

**Joint Comments of the American Bar Association’s  
Section of Antitrust Law and Section of International Law  
on  
Competition Commission and Office of Fair Trading  
Draft Merger Assessment Guidelines**

**May 2010**

*The views stated in this submission are presented jointly on behalf of these Sections only. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and therefore may not be construed as representing the policy of the American Bar Association.*

The Section of Antitrust Law and the Section of International Law (together, the “Sections”) of the American Bar Association respectfully submit these comments regarding the Competition Commission’s (“CC”) and Office of Fair Trading’s (“OFT”) (collectively, the “Authorities”) April 2010 joint draft *Mergers Assessment Guidelines* (the “Draft Guidelines”).

The Sections appreciate the Authorities’ earlier consideration of third-party comments on the April 2009 version of the Draft Guidelines, including the comments submitted by the Sections in August 2009. We acknowledge and express our further appreciation for the Authorities’ adoption of a number of the revisions we had suggested in our 2009 comments. We also commend the drafters for providing specific guidance on areas where the OFT and CC diverge analytically based on each Agency’s standard of review, and more generally for increasing predictability and public understanding of the Authorities’ approach to reviewing mergers.

In the comments that follow we aim not to repeat the points made in our 2009 submission, but to instead focus on areas where we believe further clarification, analysis, or, in a few cases, reconsideration, would be beneficial. We wish to note that certain

comments raise issues also presented by the recently proposed United States Department of Justice and Federal Trade Commission, “Horizontal Merger Guidelines For Public Comment: Released on April 20, 2010”<sup>1</sup> (hereinafter “Proposed US HMGs”); not surprisingly, many of these issues are likely to remain matters on which there will be some divergence of opinion. The Sections will be submitting comments on the Proposed US HMGs that are consistent with the views provided here.

## **I. Evidentiary Requirements**

In paragraph 4.5, a “substantial lessening of competition” (“SLC”) is no longer described as an “adverse effect for consumers” but instead as an “adverse effect on rivalry” over time that will “be expected to lead to an adverse effect for customers.” The Sections recommend that the Authorities provide additional explanation of the difference in meaning between “effect on rivalry” and “effect for consumers.” Only the latter is described in “expectation” terms, even though likely “effect on rivalry” is also a function of expectation based on the evidence, particularly for proposed mergers. It is unclear whether (and, if so, how) the Authorities evaluate evidence differently as it relates to rivalry per se, on the one hand, and the manifestation of rivalry (*e.g.*, prices, quality, or innovation), on the other.

The construction of paragraph 4.5 appears to suggest that the Authorities could find an SLC from a proposed merger that is deemed to adversely affect the competitive process (*i.e.*, the dynamics of competitive rivalry) even absent specific evidence of an adverse effect on competitive outcomes (*e.g.*, consumer prices). The Sections respectfully recommend that the Authorities clarify what if any practical impact this

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<sup>1</sup> Available at <http://www.ftc.gov/opa/2010/04/hmg.shtm>.

change will have on the Authorities' analysis of whether a proposed merger is likely to result in an SLC.

The Sections commend the Authorities for acknowledging in paragraph 4.8 that a transaction's commercial rationale may be relevant to the competitive analysis. For example, documents created in the ordinary course that reflect the acquiring firm's expectation of efficiencies from a merger may provide insight into potential pro-competitive attributes that will result. We similarly commend the identification of types of background documentary evidence that may assist the Authorities in this inquiry.

Regarding the submission of technical evidence, discussed in paragraph 4.16, we encourage the Authorities to consider adopting into their Draft Guidelines recognition of a reciprocal enforcement agency "best practice" that would provide information about the Authorities' technical analyses to the merger parties, subject to appropriate confidentiality limitations. Such transparency may foster resolution of inconsistencies in interpretations of quantitative evidence, and thereby facilitate more timely and well-grounded decisions regarding the competitive implications of a merger.<sup>2</sup>

## **II. The Counterfactual**

The Authorities have substantially revised the Draft Guidelines' discussion of the counterfactual. The additional detail provides a welcome increase in transparency and clarity. The Sections believe that additional clarification on one particular point would be beneficial.

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<sup>2</sup> The European Commission ("EC") and the Federal Trade Commission ("FTC") have incorporated such practices not in merger guidelines but in companion publications. For the EC, see [http://ec.europa.eu/competition/consultations/2010\\_best\\_practices/index.html](http://ec.europa.eu/competition/consultations/2010_best_practices/index.html) (economic evidence). For the FTC, see <http://www.ftc.gov/be/bestpractices.shtm>.

At paragraph 4.17, the Draft Guidelines state that “[t]he counterfactual is an analytical tool used in answering the question of whether the merger gives rise to an SLC and is therefore not comparable in detail to that of the Authorities’ analysis of the competitive effects of the merger.” The extensive discussion in the Draft Guidelines regarding the counterfactual implies this analytical tool is a critical factor in the Authorities’ assessment of the likely competitive effects of a merger. If so, then the Sections submit that the Guidelines should expressly confirm that the counterfactual must be grounded in sufficient factual detail to serve as a reliable benchmark for comparison to the post-merger market and recommend that the Draft Guidelines be revised to acknowledge this point. Doing so would be consistent with paragraphs 4.21 (OFT requires counterfactual to be “realistic”) and 4.22 (CC applies counterfactual that “is the most appropriate based upon the facts available to it” and sometimes must make a “more detailed investigation of the circumstances”).

### **III. Failing Firms**

The Sections welcome the inclusion of more detail in the Draft Guidelines’ failing firm analysis, including the more flexible approach described in paragraph 4.31 regarding divestitures of failing divisions. This provision accounts for corporate obligations to act in the best interests of shareholders, which can lead to a decision to close a subsidiary for reasons beyond a simple financial assessment. The Sections believe that clarification on certain other provisions relating to failing firms would be beneficial.

Revised paragraph 4.25 explains that “[i]n forming a view on a failing firm scenario, the Authorities will consider: (a) whether the firm would have failed; and if so:

(b) whether there would have been an alternative purchaser for the firm or its assets—ie so as to ascertain whether the failure of the firm would result in its exit or in the exit of its assets; and (c) what would have happened to the sales of the firm in the event of its exit.” The original test (embodied in old paragraph 4.27), in contrast, explained that the failing firm defense included an analysis of “(a) the inevitability of exit of the firm in question; (b) whether there would be a substantially less anti-competitive alternative buyer for the firm; and (c) whether failure of the firm would be a substantially less anti-competitive outcome than the merger.”

The Sections observe the following notable word differences in the foregoing subparagraphs, as between the current and prior Draft Guidelines: in (a), deletion of “inevitability;” in (b), deletion of the “substantially less anti-competitive” test for an alternative purchaser; and in (c), a shift away from whether failure would have been a substantially less anti-competitive outcome rather than the merger. Current paragraph 4.27 appears to suggest that the foregoing word changes may not matter, however, since it largely incorporates wording that was eliminated in new 4.25. We recommend that the Authorities clarify whether the revisions describe changes in policy toward failing firm analysis.

Paragraphs 4.24 and 4.26 provide that firms may exit for reasons other than failure. In 4.26, the Authorities provide one example of such a reason—that the selling firms’ corporate strategy may have changed. We recommend that the Draft Guidelines provide examples of reasons for exit other than failure that may, depending on the facts, tend to show that the counterfactual reflects a less competitive scenario than that which would exist even if the merger results in an SLC. Such guidance would enhance parties’

ability to assess the relative weight that the Authorities will give to particular exit decisions in the context of the counterfactual.

#### **IV. Market Definition**

The Sections endorse the recognition in paragraph 4.49 that market definition and competitive effects analysis are closely related and that the same facts are often relevant to both issues. We interpret the statement that market definition and competitive effects “should not be viewed as two distinct analyses” to be a further expression of this inter-relationship and the importance of ensuring analytical consistency between the market(s) that the Authorities define and the theories of competitive harm they investigate in a particular merger review. We also concur in paragraph 4.52’s observation that market definition is “a useful tool, not an end in itself.” The “end” in merger analysis is to determine reliably and timely whether a particular transaction will, or will not, likely create, enhance or facilitate the acquisition of market power.

The Sections recommend that the Authorities confirm in the Draft Guidelines that market definition is an important tool of merger assessment that is always helpful at some point in the analysis. Moreover, as the Proposed US HMGs state, we encourage the Authorities to conduct an evaluation of competitive alternatives available to customers at some point during every merger assessment. Market definition enables better and more predictable enforcement decisions by focusing on the competitive alternatives available to customers, and on the economic significance of those alternatives individually and collectively.

The Sections observe that paragraph 4.56 has a revised explanation of the hypothetical monopolist test as compared to predecessor paragraph 4.53 of the prior Draft

Guidelines. The new language states that “[a] set of substitute products will satisfy the hypothetical monopolist test if a hypothetical firm that was the only present and future seller of the products would find it profitable to raise prices *of at least one product* by at least a small but significant and non-transitory amount” (said amount referred to as a “SSNIP”) (emphasis added). Predecessor paragraph 4.53, in contrast, posited whether a hypothetical monopolist “of a certain product or set of products” could profitably impose a SSNIP, without reference to whether a SSNIP could be imposed on “at least one product” within the “set of products.” The Sections recommend that the Authorities explain the reasons for this revision and the extent to which, if at all, it reflects a methodological change in their approach to market definition.

In paragraph 4.52, the Draft Guidelines provide that the Authorities may define two markets: (i) the “relevant market,” which provides “a framework for the analysis of the competitive effects of the merger,” and (ii) a separate “market for the particular purpose of measuring and evaluating market concentration,” which may be narrower than the relevant market. The Sections respectfully submit that this two-market approach risks introducing uncertainty and confusion into the process. It is unclear why the Authorities would not, in all cases, evaluate concentration and competitive effects in the “relevant market,” particularly because concentration is meaningful only as one factor out of many in a comprehensive competitive effects analysis. The two-market paradigm risks confusion concerning which of the two markets provides a more accurate description of the competitive arena within which a particular merger takes place.

Paragraph 4.58 provides that “market definition is always based on the hypothetical monopolist test.” It explains that different markets are possible from the

same test, because the Authorities may apply the test to different sets of products—depending on whether the Authorities are defining the relevant market or the market to assess concentration. For the relevant market, paragraph 4.57 states that the Authorities “include the substitute products (narrowly defined) of the merger firms in horizontal mergers” along with “any products that are close substitutes for those products.” “[M]arkets defined for purposes of measuring concentration,” on the other hand, according to paragraph 4.58, “may feature a narrower set of products (or smaller geographic area) than the relevant market, in order to ensure that market shares provide a reliable indication of market power.” This response does not address the threshold question why the Authorities do not measure concentration in the “relevant market.”

Under the Draft Guidelines’ relevant market test, the objective is to determine which substitute products competitively constrain a hypothetical monopolist seller of the merger firms’ products from exercising market power, *i.e.*, from profitably raising price. The ultimate objective of the Draft Guidelines’ test to define the market in which to assess concentration, likewise, is to determine whether the merger firms can exercise market power. Because the two tests fundamentally address the same core issue of identifying market power, when appropriately applied the tests should lead to the same market definition. To avoid the risk of unintentionally creating confusion by suggesting that the two tests have different objectives, when they both appear to lead to the same conclusion, the Sections respectfully recommend speaking solely in terms of defining the “relevant market.”

The Sections further observe that if a SSNIP would be profitable in the product grouping (or geography) defined as the “narrower set of products (or smaller geographic



market)” isolated solely for purposes of defining a market to measure concentration, then that latter set of products is itself a “relevant market” —not just for measuring concentration, but also for assessing competitive effects. This analysis follows the “smallest market principle” that, *e.g.*, the E.C., U.S. and Australian authorities incorporate into their respective methods to define the market.<sup>3</sup> The Sections recommend that the Authorities consider the same approach, to minimize the risk that a market is defined too broadly because the hypothetical monopolist test was not conducted over a more narrow set of products.

The Sections respectfully suggest that the method described in paragraph 4.57 potentially could result in overly broad markets. This method provides that first the Authorities identify the parties’ “substitute products” and “close substitutes for those products,” then for that set of products apply the hypothetical monopolist test. It is not clear on what basis the Authorities determine to include a particular product for this exercise. It is possible that a given collection of products will satisfy the hypothetical monopolist test, but a subset of one or more products from the larger collection might also satisfy the test. By conducting the test by starting with a single product and then proceeding iteratively using the smallest market principle, rather than by starting with a collection of putative substitutes, the Authorities may avoid defining markets that are overly broad.

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<sup>3</sup> See *European Commission Notice on the definition of the relevant market for the purposes of community competition law*, Official Journal C 372, 09.12.1997, at 5 ¶¶ 13-19); Proposed US HMGs, at 10 (“the Agencies usually evaluate mergers in the smallest relevant market satisfying the hypothetical monopolist test”); *Merger Guidelines of the Australian Competition and Consumer Commission* at ¶¶ 4.19-4.20, available at [www.accc.gov.au/content/item.phtml](http://www.accc.gov.au/content/item.phtml).

Paragraph 4.53(c) introduces the topic of markets defined by customer group. Under certain conditions, a merger will adversely affect only a subset of customers for the relevant product, because only that subset is unable to avoid a post-merger price increase. For this to occur, suppliers must be able to “target” (identify) the customers that will pay a higher price, and customers must be unable to defeat the price increase by arbitrage, *i.e.*, by purchasing indirectly from other customers not subject to the higher price. Paragraph 4.53(c) focuses only on the ability to identify customer groups and not on arbitrage (although paragraph 4.76 does address both factors). The Sections recommend that paragraph 4.53(c) be revised to clarify that a market cannot be defined by customer group if customers can defeat a SSNIP through arbitrage.

## **V. Inferences from Variable Profit Margins**

In several paragraphs in Part 4, the Draft Guidelines suggest that high pre-merger margins may be evidence that the proposed merger is taking place in markets conducive to adverse competitive effects, either because (i) demand is inelastic (and thus susceptible to unilateral increases in price) or (ii) market participants are coordinating their competitive activity. From this premise, the Authorities appear to draw conclusions about the competitive implications of high margins.

- In addressing types of evidence that may be informative on whether a SSNIP by a hypothetical monopolist would be profitable, paragraph 4.63(b) provides that “[t]he higher the variable profit margins of products within the candidate market, the lower the cost to the hypothetical monopolist of the price increase.”
- As part of unilateral effects analysis, paragraph 4.88(b) states that “[i]f the variable product margins of the products of the merger firms are high, then the capture by one firm of sales lost by the other firm following a price rise will make that price increase less costly. In many cases, low variable margins are associated with intense competition and highly price-sensitive customers.”

In many industries, however, the price-cost margin may reflect more on the seller's need to obtain a return on fixed costs such as research and development (appropriately adjusted for risk), than it is informative about the own-price elasticity of demand or the intensity of competition that the merger firms face. As such, a gap between price and variable cost, taken alone, may not imply the presence of market power. The Sections recommend that the foregoing sentences be revised to clarify that inferences from variable margins depend on the circumstances of the particular transaction and the market in which it occurs.

Similarly, in paragraph 4.109 of the Draft Guidelines, the Authorities posit:

There may be evidence to suggest that the market was tacitly coordinated before the merger. For example, market outcomes pre-merger such as pricing and market share may be hard to reconcile with non-coordinated behaviour, or there may be evidence (*e.g.*, based on demand elasticities and profit margins) that unilateral price decreases would be profitable. If so, this may imply that the three conditions for coordination (paragraph 4.112 below) were met pre-merger.

The Sections note that markets in which high margins may be observed – *e.g.*, markets where firms supply differentiated products, face large sunk costs, or engage in costly and risky R&D efforts – may also be markets in which coordination (particularly tacit coordination) is less likely. In a market for a differentiated good, there are multiple non-price elements of competition, each of which typically would have to be controlled and curtailed for successful coordination. In markets with large sunk costs, firms often have incentives to make incremental sales by undercutting their rivals, so as to earn more contribution towards fixed costs. Similarly, in R&D-intensive industries, ongoing product innovation often creates impediments to coordination. Because high margins also exist in markets performing competitively, the Sections believe that inferences about pre-merger coordination from margin and profit evidence must be consistent with all the

facts and circumstances of the particular market under review. In addition, we note that with high fixed-costs profits, margins above variable costs may not reflect durable market power or market power that is of competitive concern.

Accordingly, the Sections respectfully suggest that significantly more guidance be provided on the intended application of Paragraph 4.109. For example, it would be helpful to provide a clear understanding as to how margins or profits will be measured and over what time horizon. Additionally, it would be helpful for the Draft Guidelines explicitly to acknowledge that high margins or profits also can be fully consistent with non-coordinated behavior, for a variety of reasons including the presence of significant sunk costs, risky R&D, and differentiated products.

The Sections welcome the observation in footnote 60 that “[i]dentifying coordinated outcomes on this basis may be difficult,” since intense price competition often results in price parallelism. To emphasize the importance of this fact and to help minimize the risk that the main text could be read to suggest that high margins alone may be sufficient to suggest pre-merger coordination, the Sections urge that this statement be inserted into the main text of the Draft Guidelines.

## **VI. Coordinated Effects**

In Paragraph 4.110, the Draft Guidelines note that evidence of past proven or suspected cartel actions in the same product market, in the UK or elsewhere, may inform the analysis as to whether the proposed merger increases the likelihood of adverse coordinated effects. The Authorities also recognize, however, that inferences about the likelihood of post-merger coordination “cannot automatically be made” from historical

evidence.<sup>4</sup> The Sections invite the Authorities to clarify the limited circumstances where they believe reliable inferences can be drawn.

The Sections recognize that evidence of past collusion frequently is relevant to merger investigations when the collusion is ongoing (or ended only shortly before the merger) and took place in the same market impacted by the merger. The Sections urge the Authorities, however, to discount the relevance of prior collusion when it occurred in the distant past or in product or geographic markets not implicated by the merger under review.

The Sections recommend that the third bullet point of Paragraph 4.121 be deleted. This provision suggests that coordination among rivals may be more internally sustainable in markets characterized by inelastic demand. Although firms facing inelastic demand tend to have fewer incentives to deviate from terms of coordination because price reductions would garner minimal additional sales, it is also the case that punishment of cheating would also likely be less effective, because a price war would lead to few lost sales by the cheating firm. That is, inelastic demand makes collusion both more sustainable and less sustainable, suggesting that it may not be a useful factor to consider in an assessment of the sustainability of any potential post-merger collusion.

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<sup>4</sup> In discussing market definition in its recently published Proposed Recommended Practices for Merger Analysis (Comment 4 at page 2), the International Competition Network noted instructively: “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 an agency’s assessment of the merger in question when, for example, market conditions differ (or have evolved) over time or across geographic areas.”

## **VII. Non-Horizontal Mergers**

The Sections commend the Authorities for stating, in paragraph 4.127, that “most non-horizontal mergers are benign or even pro-competitive.” This addition to the Draft Guidelines indicates that the Authorities will analyze vertical mergers with an appropriate recognition of the substantial efficiencies that typically flow from vertical combinations.

Certain other additions to the Draft Guidelines regarding non-horizontal mergers, however, may have the unintended effect of discouraging parties from entering into efficiency-generating vertical mergers. For example, paragraph 4.139 outlines factors the Authorities will take into account when reviewing conglomerate mergers. We recommend that the Draft Guidelines be revised to identify market conditions that individually or collectively tend to heighten (or reduce) the Authorities’ concerns regarding the risk that a particular non-horizontal merger would result in an anti-competitive tying or bundling arrangement.

Similarly, the fifth bullet point of paragraph 4.139 addresses commercially sensitive information, and notes that vertically integrated entities with access to such information from their non-integrated rivals could have the unilateral incentive “to compete less aggressively in the market for the final manufactured product” or otherwise permit the integrated company “to put rivals at a competitive disadvantage.” This may place vertically integrated firms in an untenable situation: either they refuse to supply their competitors and risk foreclosure concerns, or they supply their rivals and risk running afoul of this provision. The Sections respectfully suggest the Authorities clarify this bullet point and highlight that its import will be reduced (if not eliminated) to the extent the integrated firm has internal procedures to limit the flow of competitively

sensitive information received from rivals (as such rivals often require as part of their commercial arrangements).