PCC MERGER GUIDELINES

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1. Introduction

1.1. These Guidelines on substantive merger analysis are adapted from the ICN Recommended Practices for Merger Analysis, which are derived from the ICN Merger Guidelines Workbook and common practices across member jurisdictions.

1.2. These Guidelines outline the principal analytical techniques, practices, and the enforcement policy of the Philippines Competition Commission (the "Commission") with respect to mergers and acquisitions that have a direct, substantial and reasonably foreseeable effect on trade, industry, or commerce in the Philippines. The Republic Act No. 10677, the Philippine Competition Act or PCA, is the relevant statutory provision in the Philippines. To effectively carry out the provisions of the Philippine Competition Act, the Commission promulgated rules and regulations referred to as the Implementing Rules and Regulations of Republic Act No. 10667 (IRR). These Guidelines describe the Commission's analytical framework and the types of evidence generally used to predict whether a merger may substantially prevent, restrict or lessen competition. The purpose of these Guidelines is to increase the transparency of the analytical process underlying the Commission's enforcement decisions in order to assist the business community and antitrust practitioners. These Guidelines may also assist the courts in developing an appropriate framework for interpreting and applying the merger laws and regulations.

1.3. Most mergers do not harm competition, and may contribute to consumer welfare. Many mergers enable the merged firm to reduce costs and become more efficient, leading to lower prices, higher quality, quantity and diversity of products, or increased investment in innovation.

1.4. Some mergers, however, may harm competition by creating or enhancing the merged firm's ability or incentives to exercise market power – either unilaterally or through coordination with rivals – resulting in price increases above competitive levels for a significant period of time, reductions in quality or a slowing of innovation.

1.5. In performing merger analysis, the Commission predicts a merger's competitive impact and attempts to prevent any competitive problems *before* they materialize. The Commission will only intervene to prohibit or remedy a merger when it is necessary to prevent anticompetitive effects that may be caused by that merger. The ultimate goal of Commission intervention is to restore or maintain competition affected by the merger, not to enhance premerger competition.

1.6. The identification of those mergers that potentially threaten to harm competition, and the expeditious clearance of non-problematic mergers, can lead to more efficient use of Commission resources and to more effective analysis of critical legal and economic issues.

2. Substantive Legal Standard for Merger Analysis

2.1. Merger analysis is a fact-specific process through which the Commission applies a range of analytical tools available. These Guidelines provide examples and reference the law where applicable, but do not exhaust the applications of the relevant principles or the range of evidence that may be used by the Commission. The Commission will apply its merger analysis reasonably and flexibly on a case-by-case basis, recognizing the broad range of possible factual contexts and the specific competitive effects that may arise in different transactions. In conducting this review, the Commission will assess whether a proposed merger or acquisition is likely to substantially prevent, restrict, or lessen competition in the relevant market or in the market for goods and services as may be determined by the Commission. The Commission also will take into account any substantiated efficiencies put forward by the parties to the proposed merger or acquisition, which are likely to arise from the transaction.

2.2. Although the Guidelines begin with a discussion of market definition, the Commission's analysis need not start with market definition. Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects.

2.3. In evaluating the competitive effects of a merger or acquisition, the Commission will endeavor to compare the competitive conditions that would likely result from the merger or acquisition with the conditions that would likely have prevailed without the merger or acquisition. In its evaluation, the Commission may consider, on a case-by-case basis, the broad range of possible factual contexts and the specific competitive effects that may arise in different transactions, such as:

a) the structure of the relevant markets concerned;

b) the market position of the entities concerned;

c) the actual or potential competition from entities within or outside of the relevant market;

d) the alternatives available to suppliers and users, and their access to supplies or markets; and

e) any legal or other barriers to entry.

3. Market Definition

3.1. The Commission will assess the competitive effects of a merger within well-defined, economically meaningful markets. An economically meaningful market is one that could be subject to an exercise of market power that likely would result in significant harm to competition, rather than anticompetitive effects that are insignificant or transient in nature.

3.2. The Commission assesses market definition within the context of the particular facts and circumstances of the merger at issue. Competitive conditions change over time and may vary in different geographic areas. While relevant markets identified in past investigations in the same industry, or in investigations by agencies in other jurisdictions, may be informative, they may not be applicable to the Commission's assessment of the merger in question when, for example, market conditions differ (or have evolved) over time or across geographic areas. Market definition provides the basis for market share calculations and concentration levels, and more generally a framework for the analysis of competitive effects. Market shares and concentration levels are meaningful in merger analysis only when they are based on properly defined markets. The Commission exercises particular care in defining markets where the choice among possible market definitions may have a significant impact on market shares.

3.3. Proper examination of the competitive effects of a merger rests on a sound understanding of the competitive constraints under which the merged firm will operate. Market definition helps enumerate the line of commerce and section of the country in which the competitive concern arises. Market definition also helps identify market participants and measure market share and market concentration. The measurement of market shares and market concentration is a useful indicator of the likely competitive effects of a merger, but it is not an end in itself. The identification of the relevant product market and relevant geographic market are interrelated. The Commission evaluates the extent to which buyers would shift to other products in the context of the relevant geographic market.

3.4. Market definition is a step, which helps in the process of determining whether the merged entity possesses, or will, post-merger, possess market power. For example, in some cases, the Commission may seek to develop more evidence regarding likely competitive effects. In other cases, it may be clear that a merger will not create or enhance market power in any market, or that competitive harm would be predicted in any market. In such circumstances, the Commission may not need to reach a firm conclusion on the scope of the relevant market.

3.5. An exercise of market power is feasible only when customers would not sufficiently reduce their demand for the relevant product(s), or divert sufficient demand to other products or to other locations, so as to make a price increase (or other lessening of competition) unprofitable. Thus, market definition depends primarily upon demand-side substitution, which focuses on the extent to which customers likely would switch from one product to another, or from a supplier in one geographic area to a supplier in another area, in response to changes in prices, quality, availability, or other features.

3.6. As stated in PCA, Chapter I, Section 4 (k)(1), a relevant product market comprises all those goods and/or services that are regarded as interchangeable or substitutable by the consumer or the customer, by reason of the goods and/or services' characteristics, their prices, and their intended use. Product definition considers the perspective of the consumer or the customers' response to a price increase or a corresponding non-price change.

3.7. As stated in PCA, Chapter I, Section 4 (k)(2), a relevant geographic market comprises the area in which the entity concerned is involved in the supply and demand of goods and services, in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighboring areas because the conditions of competition are different in those areas. Geography may limit some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers, which is why geography is an important component of market definition.

3.8. As stated in PCA, Chapter V, Section 24, the PCC, in determining the relevant market, will consider the following factors, among others:

(a) The possibilities of substituting the goods or services in question with others of domestic or foreign origin, considering the technological possibilities, the extent to which substitutes are available to consumers and the time required for such substitution;

(b) The cost of distribution of the good or service, its raw materials, its supplements and substitutes from other areas and abroad, considering freight, insurance, import duties, and non-tariff restrictions; the restrictions imposed by economic agents or by their associations; and the time required to supply the market from those areas;

(c) The cost and probability of users or consumers seeking other markets; and

(d) National, local or international restrictions which limit the access by users or consumers to alternate sources of supply or the access of suppliers to alternate consumers.

3.9. Once a market is defined, the Commission will consider market shares and concentration as part of the evaluation of competitive effects. Market shares and concentration are considered in conjunction with other reasonably available evidence. Market shares are a relevant aspect of the review process because they can influence firms' competitive incentives and reflect their capabilities. For example, as an initial indicator, when the combined post-merger market share of the merged entity is high, competition concerns may arise because a firm may be more reluctant to impose price reductions or pass on cost savings. Conversely, when market shares are low it may be possible to dismiss any concerns or the need for further investigation.

3.10. Some mergers may have potential effects in more than one relevant product market or geographic market, and may require an independent competitive assessment of each market in which a potential competitive concern arises. The Commission will examine all the relevant markets potentially impacted by a merger to determine whether significant harm to competition is likely to occur in any of them. In addition, supply considerations also play a key role in understanding the competitive constraints on the merging firms.

4. The Hypothetical Monopolist Test

4.1. The "hypothetical monopolist" or "SSNIP" test is a methodological tool that may be used to determine the relevant market(s) in which to analyze the competitive effects of a proposed merger. The SSNIP test is not a tolerance level for prices increases resulting from a merger. It generally identifies a product and a geographic space in which a hypothetical monopolist would profitably exercise market power. Under this test, the Commission identifies the relevant market as a product or group of products and a geographic area in which it is produced or sold, for which a hypothetical, profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of the product(s) in that area, would likely impose a "small but significant and nontransitory increase in price" (commonly referred to as a "SSNIP"), assuming the terms of sale for all products outside the candidate market are held constant.

> **'SSNIP'** The Commission normally begins the process of product market definition by applying the SSNIP test to a candidate market of each product produced or sold by each of the merging firms, assessing what would happen if a hypothetical monopolist of that product imposed at least a SSNIP on that product, while the terms of sale of all other products remained constant. If the hypothetical monopolist would not profitably impose such a price increase because of substitution by customers to other products, the candidate market is not a relevant product market by itself. The Commission then adds to the product group the product that is the next-best substitute for the merging firm's product, and apply the SSNIP test to a candidate market of the expanded product group. This process continues until a group of products is identified such that a hypothetical monopolist supplying the product(s) would be able to exercise market power, and profitably impose a SSNIP in the candidate market. The relevant product market generally will be the smallest group of products that satisfies this test.

4.2. In most cases, the Commission uses the prevailing prices of the products of the merging firms and possible substitutes as a starting point for application of the SSNIP test. Where pre-merger circumstances strongly suggest coordinated interaction or other evidence strongly indicates that current prices are above competitive levels, the Commission may consider using a price more reflective of the competitive price.

4.3. What constitutes a "small but significant and nontransitory increase in price" will depend on the nature of the industry, but a common benchmark is a price increase of between 5 and 10 percent lasting for the foreseeable future (*e.g.,* one year). In some cases, the SSNIP test is applied to the value added by suppliers in the market rather than the final price.

4.4. The Commission generally applies the “smallest market principle” to identify a relevant product and geographic market that is no bigger than necessary to satisfy the SSNIP test. At times, however, it may be appropriate to define broader markets. In some cases, applying the smallest market principle may fail to detect a horizontal overlap of concern between the merging parties. In other cases, where the competitive effects analysis is the same for a broader market, it may be unnecessary to define the smallest market. Similarly, it may be appropriate as a matter of convenience to aggregate markets where the competitive effects analysis is the same across a group of products or geographic areas, each of which could be defined as a separate relevant market.

4.5. Applying the SSNIP Test to Identify a Relevant Product Market

4.5.1. In applying the SSNIP test to identify a relevant product market, the Commission seeks to identify a product or group of products for which a hypothetical, profit-maximizing monopolist would impose profitably at least a SSNIP, assuming the terms of sale of all other products were held constant. Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. The test may identify a group of products as a relevant market even if some customers would substitute significantly to products outside that group in response to a price increase.

4.5.2. In determining the appropriate product market(s) in which to assess the competitive effects of a merger, the Commission considers not only whether products are functional substitutes, but also whether they are good economic substitutes for sufficient numbers of customers so as to make a SSNIP unprofitable. In order to do this, the Commission may use economic tools, such as own price or cross price elasticities of demand, and diversion ratios, where they can be reliably calculated. These are highly relevant methods in assessing whether products are close substitutes for one another and part of the same relevant market.

> **Cross price elasticity of demand** is a tool that measures the rate at which the quantity of a product sold changes when the price of another product goes up or down. When the cross price elasticity is positive, those products are substitutes; if they are negative, those products are complements. Where there is zero cross-elasticity, the products in question will be unrelated.

> **Diversion ratios** provide a direct measure of the closeness of competition between products. The diversion ratio between product A and B is defined as the

percentage of lost sales of product A which are diverted to product B, should A increase its price. The higher the diversion ratio from A to B, the greater is the competitive constraint that B imposes on A.

4.5.3. The boundaries of relevant product markets may not be precise, particularly in differentiated products where substitutes may exist along a continuum. In such cases, some products may be in the same market yet may be much closer substitutes for each other than they are for other products that are also in the market. The degree of product differentiation and customer substitutability may vary over time and across geographic areas. In some cases, it may be appropriate to draw a market boundary around a subset of possible substitutes that is narrower than the full range of functional substitutes from which customers choose, to the extent that a hypothetical monopolist over such a segment of the possible substitutes profitably would raise prices significantly.

4.5.4. In considering the likely reaction of customers to a price increase, the Commission considers the available evidence relevant to the likelihood of product substitution by customers in response to a SSNIP. Relevant evidence often includes, but is not limited to:

a) The characteristics, prices, functions, and customer usage of the product(s) in question;

b) The possibilities of substituting the goods or services in question with others of domestic or foreign origin, considering the technological possibilities, the extent to which substitutes are available to consumers and the time required for such substitution;

c) Evidence that customers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables. In some instances, the Commission may be able to derive such evidence from empirical analysis of quantitative data, such as through calculation of own price or cross price elasticities of demand;

d) The margins between price and marginal or incremental cost, as higher margins as a fraction of price may imply that consumers are less price sensitive;

e) Evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables;

f) Evidence regarding the strength and nature of customer preferences among products (*e.g.*, brand loyalty, preferences for certain product performance or compatibility standards, etc.);

g) Relative price levels and price movements of the products compared to costs and to potential substitutes;

h) Legal or regulatory requirements (*e.g.,* product certification standards, regulatory compliance standards, etc.) that may impact the substitutability of products from the standpoint of customers;

i) The time and costs required to switch products, as high switching costs relative to the value of a product tend to make substitution less likely.

4.6. **Applying the SSNIP Test to Identify a Relevant Geographic market**

4.6.1. The SSNIP test also is used to identify a relevant geographic market.

4.6.2. A single firm may operate in a number of geographic markets. The Commission applies the SSNIP test to a candidate market of each location in which each merging firm produces or sells the relevant product, assessing what would happen if a hypothetical monopolist in that location imposed at least a SSNIP on sales of the product in that location, while the terms of sale at all other locations remained constant. If the hypothetical monopolist would not profitably impose such a price increase because of substitution by customers to products from other geographic areas, the candidate market is not a relevant geographic market by itself.

4.6.3. The Commission then adds the location that is the next-best substitute for the merging firm's location, and applies the SSNIP test to a candidate market of the expanded area. This process will continue until an area is identified such that a hypothetical monopolist would achieve market power, and profitably impose at least a SSNIP in the candidate market. The relevant geographic market generally will be the smallest area that satisfies this test.

4.6.4. A relevant geographic market may be a city, province, national, multinational, or global in nature, and may not correspond to political or jurisdictional boundaries. In considering whether a market may be multinational or global in nature, the Commission assesses the extent to which imports, or the potential for imports, would constrain the ability of a hypothetical domestic monopolist to impose a SSNIP by constituting a competitive threat that would make such a price increase unprofitable. As part of this assessment, the Commission considers evidence regarding the extent to which customers currently view imported products as acceptable substitutes, the potential and likelihood for substitution to imports to increase in response to a SSNIP imposed by a hypothetical domestic monopolist, and whether imports would occur on a sufficient scale, and sufficiently quickly, to constrain an exercise of market power by a hypothetical domestic monopolist.

4.6.5. In considering the likely reaction of customers to a price increase, the Commission relies on the available evidence relevant to the likelihood that customers substitute to suppliers outside the geographic area in response to a SSNIP. Relevant evidence includes, but is not limited to:

a) The cost and probability of users or consumers seeking other markets;

b) The cost of distribution of the good or service, its raw materials, its supplements and substitutes from other areas and abroad, considering freight, insurance, import duties, and non-tariff restrictions; the restrictions imposed by economic agents or by their associations; and the time required to supply the market from those areas;

c) The cost and difficulty of transporting the product in relation to the value of the product (the higher the value of a product relative to its transportation costs, the more likely customers are to seek suppliers in more distant locations and the more likely suppliers located in other areas are willing to supply customers in that area);

d) Product characteristics (e.g., product perishability or fragility, the nature and requirements of offered services, etc.), geographic features, or other circumstances impacting the ability of customers to obtain products from sellers outside the geographic area;

e) Evidence that customers have shifted or have considered shifting purchases between different geographic locations in response to relative changes in price or other competitive variables. In some instances, the Commission may be able to derive such evidence from empirical analysis of quantitative data;

f) Evidence that sellers base business decisions on the prospect of buyer substitution between geographic locations in response to relative changes in price or other competitive variables;

g) Relative price levels and price movements of products in different geographic areas;

h) The willingness of customers to obtain the relevant product or service from suppliers in other geographic locations, including customer preferences for obtaining the product from a supplier with a local presence or with the ability to communicate in the local language;

i) Constraints on the ability of outside sellers to expand their sales into the geographic area (e.g., production capacity, committed capacity, the need to establish brand recognition and acceptance; distribution and after-sales service capabilities, etc.);

j) Legal or regulatory requirements (e.g., import duties, tariffs, quotas, licensing requirements, required regulatory authorizations or approvals, etc.) that may raise the costs of suppliers from outside the geographic area or impact the ability of customers to obtain the product or service from suppliers located outside the geographic area;

k) National, local or international restrictions which limit the access by users or consumers to alternate sources of supply or the access of suppliers to alternate consumers; and/or

l) The timing and costs of switching suppliers from one region to another, as high switching costs relative to the value of the product will make substitution less likely.

5. Targeted Customers and Price Discrimination

5.1. Where a hypothetical monopolist would profitably discriminate in prices charged to particular groups of customers or in particular geographic areas, the Commission may consider whether a narrower relevant market, consisting of a product or group of products sold to certain groups of customers or in particular geographic areas, is appropriate. Markets to serve targeted customers are also known as price discrimination markets.

5.2. In assessing whether a hypothetical monopolist would price discriminate to impose a SSNIP profitably on particular groups of customers or customers in particular locations, relevant factors include, but are not limited to:

a) Whether price discrimination is feasible in the market at issue;

b) Whether a hypothetical monopolist could successfully identify transactions subject to successful price discrimination;

c) Whether customers or third parties could undermine price discrimination through some form of arbitrage in which a product sold at lower prices to some customer groups is resold to customer groups intended by the firms to pay higher prices; and/or

d) Whether price discrimination would permit or enhance the successful exercise of market power against particular buyer groups or customers in particular locations.

6. Supply-side substitution

6.1. The Commission considers the potential for supply-side substitution, and whether to include as participants in the relevant market not only all firms that currently produce or sell in the relevant market, but also firms that likely would, in response to a SSNIP in the relevant market, produce or sell in the relevant market within a short time frame and without incurring significant sunk costs.

> **Sunk Costs:** The term "sunk costs" means the acquisition costs of tangible and intangible assets necessary to manufacture and sell the relevant product or provide the relevant service that cannot be recovered through the redeployment of these assets for other uses. A merger would not attract entry if the anticipated reward were not commensurate with the risk from being unable to recover ***sunk costs***.

6.2. The relevant question for analysis is not whether a firm has the capability to produce or sell the relevant product, but whether it would likely make such sales profitably in response to a SSNIP. If a firm has existing assets that could be shifted or extended quickly into production or sale of the relevant product in the relevant geographic market, it does not necessarily mean that (a) the firm would have the incentive to produce or sell the relevant product, (b) the firm would entirely switch or extend its production or sales of the relevant product, and/or (c) all firms producing the other product would do so.

6.3. In determining the extent to which supply-side substitution is likely, the Commission takes into account reasonably available and reliable evidence, including, but not limited to:

a) The extent to which obtaining new tangible or intangible assets, or switching or extending existing assets, to enter into production or sale in the relevant market is technically feasible;

b) The extent to which customers would be willing to switch to products offered by the firm in the relevant market;

c) The time it would take to enter into production or sale, including the time necessary to comply with any applicable legal or regulatory requirements;

d) The costs of shifting or entering into production or sale relative to the profitability of sales at the elevated price; and/or

e) Whether the firm's capacity is elsewhere committed or elsewhere so profitably employed that such capacity likely would not be made available to respond to an increase in price in the relevant market.

6.4. The Commission assesses the competitive significance of probable supply responses that will not meet the requirements for quick supply-side substitution in the analysis of entry.

7. Use of Market Shares: Thresholds & Presumptions

7.1. Market shares are an indication of the competitive significance of each merging firm in the relevant market. They provide an indication of a firm's incentives to coordinate its actions with rivals and its ability to exercise market power. The significance of market shares and measures of market concentration is specific to the analytical context presented in each investigation. They are not determinative of possible competition concerns in themselves, as they may, for instance, either underestimate or overestimate the future competitive significance of a firm or the impact of a merger.

7.2. Mergers that require more attention are those that significantly increase market concentration. The change in concentration caused by a merger is a useful, although imperfect, indicator of the loss of direct competition between the parties and of the potential for competitive harm.

7.3. Market share and concentration estimates used for merger analysis should reflect the best available indication of the firms' future competitive significance. In most cases, market share measurements will be based on units or monetary values, in order to express the distinction between different products. The Commission may also examine volume of sales, production, supply and number of customers when appropriate.

7.4. The Commission considers reasonably predictable effects of recent or ongoing changes in market conditions when calculating and interpreting market share data, in order to avoid understating or overstating a firm's future competitive significance.

7.5. The absence of high market shares or post-merger concentration ordinarily supports a conclusion that a given transaction requires no further analysis. Similarly, a transaction that does not significantly increase post-merger market shares or concentration ordinarily requires no further analysis, as the premerger competitive conditions are unlikely to be significantly altered by the merger. However, there may be exceptions. For example, when at least one party to the merger has substantial market power, even small increases in market share may be indicative of possible competition concerns.

8. Market Concentration

8.1. High market concentration and significant increases in market shares brought about by a merger are useful indicators that a merger is likely to harm competition significantly. Market concentration and market shares are used to presume competitive harm, and can be either overcome or confirmed by a detailed review of market conditions.

8.2. High market share for the merging firms post merger of at least 50% or high market concentration gives rise to a presumption of market power. However, the

Commission's investigatory process will take into account evidence that may overcome or confirm the presumption, including an assessment of entry and further criteria as appropriate in the specific circumstances of a particular case.Herfindahl-Hirshman Index (HHI) of market concentrations helps interpret market share data. The HHI is calculated by summing the squares of the market shares of all the firms active in the market. The HHI potentially reflects both the number of firms in the market and their relative size. Both the absolute level of the HHI and the change in the HHI as a result of the merger can provide an indication of whether a merger is likely to raise competition concerns. The HHI is calculated by summing the squares of the market shares of all the firms active in the market. When using HHIs, the PCC considers both the post-merger level of the HHI and the increase in the HHI resulting from the merger. The increase in the HHI is equal to twice the product of the market shares of the merging firms.

Measuring HHI: Example
A market of 4 firms with market shares of 30, 30, 20, and 20 produces an HHI of 2600. 302 + 302 + 202 + 202 = 900 + 900 + 400 + 400 = 2600. If one of the firms with 30 percent market share merged with one of the 20 percent market share firms, the new HHI would be 3800, an increase of 1200 points. Example: $(30 + 20)^2$ + 302 + 202 = 2500 + 900 + 400 = 3800

8.3. In interpreting Post-merger HHIs, the PCC classifies markets into three types: 1) Unconcentrated Markets with HHI below 1500; 2) Moderately Concentrated Markets with HHI between 1500 and 2500; and Highly Concentrated Markets with HHI above 2500.

8.4. The PCC employs the following general standards for changes in concentration from the merger:

8.4.1. Small change in concentration: mergers involving increases in HHI of less than 100 points, anticompetitive effects are unlikely.

8.4.2. Unconcentrated Markets: mergers resulting in unconcentrated markets are unlikely to have anticompetitive effects.

8.4.3. Moderately Concentrated Markets: mergers resulting in moderately concentrated markets that involve increases in the HHI of more than 100 points, potentially raise significant competitive concerns and often warrant scrutiny.

8.4.4. Highly Concentrated Markets: mergers resulting in highly concentrated markets that involve an increase in the HHI between 100 points and 200 points, potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points, are presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

8.5. The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the PCC's potential competitive concerns and the greater the likelihood that the PCC will request additional information to conduct its analysis.

9. Competitive Effects Analysis in Horizontal Merger Review

9.1. The Commission will conduct competitive effects analysis in merger review to identify those mergers likely to harm competition significantly by creating or enhancing market power, either unilaterally or in coordination with rivals.

9.2. While changes in market share or market concentration are useful indicators of potential competitive concerns, competitive effects analysis involves a comprehensive assessment of market conditions, and provides more reliable means to assess potential harm to competition than changes in market share or market concentration alone.

9.3. When exercised by sellers, market power is the ability profitably to raise price above competitive levels for a significant period of time, and/or to lessen competition on parameters other than price, such as quality, service, or innovation. In some cases, market power may be exercised by buyers. In such cases, market power is the ability profitably to reduce the price paid to suppliers below competitive levels for a significant period of time, which may in some cases lead to an anticompetitive reduction in supplier output.

9.4. The Commission, once engaged in competitive effects analysis, conducts a forward- looking inquiry focusing on a comparison of the anticipated state of competition in the relevant market(s) with and without the merger. As stated in Rule 4, Section 1, the Commission's assessment of competition without the merger (sometimes called the "counterfactual") is informed not only by the existing conditions of competition, but also by any significant changes in the state of competition likely to occur without the merger.

10. Unilateral Effects

10.1. In analyzing the potential for a horizontal merger to result in anticompetitive unilateral effects, the Commission assesses whether the merger is likely to harm competition significantly by creating or enhancing the merged firm's ability or incentives to exercise market power independently.

10.2. Horizontal mergers eliminate any competitive constraint that the merging parties formerly exerted upon one another. In the majority of mergers, this has no significant adverse effect on competition because there are other sufficient competitive constraints on the merged entity. In some cases, however, the elimination of competition between the merging parties in itself may create or enhance the ability of the merged firm independently to exercise market power, depending on market conditions, including the existence and effectiveness of other competitive constraints.

10.3. Mergers may increase the likelihood of the exercise of unilateral market power in a variety of settings. Common theories and models include, but are not limited to:

a) *Merger to monopoly*: A merger that would combine the only two rivals in a properly defined market raises a high risk of significant anticompetitive unilateral effects. In examining a merger combining the only two rivals in a relevant market, the Commission assesses whether any competitive constraints exist, such as ease of entry, that would preclude the unilateral exercise of market power by the merged firm.

b) *Merger of competitors in differentiated product markets*: A merger that would combine competing suppliers of differentiated products may raise the potential for significant anticompetitive unilateral effects if a sufficient proportion of consumers view the products combined by the merger as their first and second choices (or closest substitutes). The Commission assesses whether the merger would allow the merged firm profitably to increase price on one or more products after the merger, or whether sufficient customers would switch to products of other competitors, so as to render such a price increase unprofitable for the merged firm. The Commission also considers whether rival sellers likely would replace any loss of competition by repositioning or extending their product lines to compete more closely with the merged firm.

> Examples of sources of evidence of the degree of substitutability among differentiated products include marketing surveys, analysis of purchasing patterns, cross-price elasticities, and information contained in normal course of business documents from market participants.

c) *Merger of competitors in undifferentiated product* markets: In examining a merger that would combine competing suppliers of undifferentiated products in markets in which firms are distinguished primarily by capacity, the Commission will consider whether the merged firm would find it profitable to raise price by reducing output below the level that would have prevailed absent the merger. The exercise of market power in such markets will be likely if the merged firm's (1) market share is relatively high, (2) has a low share of output that is committed to the lower prices, (3) has a low margin on the suppressed output, (4) is not subject to significant response from rivals, and/or (5) is active in a market featured by low elasticity of demand.

d) *Merger of rivals in bidding or auction markets*: A merger that would combine rival bidders in bidding or auction markets raises the potential for significant anticompetitive unilateral effects. The effects of such a merger are likely to be significant where a merging party was frequently a runner-up when the other won the business, or where one of the parties has certain advantages over the rest of its rivals.

10.4. Competitive effects analysis depends heavily on the specific facts of each case. In conducting competitive effects analysis, the Commission will refine their theories or models of likely competitive harm in light of the available qualitative and quantitative evidence.

Qualitative evidence often comes from documents or first-hand observations of the industry by customers or other market participants. Quantitative evidence is often derived from statistical analysis of price, quantity, or other data related to, among other things, prior market events (sometimes called "natural experiments") involving incumbent responses to prior events such as entry or exit by rivals. Competitive effects analysis should be flexible enough to adapt over time to evolving markets, business practices, and economic learning.

Another economic tool that the Commission may use is a natural experiment, which is the analysis of how companies' variables such as prices, volumes, costs and margins have evolved in response to particular events or shocks, such as new brand entry, new product launch, specific innovations, special promotions and advertising campaigns, and supply disruptions.

10.5. Several other competitive constraints and market conditions that will remain in the market following the merger may be adequate in order to prevent the creation or enhancement of unilateral market power. Factors that are often relevant in assessing the likelihood of a unilateral exercise of market power as a result of a merger include, but are not limited to:

a) *Availability and Responsiveness of Alternative Suppliers*: If alternative suppliers (offering adequate substitutes and with sufficient available capacity) will remain post-merger, and a significant number of customers are willing and able to turn to these alternative suppliers in the event of an anticompetitive increase in price, the threat of losing such customers may be enough to deter the exercise of market power by the merged firm;

b) *Entry, Repositioning, or Expansion*: The prospect of entry by new competitors, or expansion or repositioning by existing competitors, may be sufficient in time, scope, and likelihood to deter or defeat any attempt by the merged firm to exercise market; and/or

c) *Buyer Power*: In some circumstances, customers may have the incentive and ability to defeat the exercise of market power through their bargaining strength against the seller because of their size, commercial significance to the seller, or ability to switch to alternative sources of supply. Customers also may have the ability to encourage or sponsor competitive entry or expansion, or to produce the relevant product themselves. In such cases, even firms with very high market share may not be in a position to exercise market power post-merger. To prevent significant anticompetitive effects, however, buyer power must constrain the exercise of market power in the market and not merely protect certain individual customers.

11. Coordinated Effects

11.1. In analyzing the potential for coordinated effects, the Commission assesses whether the merger increases the likelihood that firms in the market will successfully coordinate their behavior or strengthen existing coordination in a manner that harms competition.

11.2. To identify those mergers that materially enhance the likelihood of coordination or strengthen existing coordination, the Commission: (a) assesses whether market conditions are conducive to coordination in the relevant market(s) affected by the merger; and (b) analyzes specifically whether and how the merger would affect market conditions and firms' ability or incentives that would make coordination more likely post-merger.

11.3. The Commission will determine whether the merger will make coordination easier or more likely, considering the specific features of the market that affect the merged firm's ability and incentives to exercise market power in coordination with rivals.

11.4. Coordinated behavior may be tacit or explicit, and may or may not be lawful in itself. For example, in some markets, firms may coordinate their behavior on prices in order to keep them above the competitive level. In other markets, firms' 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 or other customer characteristics, or by allocating contracts in bidding markets.

11.5. In order to coordinate, firms need to achieve an understanding as to how to do so, which does not require an explicit agreements among competitors, or any communication between them, nor need it involve all firms or perfect coordination between firms. When assessing market conditions conducive to reaching terms of coordination, relevant factors include, but are not limited to:

a) The number of firms in a market, since it is easier to coordinate among a few players than among many;

b) The existence of frequent and regular orders, which make it easier to coordinate and to detect deviations from the terms of coordination;

c) The homogeneity of the products, since it is easier to coordinate on terms such as price when competing products are substantially the same;

d) The homogeneity of the firms, especially in terms of symmetry of market shares, similarity of cost structures, levels of vertical integration, and the impact that such homogeneity may have on their ability or incentives to coordinate;

e) The degree of transparency of important information that could provide a focal point for coordination, such as information concerning prices, output, capacity, customers served, territories served, discounts, new product introductions, etc.;

f) Cross-shareholdings and other links that may make it easier for competitors to exchange information on terms of coordination, and may reduce their incentives to compete; and/or

g) Other market conditions: for instance, it is easier to coordinate on price when demand and supply conditions are relatively stable than when they are frequently changing (e.g., because of the ease of entry by new firms or rapid, significant product innovations).

11.6. Firms may be able to identify terms of coordination 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 coordinating on a large number of prices or to coordinate on terms other than prices. Moreover, coordination may not necessarily be achieved on all dimensions of competition.

11.7. For coordination to be maintained, participants must have the ability to detect and respond to deviations from the terms of coordination. Although coordination may be in the collective interest of participants, it is often 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 behavior. The Commission assesses the extent to which firms would have the ability to monitor the important terms of coordination and to detect deviations from the terms of coordination in a timely manner.

11.8. In order to deter deviations from the terms of coordination, firms must have the ability to punish deviations in a manner that will ensure that coordinating firms find it more profitable to adhere to the terms of coordination than to deviate, given the cost of reprisal. Punishment may take many forms, including temporary abandonment of the terms of coordination by other firms in the market. In assessing whether there will be a sufficiently credible and severe punishment when a deviation by one of the firms is detected, relevant factors include, but are not limited to:

a) The effectiveness of the deterrent mechanism itself: 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;

b) The speed with which the deterrent mechanism can be implemented, given that reprisal that manifests itself after some significant time lag is less likely to be sufficient to offset the benefits from deviating; and/or

c) The costs of implementing the deterrent mechanism compared to the long-term benefits of coordination.

11.9. Other factors, such as the presence of the same firms in several markets (sometimes called "multi-market contacts"), may also be of relevance in determining the likelihood of sufficiently credible and severe punishment.

11.10. The Commission assesses whether competitive constraints or other market conditions that will remain in the market following the merger are adequate to prevent the creation or enhancement of coordinated interactions. Relevant factors include, but are not limited, to:

a) *Past Coordination/Behavior of Firms*: The Commission takes into account information on the pre-merger characteristics of the markets concerned, including the past behavior of firms. Evidence of past coordination is important and may serve as strong evidence that all three conditions for successful coordination are present if the relevant market characteristics have not changed appreciably or are not likely to do so in the near future;

b) *Maverick Firm*: Coordination may also be difficult to sustain in the presence of a maverick firm – a firm with a different competitive strategy and a greater economic incentive than its rivals to deviate from the terms of coordination. Particular care is needed in mergers involving the acquisition of a maverick firm because in some circumstances those mergers may eliminate a significant constraint to effective coordination and make coordinated interaction more likely, more successful, or more complete; and/or

c) *Buyer Power*: The Commission considers whether the actions or characteristics of customers affect the likelihood of successful coordination. In some circumstances, buyers may be able to undermine coordinated behavior, for example by sponsoring entry or expansion. Where large buyers likely would engage in long-term contracting, so that sales covered by such contracts would be large relative to a firm's total output, firms may have a greater incentive to deviate from the terms of coordination.

12. Entry & Expansion

12.1. Firm entry and/or expansion by existing competitors is an integral part of the analysis of whether a merger is likely to harm competition significantly, and allow the merged firm to raise prices or reduce output, quality, or innovation.

12.2. Entry, or the threat of entry from potential competitors or from customers turning to in-house supply, can be an important competitive constraint on the conduct of the merged firm. If the merged firm is subject to significant competitive constraints from the threat of market entry (*e.g.*, if barriers to entry are low and entry is likely to be profitable at premerger prices), the merger is unlikely to have meaningful anticompetitive effects.

12.3. The ability of rival firms to expand capacity in a timely manner, or use existing spare capacity or switch capacity from one use to another, can constitute an important competitive constraint on the merged firm's conduct. Many of the factors that are used to assess entry are relevant to the analysis of expansion, including competitor expansion plans, barriers to expansion, and the profitability of expansion.

12.4. In assessing whether entry and/or expansion would effectively constrain the merged entity, the Commission considers whether entry and/or expansion would be: (a) likely; (b) timely; and, (c) sufficient in nature, scale and scope.

12.5. For entry and/or expansion to be *likely*, it should be profitable for competitors of the merged entity to expand output and/or for potential entrants to enter the market in response to an attempt by the merged entity to profit from the potential reduction in competition brought about by the merger (*e.g.*, a post-merger price increase). In assessing the *likelihood* of entry, the Commission considers the history of entry into and/or exit from the relevant market using available evidence, including information on firms that have recently entered or exited the market, information about past and expected market growth, evidence of planned entry and/or expansion, direct observation of the costs, risks and benefits associated with entry and information from firms identified as potential entrants.

12.6. In assessing the *likelihood* of entry and/or expansion, the Commission considers the existence and significance of barriers to entry and expansion to the relevant market. Relevant factors include, but are not limited to:

a) Economies of scope and/or scale, the availability of a scarce resource that is an essential input, technical capability or intellectual property rights;

b) The reputation of incumbent firms, incumbent firms' investment in excessive capacity, or the duration, termination and renewal provisions in existing contracts;

c) Government regulations that might, for example, limit the number of market participants or impose substantial regulatory approval costs; and/or

d) Sunk costs that could not be recovered if the entrant left the market including machinery that might be site specific or R&D that has not yet resulted in any marketable invention or innovation.

12.7. In assessing whether entry and/or expansion is *timely*, the Commission considers whether entry and/or expansion would take place within a reasonable period of time after the merger. This often means that entry must have a competitive impact within two years to have a sufficiently disciplining effect. The appropriate time horizon may vary according to the characteristics of the relevant market.

12.8. For entry and/or expansion to be *sufficient*, the Commission considers whether entry and/or expansion would be:

e) Of sufficient in scale to compete effectively with the merged entity;

f) Able to counteract any specific anti-competitive effects resulting from the merger; and

g) Able to counteract any localized effects of the merger (e.g., in markets differentiated by geographic areas or customer categories).

13. Efficiencies

13.1. A primary benefit of mergers to the economy is their potential to generate significant efficiencies and enhance the merger firm's ability and incentive to compete. Benefits include lower prices, improved quality, enhanced service and new products.

13.2. Chapter IV, Section 21 (a) of the PCA and Rule 4, Section 10 of the Rules provide that otherwise anticompetitive mergers may nonetheless be exempt from prohibition by the Commission when the parties establish the merger has brought about or is likely to bring about gains in efficiencies that are greater than the effects of any limitation on competition that result or are likely to result from the merger or acquisition.

13.3. Efficiencies are difficult to verify, and many projected efficiencies may never be realized. Thus, as noted in PCA Chapter IV, Section 22, and IRR Rule 4, Section 11, a party seeking to rely on an efficiencies justification must demonstrate that if the proposed merger or acquisition were not implemented, significant efficiency gains would not be realized.

13.4. The Commission will carefully assess any cognizable claims asserted by the merging parties that a merger will generate efficiencies sufficient to prevent or mitigate anticompetitive effects from the merger. The Commission will consider the impact on the merged firm's ability and incentives to compete, and whether such efficiencies may preserve or intensify competition, thereby benefiting consumers. For instance, cost reductions may reduce a merged firm's incentive to raise price. Efficiencies may also result in benefits in the form of new or improved products, even when price is not immediately and directly affected.

13.5. The merging firms should substantiate efficiency claims so that the Commission can verify by reasonable means the likelihood and magnitude of each asserted efficiency and how and when each would be achieved, among other things. The Commission will credit only cognizable efficiencies, which are merger specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service.

13.6. Merger specific efficiencies are those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects.

13.7. Efficiencies must be substantiated; not vague, speculative, or otherwise unverifiable by reasonable means. The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers.

13.8. Some examples of cognizable and substantial efficiencies include efficiencies resulting from shifting production among facilities formerly owned separately or efficiency claims substantiated by analogous past experience.

14. Failing Firm/Exiting Assets

14.1. Under Chapter IV, Section 21(b) of the PCA and Rule 4, Section 10 of the Rules, when a party to a merger or acquisition agreement is faced with actual or imminent financial failure, and the agreement represents the least anti-competitive arrangement among the known alternatives for the failing entity's assets, the Commissionmay exempt from prohibition an otherwise anticompetitive merger. As stated in PCA Chapter 4, Section 21, the burden of proof lies with the parties seeking the exemption.

14.2. A merger is not likely to create or enhance market power if one of the merging parties is likely to fail and its assets are likely to exit the market in the imminent future. If the parties trigger the failing firm doctrine, the Commission will produce a counterfactual against which it shall analyze the competitive effects of the merger.

14.3. The basis for concluding that a merger with a failing firm does not harm competition is that the competition provided by a failing firm would be lost even without the merger and, consequently, the competitive situation post-merger may be no worse than the counterfactual (the competitive situation absent the merger). In other words, the Commission may conclude, based on the failing firm doctrine, that the merger has no causal connection with worsened competitive conditions in the future.

14.4. The Commission may examine more than one relevant counterfactual scenario (*e.g.*, the failing firm's assets exit the market or are bought by a less competitively significant incumbent or a potential new entrant). The burden of proof of exit lies on the merging parties, who also hold the relevant evidence. In the absence of sufficient evidential support for exit, the Commission cannot make use of failing firm analysis.

14.5. Many firms, despite temporary difficulties, are able to survive and continue competing. The fact that a firm has not been profitable does not necessarily mean that it is a "failing firm" since accounting losses do not necessarily reflect the true economic losses from ongoing operations, *i.e.*, its fundamental ability to compete effectively in the future. For instance, a firm with a substantial debt may be able to emerge from its financial trouble as an effective competitor through a new business strategy or new management because it possesses valuable assets.

14.6. The Commission considers whether ordinary course of business documents indicate an imminent financial failure, or whether the claims of failure appear overstated to justify the merger. The material tests for showing that one of the merging parties is failing are that (a) the firm is unable to meet its financial obligations in the imminent future; (b) there would be no serious prospect of reorganizing the business; (c) there would be no credible less anticompetitive alternative outcome than the merger in question; and, (d) the firm and its assets would exit the market in the imminent future absent the merger.

14.7. Relevant evidence shall include profit and loss and cash flow information, recent balance sheets and analysis of the most recent statutory accounts, the timing and nature of the firm's financial obligations, the relationship between the company's costs and its revenues, the likely ability of the firm to obtain new revenues or new customers, and the current and future availability of key inputs. Prospective financial information should also be requested including forecast information for the current year, ideally forecasts produced either in advance of the proposed transaction or for another purpose and not produced solely for us. In most cases, we will seek the (in-house or outsourced) assistance of financial and accounting expertise.

14.8. Next, the Commission assesses whether the failing firm has unsuccessfully sought in good faith any credible alternative offers of acquisition of the firm or its assets that would both retain the assets in the relevant market and pose less harm to competition than the merger in question. The parties are required to provide evidence that there is sufficient awareness regarding the sale of the firm or its assets to attract the attention of likely prospective purchasers. The Commission will consider other offers to purchase the assets of the failing firm above the liquidation value of those assets (net of the costs associated with the liquidation process). The fact that an alternative purchaser's offer is not commercially preferable to that of the merging parties does not dismiss the alternative purchaser's offer so long as it is above the asset liquidation value.

14.9. Finally, the Commission considers whether the failure of the firm and the liquidation of its assets could be a less anticompetitive alternative to the merger since the remaining firms in the market would compete for the failing firm's market share and assets that otherwise would have been transferred wholesale to a single purchaser. Valuable assets are unlikely to exit the market, even if the firm cannot meet its financial obligations in the imminent future.

14.10. Assets that are not economically viable would not be expected to remain in the market unless the acquirer expects the acquisition to generate significant efficiencies that will make the assets economically viable. In such cases, the acquiring firm would acquire the failing firm to benefit from the resulting efficiencies, arising from the merger, rather than from a reduction in competition since the failing firm would leave the market in any event. Such a merger is likely to result in consumer benefits since the competitive outcome with the merger may be better than without the merger.

14.11. Merging parties may advance claims that a merger will not harm competition on the grounds that one of the merging parties is "flailing", *i.e.*, is in financial distress but does not meet the conditions of a failing firm. If the criteria to establish a failing firm are not met, the Commission will appropriately consider these claims in the analysis of competitive effects since the financial weakness of the firm may still be a relevant factor in determining whether the merger is anticompetitive. In such cases, a firm's weakened financial condition may indicate that it is likely to compete less effectively in the future, such that the merger will not substantially lessen competition.