/156/EC in Case COMP/M.2097 — SCA/Metsä Tissue, OJ L 57, 27.2.2002, p. 1, point 148.

<sup>61</sup> See, e.g. Case IV/M.1298 — Kodak/Imation, point 60.

48. Firms may find it easier to reach a common understanding on the terms of coordination if they are relatively symmetric<sup>62</sup>, especially in terms of cost structures, market shares, capacity levels and levels of vertical integration<sup>63</sup>. Structural links such as cross-shareholding or participation in joint ventures may also help in aligning incentives among the coordinating firms<sup>64</sup>.

#### Monitoring deviations

##### *Retaliation*

49. Coordinating firms are often tempted to increase their share of the market by deviating from the terms of coordination, for instance by lowering prices, offering secret discounts, increasing product quality or capacity or trying to win new customers. *Only the credible threat of timely and sufficient retaliation* keeps firms from deviating. Markets therefore *need to be sufficiently transparent* to allow the coordinating firms to monitor to a sufficient degree whether other firms are deviating, and thus know when to retaliate<sup>65</sup>.

##### *Transparency*

50. *Transparency* in the market is *often higher, the lower the number of active participants in the market*. Further, the degree of transparency often depends on how market transactions take place in a particular market. For example, *transparency is likely to be high in a market where transactions take place on a public exchange or in an open outcry auction*<sup>66</sup>. Conversely, *transparency may be low in a market where transactions are confidentially negotiated between buyers and sellers on a bilateral basis*<sup>67</sup>. When evaluating the level of transparency in the market, the key element is to identify what firms can infer about the actions of other firms from the available

<sup>62</sup> Case T-102/96, *Gencor v Commission*, [1999] ECR II-753, paragraph 222; Commission Decision 92/553/EC in Case IV/M.190 — *Nestlé/Perrier*, OJ L 356, 5.12.1992, p. 1, points 63-123.

<sup>63</sup> In assessing whether or not a merger may increase the symmetry of the various firms present on the market, efficiency gains may provide important indications (see also paragraph 82 of the notice).

<sup>64</sup> See, e.g. Commission Decision 2001/519/EC in Case COMP/M.1673 — *VEBA/VIAG*, OJ L 188, 10.7.2001, p. 1, point 226; Case COMP/M.2567 — *Nordbanken/Postgirot*, point 54.

<sup>65</sup> See, e.g. Case COMP/M.2389 — *Shell/DEA*, points 112 et seq.; and Case COMP/M.2533 — *BP/E.ON*, points 102 et seq.

<sup>66</sup> See also Commission Decision 2000/42/EC in Case IV/M.1313 — *Danish Crown/Vestjyske Slagterier*, OJ L 20, 25.1.2000, p. 1, points 176-179.

<sup>67</sup> See, e.g. Case COMP/M.2640 — *Nestlé/Schöller*, point 37; Commission Decision 1999/641/EC in Case COMP/M.1225 — *Enso/Stora*, OJ L 254, 29.9.1999, p. 9, points 67-68.

information<sup>68</sup>. Coordinating firms should be able to interpret with some certainty whether unexpected behaviour is the result of deviation from the terms of coordination. For instance, in unstable environments it may be difficult for a firm to know whether its lost sales are due to an overall low level of demand or due to a competitor offering particularly low prices. Similarly, when overall demand or cost conditions fluctuate, it may be difficult to interpret whether a competitor is lowering its price because it expects the coordinated prices to fall or because it is deviating.

*Facilitating devices that ease monitoring*

51. In some markets where the general conditions may seem to make monitoring of deviations difficult, firms may nevertheless engage in practices which have the effect of easing the monitoring task, even when these practices are not necessarily entered into for such purposes. These practices, *such as meeting-competition or most-favoured-customer clauses, voluntary publication of information, announcements, or exchange of information through trade associations*, may increase transparency or help competitors interpret the choices made. *Cross-directorships, participation in joint ventures and similar arrangements may also make monitoring easier.*

Deterrent mechanisms

*Certainty of punishment*

52. Coordination is *not sustainable unless the consequences of deviation are sufficiently severe* to convince coordinating firms that it is in their best interest to adhere to the terms of coordination. It is thus the threat of future retaliation that keeps the coordination sustainable<sup>69</sup>. However *the threat is only credible if*, where deviation by one of the firms is detected, there is *sufficient certainty that some deterrent mechanism will be activated*<sup>70</sup>.

*Time lag – lumpy orders*

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<sup>68</sup> See, e.g. Case IV/M.1939 — Rexam (PLM)/American National Can, point 24.

<sup>69</sup> See Case COMP/M.2389 — Shell/DEA, point 121, and Case COMP/M.2533 — BP/E.ON, point 111.

<sup>70</sup> Although deterrent mechanisms are sometimes called ‘punishment’ mechanisms, this should not be understood in the strict sense that such a mechanism necessarily punishes individually a firm that has deviated. The expectation that coordination may break down for a certain period of time, if a deviation is identified as such, may in itself constitute a sufficient deterrent mechanism.

53. *Retaliation* that manifests itself *after some significant time lag*, or is *not certain* to be activated, is *less likely to be sufficient to offset the benefits from deviating*. For example, if a market is characterised by *infrequent, large-volume orders*, it may be difficult to establish a sufficiently severe deterrent mechanism, since the gain from deviating at the right time may be large, certain and immediate, whereas the losses from being punished may be small and uncertain and only materialise after some time. The speed with which deterrent mechanisms can be implemented is related to the issue of transparency. If firms are only able to observe their competitors' actions after a substantial delay, then retaliation will be similarly delayed and this may influence whether it is sufficient to deter deviation.

*Incentive to retaliate*

54. The *credibility of the deterrence mechanism depends on whether the other coordinating firms have an incentive to retaliate*. Some deterrent mechanisms, such as punishing the deviator by *temporarily engaging in a price war* or *increasing output significantly*, may *entail a short-term economic loss for the firms carrying out the retaliation*. This does not necessarily remove the incentive to retaliate since the short-term loss may be smaller than the long-term benefit of retaliating resulting from the return to the regime of coordination.

*In the same or another market*

55. Retaliation need not necessarily take place in the same market as the deviation<sup>71</sup>. If the coordinating firms have commercial interaction in other markets, these may offer various methods of retaliation<sup>72</sup>. The *retaliation could take many forms*, including cancellation of joint ventures or other forms of cooperation or selling of shares in jointly owned companies.

Reactions of outsiders

*By competitors, actual or potential, and customers*

56. For coordination to be successful, the *actions of non-coordinating firms and potential competitors, as well as customers*, should not be able to jeopardise the outcome

<sup>71</sup> See, e.g. Commission Decision 2000/42/EC in Case IV/M.1313 — Danish Crown/Vestjyske Slagterier, OJ L 20, 25.1.2000, p. 1, point 177.

<sup>72</sup> See Case T-102/96, Gencor v Commission, [1999] ECR II-753, paragraph 281.

expected from coordination. For example, if coordination aims at reducing overall capacity in the market, this will only hurt consumers if non-coordinating firms are unable or have no incentive to respond to this decrease by increasing their own capacity sufficiently to prevent a net decrease in capacity, or at least to render the coordinated capacity decrease unprofitable<sup>73</sup>.

#### *Buyer power*

57. The effects of entry and countervailing buyer power of customers are analysed in later sections (Points 61-67). However, special consideration is given to the possible impact of these elements on the stability of coordination. For instance, by concentrating a large amount of its requirements with one supplier or by offering long-term contracts, a large buyer may make coordination unstable by successfully tempting one of the coordinating firms to deviate in order to gain substantial new business.

#### **Merger with a potential competitor**

##### *Merger with potential competitor*

58. Concentrations where an undertaking already active on a relevant market merges with a potential competitor in this market *can have similar anti-competitive effects* to mergers between two undertakings already active on the same relevant market and, thus, significantly impede effective competition, in particular through the creation or the strengthening of a dominant position.

##### *Absence of sunk switching costs for potential competitor*

59. *A merger with a potential competitor can generate horizontal anti-competitive effects, whether coordinated or non-coordinated, if the potential competitor significantly constrains the behaviour of the firms active in the market. This is the case if the potential competitor possesses assets that could easily be used to enter the market without incurring significant sunk costs.* Anticompetitive effects may also occur where the merging partner is very likely to incur the necessary sunk costs to enter the

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<sup>73</sup> These elements are analysed in a similar way to non-coordinated effects.

market in a relatively short period of time after which this company would constrain the behaviour of the firms currently active in the market<sup>74</sup>.

*Two basic conditions for merger with potential competitor to have significant anti-competitive effects*

60. For a merger with a potential competitor to have significant anti-competitive effects, two basic conditions must be fulfilled. First, the *potential competitor must already exert a significant constraining influence or there must be a significant likelihood that it would grow into an effective competitive force*. Evidence that a potential competitor has plans to enter a market in a significant way could help the Commission to reach such a conclusion<sup>75</sup>. Second, there must not be a sufficient number of other potential competitors, which could maintain sufficient competitive pressure after the merger<sup>76</sup>.

**Mergers creating or strengthening buyer power in upstream markets**

*Detriments to competition*

61. The Commission may also analyse *to what extent a merged entity will increase its buyer power in upstream markets*. On the one hand, a merger that creates or strengthens the market power of a buyer may significantly impede effective competition, in particular by creating or strengthening a dominant position. *The merged firm may be in a position to obtain lower prices by reducing its purchase of inputs. This may, in turn, lead it also to lower its level of output in the final product market, and thus harm consumer welfare*<sup>77</sup>. Such effects may in particular arise when upstream sellers are relatively fragmented. *Competition in the downstream markets could also be adversely affected if, in particular, the merged entity was likely to use its buyer power vis-à-vis its suppliers to foreclose its rivals*<sup>78</sup>.

*Benefits to consumers*

<sup>74</sup> See, e.g. Case IV/M.1630 — Air Liquide/BOC, points 201 et seq. For an example of a case where entry by the other merging firm was not sufficiently likely in the short to medium term (Case T-158/00, *ARD v Commission*, [2003] ECR II-000, paragraphs 115-127).

<sup>75</sup> Commission Decision 2001/98/EC in Case IV/M.1439 — *Telia/Telenor*, OJ L 40, 9.2.2001, p. 1, points 330-331, and Case IV/M.1681 — *Akzo Nobel/Hoechst Roussel Vet*, point 64.

<sup>76</sup> Case IV/M.1630 — *Air Liquide/BOC*, point 219; Commission Decision 2002/164/EC in Case COMP/M.1853 — *EDF/EnBW*, OJ L 59, 28.2.2002, p. 1, points 54-64.

<sup>77</sup> See Commission Decision 1999/674/EC in Case M.1221 — *Rewe/Meinl*, OJ L 274, 23.10.1999, p. 1, points 71-74.

<sup>78</sup> Case T-22/97, *Kesko v Commission*, [1999] ECR II-3775, paragraph 157; Commission Decision 2002/156/EC in Case M.877 — *Boeing/ McDonnell Douglas*, OJ L 336, 8.12.1997, p. 16, points 105-108.

62. On the other hand, *increased buyer power may be beneficial for competition*. If increased buyer power lowers input costs without restricting downstream competition or total output, then a proportion of these cost reductions are likely to be *passed onto consumers* in the form of lower prices.

*Analysis required*

63. In order to assess whether a merger would significantly impede effective competition by creating or strengthening buyer power, an *analysis of the competitive conditions in upstream markets and an evaluation of the possible positive and negative effects described above are therefore required*.

## V. COUNTERVAILING BUYER POWER

64. The *competitive pressure on a supplier* is not only exercised by competitors but *can also come from its customers*. Even firms with very high market shares may not be in a position, post-merger, to significantly impede effective competition, in particular by acting to an appreciable extent independently of their customers, *if the latter possesses countervailing buyer power*<sup>79</sup>. Countervailing buyer power in this context should be understood as *the bargaining strength that the buyer has vis-à-vis the seller in commercial negotiations* due to its size, its commercial significance to the seller and its ability to switch to alternative suppliers.

*Ability to counter market power*

65. The *Commission considers, when relevant, to what extent customers will be in a position to counter the increase in market power that a merger would otherwise be likely to create*. One source of countervailing buyer power would be if a customer could credibly threaten to resort, within a reasonable timeframe, to alternative sources of supply should the supplier decide to increase prices<sup>80</sup> or to otherwise deteriorate quality or the conditions of delivery. This would be the case if the buyer could immediately switch to other suppliers<sup>81</sup>, credibly threaten to vertically integrate

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<sup>79</sup> See, e.g. Case IV/M.1882 — Pirelli/BICC, points 73-80.

<sup>80</sup> See, e.g. Case IV/M.1245 — Valeo/ITT Industries, point 26.

<sup>81</sup> Even a small number of customers may not have sufficient buyer power if they are to a large extent 'locked in' because of high switching costs (see Case COMP/M.2187 — CVC/Lenzing, point 223).

into the upstream market or to sponsor upstream expansion or entry<sup>82</sup> for instance by persuading a potential entrant to enter by committing to placing large orders with this company. It is *more likely that large and sophisticated customers will possess this kind of countervailing buyer power than smaller firms in a fragmented industry*<sup>83</sup>. A buyer may also exercise countervailing buying power *by refusing to buy other products produced by the supplier* or, particularly in the case of durable goods, delaying purchases.

*Incentives to exercise buying power*

66. In some cases, it may be important to pay particular attention to the incentives of buyers to utilise their buyer power<sup>84</sup>. For example, *a downstream firm may not wish to make an investment in sponsoring new entry if the benefits of such entry in terms of lower input costs could also be reaped by its competitors.*

*Countervailing power beneficial, only if most customers protected after merger*

67. *Countervailing buyer power cannot be found to sufficiently off-set potential adverse effects of a merger if it only ensures that a particular segment of customers*<sup>85</sup>, *with particular bargaining strength, is shielded from significantly higher prices or deteriorated conditions after the merger*<sup>86</sup>. Furthermore, it is not sufficient that *buyer power* exists prior to the merger; *it must also exist and remain effective following the merger*. This is because a merger of two suppliers may reduce buyer power if it thereby removes a credible alternative.

## VI. ENTRY

*Little anti-competitive risk if entry easy*

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<sup>82</sup> Commission Decision 1999/641/EC in Case COMP/M.1225 — Enso/Stora, OJ L 254, 29.9.1999, p. 9, points 89-91.

<sup>83</sup> It may also be appropriate to compare the concentration existing on the customer side with the concentration on the supply side (Case COMP/JV 55 — Hutchison/RCPM/ECT, point 119, and Commission Decision 1999/641/EC in Case COMP/M.1225 — Enso/Stora, OJ L 254, 29.9.1999, p. 9, point 97).

<sup>84</sup> Case COMP/JV 55 — Hutchison/RCPM/ECT, points 129-130.

<sup>85</sup> Commission Decision 2002/156/EC in Case COMP/M.2097 — SCA/Metsä Tissue, OJ L 57, 27.2.2002, point 88.

Price discrimination between different categories of customers may be relevant in some cases in the context of market definition (See the Commission's notice on the definition of the relevant market, cited above, at paragraph 43).

<sup>86</sup> Accordingly, the Commission may assess whether the various purchasers will hold countervailing buyer power, see, e.g. Commission Decision 1999/641/EC in Case COMP/M.1225 — Enso/Stora, OJ L 254, 29.9.1999, p. 9, points 84-97.

68. *When entering a market is sufficiently easy, a merger is unlikely to pose any significant anti-competitive risk. Therefore, entry analysis constitutes an important element of the overall competitive assessment. For entry to be considered a sufficient competitive constraint on the merging parties, it must be shown to be likely, timely and sufficient to deter or defeat any potential anti-competitive effects of the merger.*

#### Likelihood of entry

69. The Commission examines whether entry is likely or whether potential entry is likely to constrain the behaviour of incumbents post-merger. For entry *to be likely, it must be sufficiently profitable taking into account the price effects of injecting additional output into the market and the potential responses of the incumbents.* Entry is thus less likely if it would only be economically viable on a large scale, thereby resulting in significantly depressed price levels. And entry is likely to be more difficult if the incumbents are able to protect their market shares by offering long-term contracts or giving targeted pre-emptive price reductions to those customers that the entrant is trying to acquire. Furthermore, high risk and costs of failed entry may make entry less likely. *The costs of failed entry will be higher; the higher is the level of sunk cost associated with entry*<sup>87</sup>.

#### *Entry barriers*

70. Potential entrants may encounter barriers to entry which determine entry risks and costs and thus have an impact on the profitability of entry. Barriers to entry are specific features of the market, which give incumbent firms advantages over potential competitors. When entry barriers are low, the merging parties are more likely to be constrained by entry. Conversely, when entry barriers are high, price increases by the merging firms would not be significantly constrained by entry. Historical examples of entry and exit in the industry may provide useful information about the size of entry barriers.

#### *Examples of entry barriers*

71. Barriers to entry can take various forms:

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<sup>87</sup> Commission Decision 97/610/EC in Case IV/M.774 — Saint-Gobain/Wacker-Chemie/NOM, OJ L 247, 10.9.1997, p. 1, point 184.

- (a) Legal advantages encompass situations where *regulatory barriers limit the number of market participants* by, for example, restricting the number of licences<sup>88</sup>. They also cover tariff and non-tariff trade barriers<sup>89</sup>.
- (b) The incumbents may also enjoy *technical advantages, such as preferential access to essential facilities, natural resources<sup>90</sup>, innovation and R & D<sup>91</sup>, or intellectual property rights<sup>92</sup>*, which make it difficult for any firm to compete successfully. For instance, in certain industries, it might be difficult to obtain essential input materials, or patents might protect products or processes. Other factors such as economies of scale and scope, distribution and sales networks<sup>93</sup>, access to important technologies, may also constitute barriers to entry.
- (c) Furthermore, barriers to entry may also exist because of the *established position of the incumbent firms on the market*. In particular, it may be difficult to enter a particular industry because experience or reputation is necessary to compete effectively, both of which may be difficult to obtain as an entrant. Factors such as consumer loyalty to a particular brand<sup>94</sup>, the closeness of relationships between suppliers and customers, the importance of promotion or advertising, or other advantages relating to reputation<sup>95</sup> will be taken into account in this context. Barriers to entry also encompass situations where *the incumbents have already committed to building large excess capacity<sup>96</sup>*, or where the *costs faced by customers in switching to a new supplier* may inhibit entry.

### *Market evolution*

*Slow growth, minimum efficient scale large in relation to market, network effects*

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<sup>88</sup> Case IV/M.1430 — Vodafone/Airtouch, point 27; Case IV/M.2016 — France Télécom/Orange, point 33.

<sup>89</sup> Commission Decision 2002/174/EC in Case COMP/M.1693 — Alcoa/Reynolds, OJ L 58, 28.2.2002, point 87.

<sup>90</sup> Commission Decision 95/335/EC in Case IV/M.754 — Anglo American Corp./Lonrho, OJ L 149, 20.5.1998, p. 21, points 118-119.

<sup>91</sup> Commission Decision 97/610/EC in Case IV/M.774 — Saint-Gobain/Wacker-Chemie/NOM, OJ L 247, 10.9.1997, p. 1, points 184-187.

<sup>92</sup> Commission Decision 94/811/EC in Case IV/M.269 — Shell/Montecatini, OJ L 332, 22.12.1994, p. 48, point 32.

<sup>93</sup> Commission Decision 98/327/EC in Case IV/M.833 — The Coca-Cola Company/Carlsberg A/S, OJ L 145, 15.5.1998, p. 41, point 74.

<sup>94</sup> Commission Decision 98/327/EC in Case IV/M.833 — The Coca-Cola Company/Carlsberg A/S, OJ L 145, 15.5.1998, p. 41, points 72-73.

<sup>95</sup> Commission Decision 2002/156/EC in Case COMP/M.2097 — SCA/Metsä Tissue, OJ L 57, 27.2.2002, p. 1, points 83-84.

<sup>96</sup> Commission Decision 2001/432/EC in Case IV/M.1813 — Industri Kapital Nordkem/Dyno, OJ L 154, 9.6.2001, p. 41, point 100.

72. The expected evolution of the market should be taken into account when assessing whether or not entry would be profitable. *Entry is more likely to be profitable in a market that is expected to experience high growth in the future<sup>97</sup> than in a market that is mature or expected to decline<sup>98</sup>. Scale economies or network effects may make entry unprofitable unless the entrant can obtain a sufficiently large market share<sup>99</sup>.*

*Production facilities from other markets*

73. Entry is particularly likely if suppliers in other markets already possess production facilities that could be used to enter the market in question, thus reducing the sunk costs of entry. The smaller the difference in profitability between entry and non-entry prior to the merger, the more likely such a reallocation of production facilities.

Timeliness

74. The Commission examines whether *entry would be sufficiently swift and sustained to deter or defeat the exercise of market power*. What constitutes an appropriate time period depends on the characteristics and dynamics of the market, as well as on the specific capabilities of potential entrants<sup>100</sup>. However, *entry is normally only considered timely if it occurs within two years*.

Sufficiency

75. Entry must be of sufficient scope and magnitude to deter or defeat the anti-competitive effects of the merger<sup>101</sup>. *Small-scale entry, for instance, into some market 'niche', may not be considered sufficient*.

## VII. EFFICIENCIES

*Factors relevant to overall assessment*

76. Corporate reorganisations in the form of mergers may be in line with the *requirements of dynamic competition* and are *capable of increasing the competitiveness of industry*,

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<sup>97</sup> See, e.g. Commission Decision 98/475/EC in Case IV/M.986 — Agfa-Gevaert/Dupont, OJ L 211, 29.7.1998, p. 22, points 84-85.

<sup>98</sup> Case T-102/96, Gencor v Commission, [1999] ECR II-753, paragraph 237.

<sup>99</sup> See, e.g. Commission Decision 2000/718/EC in Case IV/M.1578 — Sanitec/Sphinx, OJ L 294, 22.11.2000, p. 1, point 114.

<sup>100</sup> See, e.g. Commission Decision 2002/174/EC in Case COMP/M.1693 — Alcoa/Reynolds, L 58, 28.2.2002, points 31-32, 38.

<sup>101</sup> Commission Decision 91/535/EEC in Case IV/M.68 — Tetra Pak/Alfa Laval, OJ L 290, 22.10.1991, p. 35, point 3.4.

thereby improving the conditions of growth and raising the standard of living in the Community<sup>102</sup>. It is *possible that efficiencies brought about by a merger counteract the effects on competition and in particular the potential harm to consumers that it might otherwise have*<sup>103</sup>. In order to assess whether a merger would significantly impede effective competition, in particular through the creation or the strengthening of a dominant position, within the meaning of Article 2(2) and (3) of the Merger Regulation, the *Commission performs an overall competitive appraisal of the merger*. In making this appraisal, the *Commission takes into account the factors mentioned in Article 2(1)*, including the development of technical and economic progress provided that it is to the consumers' advantage and does not form an obstacle to competition<sup>104</sup>.

*Substantial efficiencies – balance adverse effects*

77. The Commission considers any substantiated efficiency claim in the *overall assessment of the merger*. It may decide that, as a consequence of the efficiencies that the merger brings about, there are no grounds for declaring the merger incompatible with the common market pursuant to Article 2(3) of the Merger Regulation. This will be the case when the Commission is *in a position to conclude on the basis of sufficient evidence that the efficiencies generated by the merger are likely to enhance the ability and incentive of the merged entity to act pro-competitively for the benefit of consumers, thereby counteracting the adverse effects on competition which the merger might otherwise have*.

*Conditions: benefit consumers, merger specific and verifiable*

78. For the Commission to take account of efficiency claims in its assessment of the merger and be in a position to reach the conclusion that as a consequence of efficiencies there are no grounds for declaring the merger to be incompatible with the common market, *the efficiencies have to benefit consumers, be merger-specific and be verifiable. These conditions are cumulative*.

Benefit to consumers

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<sup>102</sup> See Recital 4 of the Merger Regulation.

<sup>103</sup> See Recital 29 of the Merger Regulation.

<sup>104</sup> Cf. Article 2(1)(b) of the Merger Regulation.

79. The relevant benchmark in assessing efficiency claims is that consumers<sup>105</sup> will not be worse off as a result of the merger. For that purpose, *efficiencies should be substantial and timely, and should, in principle, benefit consumers in those relevant markets where it is otherwise likely that competition concerns would occur.*

*Cost savings especially in marginal costs- balance benefits and detriments to consumers*

80. Mergers may bring about various types of efficiency gains that can lead to lower prices or other benefits to consumers. For example, *cost savings* in production or distribution may give the merged entity the *ability and incentive to charge lower prices following the merger*. In line with the need to ascertain *whether efficiencies will lead to a net benefit to consumers*, cost efficiencies that lead to *reductions in variable or marginal costs*<sup>106</sup> are more likely to be relevant to the assessment of efficiencies than reductions in fixed costs; the former are, in principle, more likely to result in lower prices for consumers<sup>107</sup>. Cost reductions, which merely result from anti-competitive reductions in output, cannot be considered as efficiencies benefiting consumers.

*New or improved products*

81. Consumers may also benefit from new or improved products or services, for instance resulting from efficiency gains in the sphere of R & D and innovation. A joint venture company set up in order to develop a new product may bring about the type of efficiencies that the Commission can take into account.

*Co-ordinated effects*

82. In the context of coordinated effects, *efficiencies may increase the merged entity's incentive to increase production and reduce prices, and thereby reduce its incentive to coordinate its market behaviour with other firms in the market*. Efficiencies may *therefore lead to a lower risk of coordinated effects* in the relevant market.

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<sup>105</sup> Pursuant to Article 2(1)(b), the concept of 'consumers' encompasses intermediate and ultimate consumers, i.e. users of the products covered by the merger. In other words, consumers within the meaning of this provision include the customers, potential and/or actual, of the parties to the merger.

<sup>106</sup> Variable costs should be viewed as those costs that vary with the level of production or sales over the relevant time period. Marginal costs are those costs associated with expanding production or sales at the margin.

<sup>107</sup> Generally, fixed cost savings are not given such weight as the relationship between fixed costs and consumer prices is normally less direct, at least in the short run.

*Less weight given to delayed effects*

83. In general, the later the efficiencies are expected to materialise in the future, the less weight the Commission can assign to them. This implies that, in order to be considered as a counteracting factor, the *efficiencies must be timely*.

*Need to pass benefit on to consumers*

84. The *incentive on the part of the merged entity to pass efficiency gains on to consumers is often related to the existence of competitive pressure* from the remaining firms in the market and from potential entry. The greater the possible negative effects on competition, the more the Commission has to be sure that the claimed efficiencies are substantial, likely to be realised, and to be passed on, to a sufficient degree, to the consumer. It is *highly unlikely that a merger leading to a market position approaching that of a monopoly, or leading to a similar level of market power, can be declared compatible* with the common market on the ground that efficiency gains would be sufficient to counteract its potential anti-competitive effects.

## Merger specificity

*Burden of proof*

85. *Efficiencies are relevant to the competitive assessment when they are a direct consequence of the notified merger and cannot be achieved to a similar extent by less anticompetitive alternatives.* In these circumstances, the efficiencies are deemed to be caused by the merger and thus, merger-specific<sup>108</sup>. It is for the merging parties to provide in due time all the relevant information necessary to demonstrate that there are *no less anticompetitive, realistic and attainable alternatives of a non-concentrative nature* (e.g. a licensing agreement, or a cooperative joint venture) *or of a concentrative nature* (e.g. a concentrative joint venture, or a differently structured merger) than the notified merger which preserve the claimed efficiencies. *The Commission only considers alternatives that are reasonably practical in the business situation faced by the merging parties having regard to established business practices in the industry concerned.*

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<sup>108</sup> In line with the general principle set out in paragraph 9 of this notice.

## Verifiability

*Quantify if reasonably possible*

86. *Efficiencies have to be verifiable such that the Commission can be reasonably certain that the efficiencies are likely to materialise, and be substantial enough to counteract a merger's potential harm to consumers. The more precise and convincing the efficiency claims are, the better the Commission can evaluate the claims. Where reasonably possible, efficiencies and the resulting benefit to consumers should therefore be quantified. When the necessary data are not available to allow for a precise quantitative analysis, it must be possible to foresee a clearly identifiable positive impact on consumers, not a marginal one. In general, the longer the start of the efficiencies is projected into the future, the less probability the Commission may be able to assign to the efficiencies actually being brought about.*

*Burden of proof on parties*

87. Most of the information, allowing the Commission to assess whether the merger will bring about the sort of efficiencies that would enable it to clear a merger, is solely in the possession of the merging parties. It is, therefore, *incumbent upon the notifying parties to provide in due time all the relevant information necessary to demonstrate that the claimed efficiencies are merger-specific and likely to be realised. Similarly, it is for the notifying parties to show to what extent the efficiencies are likely to counteract any adverse effects on competition that might otherwise result from the merger, and therefore benefit consumers.*

*Evidence*

88. Evidence relevant to the assessment of efficiency claims includes, in particular, internal documents that were used by the management to decide on the merger, statements from the management to the owners and financial markets about the expected efficiencies, historical examples of efficiencies and consumer benefit, and pre-merger external experts' studies on the type and size of efficiency gains, and on the extent to which consumers are likely to benefit.

**VIII. FAILING FIRM**Causation

89. The Commission may decide that an otherwise problematic merger is nevertheless compatible with the common market if one of the merging parties is a failing firm. The basic requirement is that the deterioration of the competitive structure that follows the merger cannot be said to be caused by the merger<sup>109</sup>. This will arise where the competitive structure of the market would deteriorate to at least the same extent in the absence of the merger<sup>110</sup>.

*Three criteria*

90. The Commission considers the following three criteria to be especially relevant for the application of a 'failing firm defence'. First, the *allegedly failing firm would in the near future be forced out of the market* because of financial difficulties if not taken over by another undertaking. Second, there is *no less anti-competitive alternative purchase than the notified merger*. Third, *in the absence of a merger, the assets of the failing firm would inevitably exit the market*<sup>111</sup>.

*Burden of proof*

91. It is for the notifying parties to provide in due time all the relevant information necessary to demonstrate that the deterioration of the competitive structure that follows the merger is not caused by the merger.

**Notes and questions on Horizontal merger guidelines**

1. (Points 2-4). It was widely thought that the criteria developed by the CFI in *Airtours* (CB p.631) and later approved by the ECJ would not cover unilateral effects. Do you agree?
2. (Point 3). Is an effect on the structure of competition the same as an effect on competition in the market?
3. (Point 7) Note that the courts have left a margin of appreciation of complex economic questions to the Commission as the institution responsible for the orientation of competition policy. What effect does this have on the status of the guidelines? See *IMPALA* para. 69.

<sup>109</sup> Joined Cases C-68/94 and C-30/95, Kali and Salz, paragraph 110.

<sup>110</sup> Joined Cases C-68/94 and C-30/95, Kali and Salz, paragraph 114. See also Commission Decision 2002/365/EC in Case COMP/M.2314 — BASF/Pantochim/Eurodiol, OJ L 132, 17.5.2002, p. 45, points 157-160. This requirement is linked to the general principle set out in paragraph 9 of this notice.

<sup>111</sup> The inevitability of the assets of the failing firm leaving the market in question may, in particular in a case of merger to monopoly, underlie a finding that the market share of the failing firm would in any event accrue to the other merging party. See Joined Cases C-68/94 and C-30/95, Kali and Salz, paragraphs 115-116.

4. (Point 7). Note that there is no presumption that a particular merger benefits consumers (*IMPALA*\* Para \*)
5. (Point 9). The counterfactual is the same as has been used for Articles 81 and 82 since the Commission's guidelines on technology transfer, OJ 2004, C101/2 and the notice on Article 81(3), OJ 2004, C101/97. Before then, the Commission often compared the current position with what would have occurred with the transaction but without the restriction of conduct. Which approach to the counterfactual makes better economic sense?
6. (Point 10). Does the Commission define markets merely because the ECJ held in *Continental Can* that it should do so before finding a dominant position, or does it do so for reasons of policy? Would it be better to analyse than define the market. Why?
7. (Points 12 & 89-91). Note that it is not easy to establish the failing firm defence. It must be shown not only that the firm would have left the market had the merger not taken place, but also that its assets could not have been acquired by another firm which would have taken its place.
8. (Point 13). Is the treatment of Article 82 by the ECJ as flexible as merger control?
9. (Point 15). Is it easy to ascertain post-merger market shares in advance of the merger? Why is market share important? What is the problem of using market shares when they are volatile?
10. (Point 15). Should the Commission merely add the former market shares? In a concentrated industry, would you expect buyers to shift from the merging firms in order to ensure a second source of the product?
11. (Point 17). Do you consider 50% a very large market share? Note that the Agencies in the US do not consider monopolisation when the post market share is below 70%. Nor is an attempt to monopolise often found below 50%.
12. (Point 18). At what level is dominance presumed under article 82? Is the presumption rebuttable? See *AKZO* (CB 159 para. 59).
13. (Points 16 & 19). What is the minimum number of firms in a market with an HHI of at least 25%? Is this a significant safe harbour?
14. (Points 17-21). What is the minimum number of firms in a market with an HHI of 2000?
15. (Point 20 (e)). What are facilitating devices? (See Case book 364). Consider agreements to exchange information about prices or quantities bought or sold, announcement of prices well in advance. Would you be concerned if the markets were not concentrated: would the Commission?

16. (Point 22 (a)). Did the former merger regulation cover unilateral effects? Convince me! They were not covered by the formulation in *Airtours* para 62. Was para 62 exhaustive?
17. (Point 25). Note the uncertainty created by words like 'generally,' 'appreciably,' 'important,' 'may'. There are more such qualifications of uncertain ambit in the guidance on the Commission's priorities under Article 82.
18. (Point 31). Note the importance of switching costs as well as the paucity of suppliers.
19. (Points 36 & 38). Note the importance of incentives as well as of rivals' capacity to increase production.
20. (Points 39- 56). See Casebook 618 et seq. & compare *Airtours* (Case book Para 631).
21. (Point 41). Would these criteria be easy to apply under Article 82? It is thought unlikely that much use will be made of the merger cases on joint dominant positions when applying article 82.
22. (Points 47-57). These are sometimes called 'facilitating devices'. See Case book, 364.
23. (Points 59, 69 & 73). Why are sunk costs important?
24. (Points 62 & 84). Most economists favour a total welfare test. Should the Commission advocate a consumer welfare test? What is the difference? Note how often the Commission refers to consumer welfare.
25. (Point 66). Note the relevance not only of buyer power, but also of incentives to exercise it. Is the Commission becoming more realistic?
26. (Point 71(a)). Note that some economists deny that there are any barriers to entry other than legal restrictions. Few go so far, but economies of scale matter only if the minimum efficient scale is large in relation to the total market. Why? Should competition law be concerned only with barriers against equally efficient firms, or also against smaller firms that pay proportionately more for their finance etc?
27. (Point 71(c)). An important first mover advantage may exclude new entrants, but should it be balanced against the need to encourage the first entrant?
28. (Point 72). For network effects, see the Commission's decision in *Microsoft*, [2005] CMLR 965, paras 448 - 464. It is not reproduced in this annex as it covered over 300 pages from the Commission's website.
29. (Point 72). Economies of scale are very important when the minimum economic size is large in relation to the market: less important when they cut out only smaller firms. Why?

30. (Points 74 and 75). Note how strict the qualifications are to the possibility of new entry. Does this reflect a view that mergers seldom result in the expected efficiencies? Half the merger decisions have related to joint ventures. Are these more likely to create efficiencies?
31. (Point 76 onwards). In the earlier merger decisions the Commission believed that efficiencies would make it difficult for longer for new comers to enter the market. We spoke of the “merger offence.” Do you think this was a sensible attitude to take? Have we still got an efficiency offence? The Commission still insists on the burden of proof being on the dominant firm (point 87). Are the criteria for appraising a merger to be found in Article 2(1) or 2(2) & (3) of the merger regulation?
32. (Points 77 – 80, 84). Note how narrow the efficiency justification is. Is this because so many mergers fail to result in the expected benefits? Before the merger takes place, how can the merging firms establish that the efficiencies outweigh the anticompetitive effects? Are efficiencies and foreclosure commensurate? Note how often the Commission refers to consumer benefit and consumer harm. Is this the test of foreclosure and efficiencies?
33. (Point 80). Why are savings in marginal costs more important than savings in sunk costs?
34. (Point 84). Note that the Commission accepts the criterion of consumer welfare and not that of total welfare, which many economists prefer. It is clear that the welfare of competitors is not the Commission’s test.
35. (Point 85). Is this burden of proof different from the burden under article 82 or 81(3)? Is it ever possible to discharge it? See *Microsoft*, para 688 in CFI judgment and in *Glaxo SmithKline* paras 235-236.
36. (Point 86). Are dynamic efficiencies likely to be more important than static efficiencies? Which is easier to establish before the event?
37. (Point 87). Experts have long been trying to persuade the Commission that only the evidentiary burden of proof is on Domco. Have they succeeded?
38. (Point 90). In *Kali und Salz (France v Commission (C-68/94 and 30/95), [1998] ECR I-1375)* it was not so much financial difficulties, but the exhaustion of the mine from which the chemicals were obtainable that led to the exit of one of the firms.
39. (Points 89 – 91) Are the three criteria in point 90 sufficiently strict? NB unless the merger is condemned, the Commission has no power to impose a remedy. Should it suffice that a division of a company would be forced out of the market? Is the third criterion stricter than the definition of the counterfactual in point 9? Should it be?