



**FEDERAL COMPETITION AND CONSUMER
PROTECTION COMMISSION**

MERGER REVIEW GUIDELINES

2020

Merger Review Guidelines

The Federal Competition and Consumer Protection Commission (the Commission) is the regulatory authority responsible for, among other things, the administration and enforcement of the Federal Competition and Consumer Protection Act 2018 (the Act). The Commission contributes to the economic development of Nigeria by protecting and promoting competitive markets and enabling informed consumer choices.

These Guidelines describe the Commission's general approach to administering the Act's merger review process applicable to proposed transactions that are the subject of a merger notification.

Overview

Legal review of mergers is an essential element of competition policy. For Nigeria's market economy to function optimally, and benefit citizens, rules are required to ensure combinations do not result in adverse effects on competition. By providing a system of prior review of concentration, the merger review function of the Commission is primarily prevent market structure that could likely impede incentives for enterprises to compete in Nigeria's markets.

The Commission recognises that majority of mergers do not present competition concerns and, indeed, may enhance efficiency. Nonetheless, periodically, certain transactions could potentially substantially prevent or lessen competition, thereby having a negative impact on consumers, businesses and the overall competitiveness of the economy. The Commission reviews these transactions with to fulfill its mandate to protect and promote competitive markets. In discharging its merger review obligations under the Act, the Commission's priority is to timely identify proposed mergers that could constitute a threat to competitive markets and to allow those that don't to proceed as expeditiously as possible.

Preserving competition, in merger review as in all areas of competition policy, is not, however, an end in itself. The ultimate goal is the promotion of economic performance, and in particular protection of consumer welfare. By seeking to preserve the competitive process, merger review plays an important role in guaranteeing efficiency in production, in preserving the incentive for enterprises to innovate, and in ensuring the optimal allocation of resources within the

economy. Consumers are the beneficiaries of a properly conducted enforcement policy, enjoying fair prices and a wider choice of products and services as a result.

These guidelines outline the general principles guiding the Commission's merger analysis under Part XII of the Federal Competition and Consumer Act 2018 (the Act). The Guidelines expand on the procedural and substantive framework under the Merger Review Regulations 2020, expounding the principal analytical techniques, practices, and the enforcement policy of the Commission with respect to mergers.

With these Guidelines, the Commission seeks to identify the bases upon which it would challenge competitively harmful mergers while avoiding needless intervention with mergers that are either competitively beneficial or neutral. Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not. Given this inherent need for prediction, these Guidelines reflect the legislative intent that merger enforcement should check competitive problems in their nascency.

The approach to merger assessment has been developed to outline the considerations that guide the Commission's merger review as well as the statutory factors relevant to the assessment. There is also an emphasis on the competitive theories of harm and the effect of constraints, which facilitates a more integrated analysis.

The Commission will continue to assess each merger on its merits according to the specific nature of the transaction, the industry and the particular competitive impact likely to result in each case. The general principles set out in these guidelines provide a framework within which mergers will be reviewed. Importantly, the application of those principles to different facts and situations may give rise to different results. Where these Guidelines provide examples, they are illustrative and do not exhaust the applications of the relevant principle.

These Guidelines also describe the main types of evidence upon which the Commission usually relies to predict whether a merger may substantially prevent or lessen competition. These Guidelines should provide an enhanced level of predictability and certainty to merger parties, their advisers, the business community and the public, by increasing the transparency of the analytical process underlying the Commission's enforcement decisions. They may also assist

the adjudicatory process in developing an appropriate framework for interpreting and applying competition laws in the merger review arena.

It is not possible for these guidelines to cover every issue or circumstance that may arise in a merger review. In practice, individual mergers involve a great variety of facts and situations, and the analysis of particular issues may need to be tailored to the specific circumstances of a merger or deal with competition issues not specifically considered in these guidelines. Accordingly, the Commission proposes to apply the Guidelines flexibly.

The unifying theme of these Guidelines is to interpret legislative intent that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise.

These Guidelines reflect the views of the Commission at the time of publication. Markets, economic theory, legal thinking and best practice evolve; the Commission may revise the Guidelines from time to time to reflect developments and may publish new or supplemental guidance. The latest version of the Merger Review Guidelines is always that appearing on the FCCPC's website.

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PART 1: PURPOSE AND DEFINITIONS

Introduction

- 1.1 Mergers and acquisitions are important for the efficient functioning of the economy. They allow businesses to achieve efficiencies, such as economies of scale or scope, and diversify risk across a range of activities. They also provide a mechanism to replace the managers of underperforming firms.
- 1.2 In the vast majority of mergers, sufficient competitive tension remains after the merger to ensure that consumers and suppliers are no worse off. Indeed, in many cases consumers or suppliers benefit from mergers. In some cases, however, mergers have anti-competitive effects. By altering the structure of markets and the incentives for firms to behave in a competitive manner, some mergers can result in significant consumer detriment.
- 1.3 The merger review function of the Federal Competition and Consumer Protection Commission ("Commission") covers mergers notified to it under Part XII of the Federal Competition and Consumer Protection Act 2019 (the "Act"). The relevant test for the Commission's merger review function is the substantial prevention or lessening of competition ("SPLC") test.

Purpose and Scope

- 1.4 These Guidelines state the policy of the Commission with respect to merger review. By stating its general policy, merger parties, advisers, the business community and the public have certainty regarding the considerations that apply to merger review. However, these Guidelines cannot remove judgment and discretion in merger review. The Commission evaluates each case in light of its own facts and apply the analytical framework set forth in these Guidelines reasonably and flexibly.
- 1.5 These guidelines provide an outline of the broad analytical framework applied by the Commission when assessing whether a merger is likely to substantially prevent or lessen competition under Part XII of the Act. These guidelines have been developed by the Commission in relation to its functions under Part XII of the Act.

- 1.6 These guidelines are designed to provide reliable, comprehensive and detailed information that merger parties, the business community, their advisers and the public can draw on to:
- (a) assess the likely level of scrutiny a merger will receive from the Commission — in particular, guidance is provided on when merger parties should notify the Commission of a merger (the threshold for notification is outlined in Part 2);
 - (b) increase understanding of the application of Part XII of the Act;
 - (c) assist in structuring (or restructuring) mergers to avoid raising competition concerns;
 - (d) identify the types of information and evidence that will assist the Commission to reach a view on how a merger is likely to affect competition. To make informed and timely decisions, the Commission relies on the cooperation of the merger parties, customers, competitors, suppliers and any other persons or bodies holding relevant information;
 - (e) identify the Commission's broad approach to assessing efficiencies and public interest gains.
- 1.7 "Merger" is used in these Guidelines to mean a merger or acquisition as defined in the Act (section 92(1)). The MRR elaborates on the circumstances that the merger connotes in the context of acquisitions and joint ventures.
- 1.8 SPLC means substantial prevention and lessening of competition as specified by the Act.

Note on Terminology

- 1.9 In these Guidelines:

- all references to statute, unless otherwise stated, relate to the Federal Competition and Consumer Protection Act 2018—referred to throughout as ‘the Act’ and all references to ‘section(s)’, unless otherwise stated, relate to the Act;
- situations leading to an SPLC are generally described in the future tense, regardless of whether the merger involved is completed or anticipated;
- the term ‘products’ is used to apply to goods and/or services;
- the term ‘price’ is used as shorthand for all aspects of competition unless otherwise specified; and
- the term ‘undertaking’ includes any person, unincorporated or incorporated, involved in the production of, or the trade in, products and is used interchangeably with the terms “firm” and “company”.

PART 2: MERGERS SUBJECT TO THE ACT (“COVERED TRANSACTIONS”)

2.1 There are two broad questions for the Commission in any merger:

- has a relevant merger situation been created (or for anticipated mergers, are arrangements in progress or in consideration which, if implemented, will result in the creation of a relevant merger situation); and if so
- does the creation of that situation result, or may be expected to result, in an SPLC within any market or markets in Nigeria for goods or services?

2.2 The Commission is not required to consider the second question if it decides that no relevant merger situation exists or will do so.

Criteria for a relevant merger situation

2.3 A merger must meet both of the criteria below to constitute a relevant merger situation for the purposes of the Act:

- two or more undertakings must come under common control, or there must be arrangements in progress or in contemplation which, if carried into effect, will lead to the undertakings to be under common control to be distinct; and
- either the value of Nigerian turnover of the undertaking which is being acquired exceeds the prescribed threshold (known as ‘the turnover test’—see relevant paragraphs of Threshold Regulations).

2.4 An undertaking may comprise any number of components, most commonly including the assets and records needed to carry on the business, together with the benefit of existing contracts and/or goodwill. In some cases, the transfer of physical assets alone may be sufficient to constitute an enterprise, for example where the facilities or site transferred enable a particular business activity to be continued. Intangible assets such as intellectual property rights are unlikely, on their own, to constitute an enterprise unless it is possible to identify turnover directly related to the transferred intangible

assets that will also transfer to the buyer. The business acquired may no longer be trading but this does not in itself prevent the business from being an enterprise for the purposes of the Act.

2.5 The following provides specific guidance about persons and the types of transactions that are subject to the Act. This does not preclude the responsibilities of the parties to a merger to consult the actual provisions of the Act to determine whether a particular transaction falls within the scope of the Act. The overriding aims of the definition of “covered transactions” are to capture those transactions that merit notification and review as “mergers” under the Act, while at the same time providing clear and easily understandable standards that enable merging parties to readily ascertain their notification obligations.

2.6 The Act applies to the following acquisitions:

- (a) acquisitions of property within Nigeria are covered by virtue of section 92(1), including (but not limited to):
 - i. shares in Nigerian companies, wherever the transaction is entered into, as the shares are domestically situated;
 - ii. domestic businesses;
 - iii. local intellectual property such as trademarks; and
 - iv. local plant and equipment.
- (b) acquisitions of property wherever situated are covered by virtue of section 92(1) and section 2(1)-(3) if the acquirer is:
 - i. incorporated in Nigeria;
 - ii. carries on business in Nigeria;
 - iii. a Nigerian citizen; or
 - iv. ordinarily resident in Nigeria.
- (c) if (a) and (b) above do not apply, acquisitions of a controlling interest (presumably shares in almost all cases) in a body corporate where that body corporate has a controlling interest in a corporation are covered by virtue of section 92(1).

- 2.7 As a general matter, merger review is often directed at business transactions in which two or more previously independent economic undertakings are combined in some fashion that involves a lasting change in the structure or ownership of one or more of the undertakings concerned.¹ Under the Act, the qualifying business include some form of merger between two or more previously independent undertakings, by the acquisition of control or some degree of influence by one undertaking over the whole or part of another undertaking, or by some combination of all or part of the business operations of two or more undertakings to create a new business enterprise (e.g., consolidations, amalgamations and joint ventures).²
- 2.8 The Act also covers acquisitions of shares that, while falling short of a controlling interest, nevertheless give rise to the potential ability of the acquiring firm to exert some degree of influence over the acquired company. Exerting material influence in such that the acquirer could exercise ‘control’ in a manner that could affect market outcomes without attaining the 50% ownership threshold.

Exemptions- Internal Restructuring

- 2.9 Besides the case of intra-group transactions, cooperative joint ventures, transfer of non-economic activities, the only exemption foreseen is the acquisition and resale involving a bank or financial institution acquiring securities of an undertaking in the ordinary course of business on a transitory basis or where the company is raising capital. Intra-group restructuring can also be excluded from merger review because it does not change incentives to use assets in the competitive process.
- 2.10 A merger within the meaning of the Act is limited to changes in control. An internal restructuring within a group of companies does not constitute a relevant merger situation- for example, an increase in shareholding not accompanied by changes of control, or a restructuring operation such as a merger of a dual listed company into a single legal entity, or a merger of subsidiaries. A relevant merger situation would only

¹ Because potential competitive concerns are normally limited to some form of combination between previously independent economic actors, restructurings and reorganizations that occur within the same group (i.e., a restructuring of two wholly-owned subsidiaries by their common parent or between two divisions of the same company) are typically not subject to merger review.

² See International Competition Network, Defining “Merger” Transactions for Purposes of Merger Review, Pg. 2

arise if the operation leads to a change in the quality of control of one undertaking and therefore is no longer purely internal.

Persons subject to the Act

- 2.11 The merger provisions of the Act also apply to all companies and other body corporates. It also applies to government agencies (Federal, State and Local Government) or government owned enterprises that undertake commerce (Section 5(2) (a),(b)).
- 2.12 The merger provisions also apply to foreign companies (though not registered in Nigeria) who produce goods and services sold into Nigeria.

Types of acquisitions

- 2.13 The Act applies to both direct and indirect acquisitions. Section 92(1)(b) of the Act makes it clear that ‘acquire’ is not limited to acquisition by way of purchase but also includes lease.

Types of Covered “Merger” Transactions

A. Share Acquisitions

- 2.14 Acquisitions of shares (or other equity interests such as partnership interests) qualify as “mergers” for merger review purposes whenever they result in an acquisition of “control” of the target. A covered transaction arises whenever the buyer obtains a controlling equity interest in the target. An acquisition of “control” presumptively arises whenever the purchaser acquires a majority of the target company’s shares, such that the purchaser obtains voting rights that permit it to control the target company’s board, management and/or business direction.

Ordinary Course Exemptions

- 2.15 Section 92(3)(a)-(b) of the Act set out special rules for “ordinary course” share acquisitions by credit institutions, financial institutions or insurance companies. Acquisitions of securities by a credit or financial institution with a view to resale within one year in the ordinary course of business benefit from an exemption from the

notification requirements, as do any transfers in control of companies to liquidators in connection with insolvency proceedings.

Control

- 2.16 Under Section 92(2)(f) of the Act, a requisite change in “control” may also be brought about by acquisitions of shareholdings falling short of an outright majority stake, where such holdings would nonetheless enable the acquirer, alone or together with other shareholders, to block the adoption of strategic decisions, for example, through the exercise of veto rights, or other arrangements which permit the acquirer to exercise de facto material influence over the target.
- 2.17 As such, covered transactions may include both acquisitions of “sole control” by one firm over another, and acquisitions of “joint control” of a firm by two or more firms.
- 2.18 “Joint control” may be achieved, for example, where a transaction results in a 50/50 equity split, such that mutual agreement is necessary for management decisions and/or where one party is capable of exercising veto rights over proposed actions. Transactions that involve shifts from “joint control” to “sole control” (or vice versa) may also give rise to a qualifying change in “control.”
- 2.19 A company that buys or proposes to buy a majority shareholding in another company is the most obvious example. However, acquisitions of lesser shareholdings may also give rise to a relevant merger situation, as might the transfer or pooling of assets or the creation of a joint venture. In this Part of the guidelines, the criteria for determining whether there is a relevant merger situation are set out and guidance is provided on the following:
- 2.20 ‘Control’ is not limited to the acquisition of outright voting control but includes situations falling short of outright control. Section 92(2) distinguishes three levels of interest referred to as control (in descending order):
- i. Company A may acquire a controlling interest (at least 50% of the shareholding) in Company B- this is known as ‘de jure’, or ‘legal’ control (section 92(2)(a));

- ii. Company A may acquire the ability to control the policy of Company B in one of four circumstances (known as ‘de facto’ control) section 92(2)(b)-(e):
 - As single largest shareholder;
 - Ability to appoint a majority of the members of the board of directors
 - As a holding company;³
 - In trustee undertakings, ability to control the appointment and votes of a majority of trustees or to appoint or change a majority of beneficiaries; and
- iii. Company A, the acquirer, may acquire the ability materially to influence the policy of Company B, the target (known as ‘material influence’);

2.21 Section 92(2)(f) provides the Commission with a discretion to treat material influence and de facto control as equivalent to legal control.

³ Company A as a holding or parent company essentially controls or influences Company B (called subsidiary) from a management and/or shareholding standpoint. Section 338 of the Companies and Allied Matters Act (CAMA), defines a holding company as follows: “A company is deemed to be a holding company of another if the other is its subsidiary”. A company is deemed to be a subsidiary of another if: (a) the company is a member of it and controls the composition of its Board of Directors; or holds more than half of its nominal equity share capital (b) the first-mentioned is a subsidiary of any company which is that other’s subsidiary”.

A common form of control is controlling the composition of the board without being a majority shareholder of the company. (It is contemplated that a company who nominates a person as a shareholder may wield the requisite influence contemplated under this section). This may happen by direct control of the Board or through one or more subsidiaries. The board occupies a preeminent position in the corporate hierarchy from the point of the view of enormous power it exercises, and control it secures over the management of another company.

The composition of board of a company (Company B) is deemed to have been controlled, by another company (Company A) if, that Company A, without the consent or concurrence of any other person, can appoint or remove the holders of all or majority of the directors of Company B by virtue of exercise of some power inherent in it, at its discretion.

Further, Company A shall be deemed to have such a power of appointment:

- i. if the person thereto cannot be appointed without the exercise of the said power in his favour by Company A;
- ii. that a person's appointment follows necessarily from his appointment as director in Company A; or
- iii. that the directorship is held by an individual nominated by Company A or its subsidiary.

In sum, a company could have a minimal amount of shareholding in the target company either through nominee arrangements or direct ownership but may have the power to control the Board of the target company in the manner described above. If it does have this power, then it would qualify as a holding company.

There is no singular prescription as to the manner of securing Board control, which essentially is a matter of business practice. The source of legally enforceable power to control the composition of the subsidiary's board might be found in the Articles of a subsidiary company or in a separate agreement among the subsidiary's shareholders (e.g. a shareholders' agreement) conferring control in the holding company.

- 2.22 The Commission will also seek to prevent situations in which a company acquires control by stages or where 'associated persons' might act together to gain control.

'Material influence'

- 2.23 The ability to exercise 'material influence' is the lowest level of control that may give rise to a relevant merger situation. Under certain conditions minority shareholdings may have anticompetitive effects. The holder of the minority interest may have the ability to influence the target to compete less aggressively, or it may decide to behave less competitively not to affect its financial interest in the target company. Even with a purely passive financial interest the holder may have a unilateral

incentive to compete less aggressively as it benefits through its minority interest if the target faces less competition.

2.24 In assessing material influence in the context of the Act, the Commission will conduct a case-by-case analysis, focusing on the overall relationship between the acquirer and the target and on the acquirer's ability materially to influence policy relevant to the behaviour of the target entity in the marketplace. The policy of the target includes its strategic direction and its ability to define and achieve its commercial objectives.

2.25 The acquirer's ability to influence the target's policy can arise through the exercise of votes at shareholders' meetings, together with any additional supporting factors that might suggest that the acquiring party exercises an influence disproportionate to its shareholding. Material influence may also arise as a result of the ability to influence the board of the target and/or through other arrangements. In considering whether material influence may be present by virtue of a shareholding in a particular case, the Commission will consider not only the ownership of the shareholding but also whether, as a matter of practice, the acquiring party is able to exert influence.

2.26 As specified in the MRR, factors that the Commission may take into account in an assessment of a particular shareholding include, among other things:

- i. the distribution and holders of the remaining shares, in particular whether the acquiring entity's shareholding makes it the largest shareholder;
- ii. patterns of attendance and voting at recent shareholders' meetings based on recent shareholder returns, and in particular whether voter attendance is such that the shareholding under consideration would be able in practice to block special resolutions;
- iii. the existence of any special voting or veto rights attached to the shareholding under consideration;
- iv. the status and expertise of the acquirer and its corresponding influence with other shareholders; and
- v. any other special provisions in the constitution of the company conferring an ability materially to influence policy.
- vi. the ownership distribution of the remaining shares and securities, including ordinary and preference shares and any special shares

- vii. the distribution of voting rights, including any special voting rights
- viii. whether other shareholders are active or passive participants at company meetings
- ix. any restrictive covenants or special benefits attaching to shares;
- x. any pre-emption rights in relation to the sale of shares or assets
- xi. any other contracts or arrangements between the parties;
- xii. the rights and influence of any significant debt holders;
- xiii. the composition of the board of directors;
- xiv. the company's memorandum and articles of association

2.27 In addition to the ability materially to influence policy through the voting of shares, the Commission's determination may also turn on whether the acquirer is able materially to influence the policy of the target entity through board representation. Indeed, it is possible that board representation alone could, in certain circumstances, confer material influence. The Commission may also consider whether any other factors, such as agreements with the company, enable the acquirer materially to influence policy. These might include the provision of consultancy services to the target or might, in certain circumstances, include agreements between firms that one will cease production and source all its requirements from the other. Financial arrangements may in certain circumstances confer material influence where the conditions are such that one party becomes so dependent on the other that the latter gains material influence over the company's commercial policy.

2.28 The following are some of the potential anti-competitive effects of shareholdings below a level delivering control:

- horizontal acquisitions may increase interdependence between rivals and lead to muted competition or coordinated conduct (see Part 6)
- joint acquisitions of assets by rivals may have coordinated effects
- vertical or conglomerate acquisitions may increase the acquirer's incentive to foreclose rival suppliers
- acquisitions may provide access to commercially sensitive information in relation to competitors
- acquisitions may block potentially pro-competitive mergers and rationalisation.

- 2.29 Under Regulation 7 of MRR, should the circumstance (e.g. a shareholding or a level of board representation) that confers the ability materially to influence a company's policy increase to a level which amounts to de facto control or a controlling interest, that further acquisition will produce a new relevant merger situation. The same applies to a move from de facto control to a controlling interest.
- 2.30 In principle, therefore, if Company A acquires Company B in stages, this could give rise to three separate mergers: first, as Company A moves to material influence; then to de facto control; and, finally, to legal control or a controlling interest. But further acquisitions of a company's shares by a person who already owns a controlling interest do not give rise to a new merger situation.

B. Asset Acquisitions

- 2.31 Transactions in which the purchaser acquires all or substantially all of the seller's business assets will be viewed as a qualifying transaction for merger review purposes. Asset purchases that do not constitute all or substantially all of the seller's assets might be subject to merger review. Here, there is no question that there has been a change in control of the assets. Rather, the pertinent question is whether the acquired assets have sufficient economic significance to merit merger review coverage. For example, an acquisition of assets will only be considered a "merger" if those assets constitute the whole or a part of an entity to which the turnover threshold can be attributed.
- 2.32 Importantly, acquisitions of assets "in the ordinary course of business" are exempted, and this exempts most acquisitions of new goods, current supplies and used durable goods. Similarly, acquisitions of certain real property assets, such as undeveloped land, and office or residential property are also exempted as such transactions as unlikely to raise competitive issues.

C. Joint Ventures

- 2.33 A joint venture (JV) occurs between two or more independent enterprises. Given the rather flexible notion of what constitutes a "joint venture", it might be difficult to generalise. As a general proposition, however, joint ventures involve some pooling of resources to create a new business enterprise on a more or less permanent basis. The

distinguishing features of qualifying joint ventures – as opposed to mere collaborative arrangements – include economic integration of the parties’ business activities (as, for example, through a contribution of productive assets to a new business undertaking), the elimination of competition between the parties in the joint venture’s field of activity through this contribution, and the relative permanence of the joint business activity.

- 2.34 Where these basic criteria are met, joint venture transactions will be brought within the general scope of merger review by reference to the fact that the creation of a qualifying joint venture will typically involve the transfer of voting equity or assets and by reference to the underlying combination of previously independent businesses.
- 2.35 Some JVs involve the integration of parts of the business activities of the enterprises to the joint venture, including a contribution of productive assets to the new joint venture. This can result in a reduction or elimination of competition between the parties to the joint venture in the joint venture’s field of activity. Whether it does so depends on the relative permanence of the joint venture and the degree of autonomy it enjoys from its parent companies.
- 2.36 However, not all JVs are subject to merger control. The Commission distinguishes between “full function” JVs and JVs that are “auxiliary” to the activities of their parent enterprises.
- 2.37 A full function JV, whose assets or turnover value is above the notification threshold, has to be notified to the Commission as a merger. By definition, such a JV performs on a lasting basis all the functions of an autonomous economic entity, competing with other undertakings in a relevant market, and has sufficient resources and staff to operate independently on the relevant market. Although full function JVs would generally conduct little business with the parent enterprises, there may be situations in which the JV uses a parent enterprise’s networks or outlets to conduct its sales. A full function JV may also rely entirely for an initial start-up period on sales to its parent enterprises or purchases from them before it can become established independently on the market. The length of the start-up period depends on the characteristics of the market concerned.
- 2.38 Two requirements must be fulfilled for an undertaking to be considered as a full-functional joint venture. Firstly, such an undertaking must be jointly controlled and at

the same time it must perform all functions of an autonomous economic entity on a lasting basis. Whether a joint venture operates on a lasting basis is assessed on case-by-case basis. This criterion is usually met if a joint venture is created for an unlimited period of time. In order to perform all functions of an autonomous economic entity, a jointly controlled undertaking must have: a) sufficient own resources; b) autonomous activities beyond specific functions of its parent companies; and c) sufficient degree of operational independence on its parent companies.

- 2.39 By contrast, transactions which are intended to last for a definite period of time (such as transactions aimed at performing a particular project) may be exempt.
- 2.40 Auxiliary JVs fulfil a specific purpose for their parent enterprises, for example in sales, production or research and development (R&D). Such JVs will not be considered as a merger subject to control. However, parties to auxiliary JVs may have to apply to the Commission for authorisation under Part VIII of the Act.

PART 3- STANDARD OF REVIEW

Types of Merger

- 3.1 These Guidelines discuss three types of merger — in each, the merger may involve firms that are either actual or potential competitors. Mergers which may give rise to market power can broadly be divided into three types (or combinations thereof):
- i. horizontal mergers — involving actual or potential suppliers of substitutable goods or services;
 - ii. vertical mergers — involving firms operating or potentially operating at different functional levels of the same vertical supply chain; and
 - iii. conglomerate mergers — involving firms that interact or potentially interact across several separate markets and supply goods or services that are in some way related to each other, for example, products that are complementary in either demand or supply.
- 3.2 The concept of “substantial prevention or lessening of competition” allows for a situation where a merger may increase the market power of the merged firm and (some of) its remaining competitors, allowing each of them to increase prices unilaterally in the face of reduced competition. In other words, the conduct of the firms is not coordinated- they are simply competing less vigorously with one another.⁴ In sum, a merger in a concentrated market can substantially lessen competition other than through tacit co-ordination by blunting competition among the remaining competitors in the market (and of course, ending such rivalry as existed between the merged parties themselves).⁵

SPLC as a Standard for Review for Mergers

⁴ ICN Merger Working Group: “THE ANALYTICAL FRAMEWORK FOR MERGER CONTROL” P. 9

⁵ Both unilateral and coordinated effects are discussed in Part 6 of these Guidelines.

- 3.3 Section 94(1) of the Act requires the Commission to undertake two levels of review. At the first level or the first phase, the Commission determines whether or not a merger is likely to substantially prevent or lessen competition. Where the Commission's review is in the negative, the transaction will be approved. If, however there is an affirmative determination by the Commission of an SPLC, then the Commission will undertake a second level/ phase of review where it looks to the twin and concurrent elements of efficiency and public interest as counterweights to the SPLC factors. The vast majority of notified transactions will end at the first phase review and this Part seeks to outline the attendant standard of review at this phase.
- 3.4 An SPLC results only from mergers that are likely to create, maintain or enhance the ability of the merged entity, unilaterally or in coordination with other firms, to exercise market power.
- 3.5 In general, when evaluating the competitive effects of a merger, the Commission's primary concerns are price and output. The Commission also assesses the effects of the merger on other dimensions of competition, such as quality, product choice, service, innovation and advertising—especially in markets in which there is significant non-price competition. To simplify the discussion, unless otherwise indicated, the term "price" in these guidelines refers to all aspects of firms' actions that affect the interests of buyers. References to an increase in price encompass an increase in the nominal price, but may also refer to a reduction in quality, product choice, service, innovation or other dimensions of competition that buyers value.
- 3.6 These guidelines describe the analytical framework for assessing market power from the perspective of a seller of a product or service ("product," as defined in section 167(1) of the Act). Market power of sellers is the ability of a firm or group of firms to profitably maintain prices above the competitive level for a significant period of time. From the Commission's standpoint, it is the ability to raise prices, not whether a price increase is likely, that is determinative.
- 3.7 As provided in the Merger Review Regulations and as will be considered in Part X of these Guidelines, the Commission analyses competitive effects under two broad headings: unilateral exercise of market power and coordinated exercise of market

power.⁶ The same merger may involve both a unilateral and a coordinated exercise of market power. A unilateral exercise of market power can occur when a merger enables the merged firm to profitably sustain higher prices than those that would exist in the absence of the merger, without relying on competitors' accommodating responses. A coordinated exercise of market power can occur when a merger reduces the competitive vigour in a market by, for example, removing a particularly aggressive competitor or otherwise enabling or enhancing the ability of the merged firm to coordinate its behaviour with that of its competitors. In these situations, higher post-merger prices are profitable and sustainable because other competitors in the market have accommodating responses.

- 3.8 Unless a merger is likely to have market power effects, it is generally not possible to demonstrate that the transaction will likely prevent or lessen competition substantially.

Prevention of competition

- 3.9 Competition may be substantially prevented when a merger enables the merged firm, unilaterally or in coordination with other firms, to sustain materially higher prices than would exist in the absence of the merger by impeding the development of probable future competition. This typically occurs when there is no or limited direct overlap between the merging firms' existing businesses, but direct competition between those businesses was expected to develop or increase in the absence of the merger. It may also occur when there is direct overlap between the merging parties' existing business(es) and the competitive effectiveness of one of the merging firms was expected to increase absent the merger, for example, because of the introduction of an improved product.
- 3.10 In these circumstances, the Commission would undertake an evaluation of the merger factors considered in Part 5 below. For instance, whether, absent the merger, timely

⁶ Although vertical and conglomerate effects are considered as a third specie, they will not attract a considerable amount of focus because they are mostly benign.

entry or expansion by either of the merging firms would likely occur on a sufficient scale and with sufficient scope to prevent incumbents from exercising market power.

3.11 The following are examples of mergers that may result in a substantial prevention of competition:

- i. the acquisition of a potential entrant or of a recent entrant that was likely to expand or become a more vigorous competitor;
- ii. an acquisition by the market leader that pre-empts a likely acquisition of the same target by a competitor;
- iii. the acquisition of an existing business that would likely have entered the market in the absence of the merger;
- iv. an acquisition that prevents expansion into new geographic markets;
- v. an acquisition that prevents the pro-competitive effects associated with new capacity; and
- vi. an acquisition that prevents or limits the introduction of new products.

Lessening of competition

3.12 A merger may substantially lessen competition when it enables the merged firm, unilaterally or in coordination with other firms, to sustain materially higher prices than would exist in the absence of the merger by shrinking or reducing existing competition. This typically occurs with horizontal mergers when there is direct or existing overlap between the operations of the merging firms. This can also occur with non-horizontal mergers, such as those that foreclose rivals from accessing inputs to production.

Substantiality

- 3.13 Not all mergers that lessen competition are prohibited by section 94 of the Act; only those that lessen competition substantially are prohibited. The term ‘substantial’ has not been defined by statute but the practice from other jurisdictions indicate that ‘substantial’ is interpreted as meaning real or of substance, not merely discernible but material in a relative sense and meaningful.⁷ The precise threshold between a lessening of competition and a substantial lessening of competition is a matter of judgement and will always depend on the particular facts of the merger under investigation. Generally, the Commission will take the view that a lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable. For example, a merger will substantially lessen competition if it results in the merged firm being able to significantly and sustainably increase prices.
- 3.14 The Commission does not consider a numerical threshold for the material price increase. Instead, it bases its conclusions about whether the prevention or lessening of competition is substantial on an assessment of market-specific factors that could have a constraining influence on price following the merger.
- 3.15 When the Commission assesses whether a merger is likely to prevent or lessen competition substantially, it evaluates whether the merger is likely to provide the merged firm, unilaterally or in coordination with other firms, with the ability to materially influence price. The Commission considers the likely magnitude and duration of any price increase that is anticipated to follow from the merger. Generally speaking, the prevention or lessening of competition is considered to be "substantial" in two circumstances:
- the price of the relevant product(s) would likely be materially higher in the relevant market than it would be in the absence of the merger ("material price increase"); and
 - sufficient new entry would not occur rapidly enough to prevent the material price increase, or to counteract the effects of any such price increase.

⁷ See the Australian case of *Rural Press Limited v Australian Competition and Consumer Commission* [2003] HCA 75 at 41.

- 3.16 Additionally, where the merging firms, individually or collectively, have pre-existing market power, smaller impacts on competition resulting from the merger will meet the test of being substantial.
- 3.17 Generally, the Commission takes the view that a prevention and lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable. For example, a merger will substantially lessen competition if it results in the merged firm being able to significantly and sustainably increase prices.
- 3.18 In some markets, particular characteristics, such as the prevalence of certain types of long-term contracts between buyers and sellers, may prevent a merged firm from exercising any market power it gains through the merger until some point in the future — for example, at contract renewal. If the exercise of market power is likely to be delayed in this way, the Commission will focus on the period commencing at the point where market power would be exercised (for example, at contract negotiations).

Likelihood

- 3.19 Section 94(2) of the Act requires the Commission to assess the probability that the undertakings in the market, after the merger, will behave competitively or cooperatively. The application of the SPLC test involves a comparison of the prospects for competition with the merger against the competitive situation without the merger. The latter is called the ‘counterfactual’. The counterfactual is an analytical tool used in answering the question of whether the merger gives rise to an SPLC. Merger analysis compares likely future states — the future with the merger and the future without the merger. This comparison isolates the merger’s impact on competition.
- 3.20 The likely future state of competition without the merger (the counterfactual) will generally be similar to the state of competition prevailing at the time of the merger. However, in some cases taking the state of competition prevailing at the time of the merger as the benchmark for analysis could risk attributing a change in the level of competition to a merger, when the real cause is some other development that is unrelated to the merger and likely to occur regardless of the merger. Focusing on the state of competition prevailing at the time of the merger might also disguise a SPLC in

situations where a merger hinders or prevents competition that would otherwise have emerged.

3.21 The Commission therefore uses information about the state of competition prevailing at the time of the merger to inform its assessment of the likely future state of competition without the merger. This applies to market definition and all the merger factors outlined in Parts 4 and 5. It also applies to likely developments involving the merger parties — in particular, mergers involving firms that are likely to be more effective competitors in the future and those involving failing firms.

3.22 However, the Commission will not take into account counterfactuals it considers have been manipulated for the purposes of making clearance more likely. Signs that a counterfactual may have been manipulated include:

- a change of policy or intention by the merger parties that occurs after the merger is proposed
- any course of action by the merger parties which cannot be demonstrated to be profit maximising and/or in the interests of shareholders (for example, refusing to sell the business to a strong competitor if the proposed merger does not proceed).

Framing the Counterfactual

The counterfactual lies at the heart of most competition analysis.

Any effects-based analysis will involve considering what the world would look like in the absence of the conduct or agreement under scrutiny.

The counterfactual appears to throw up two main challenges:

1. How to determine the correct counterfactual to assume? There may be disagreement over the precise counterfactual.
2. How to populate that counterfactual? Although competition economics provides tools that analyse why market outcomes have arisen so that alternative market outcomes can be estimated, how accurate are they? In particular, how reliable empirical analysis of the actual market in question is when the counterfactual involves, not a slight variation, but a complete paradigm shift from the actual world.

Counterfactual analysis in different contexts:

- Whilst the counterfactual pervades all aspects of competition and antitrust law it clearly has a bigger impact in some situations than others.
- A useful distinction may be between situations that require an ex ante counterfactual analysis (i.e. speculating how the world might change going forward) from those that require an ex post counterfactual analysis (i.e. speculating how the world might have been).

2. Competition could improve absent the merger: Cases where the merger may prevent a more competitive merger happening may present challenging counterfactual considerations. For instance, an analysis in relation to the potential impact of a new entrant or the development of new technology would give rise to further opportunities to compete between the parties.

Market definition typically involves a counterfactual analysis through the hypothetical monopolist test: how would customers / (potential) competitors respond to higher prices for certain goods?

Determining when there are Competing Counterfactuals

Where there are competing counterfactuals choosing between them will also depend on the robustness of the evidence.

A relevant question may be whether there are situations that merit a probabilistic assessment i.e. identifying the range of plausible scenarios and attaching a probability weighting to each instead of having to identify one above all others. This receives credence from the language of Section 94(2) of the Act where the Commission is required not only to assess the strength of competition in the relevant market but the probability that the undertakings in the market, after the merger, will behave competitively.

Populating the counterfactual

A further key problem with extrapolation arises where the counterfactual is so far removed from the actual observed world i.e. paradigm shift.

Here it is necessary or appropriate to complement empirical analysis with knowledge of industrial organisation theory (i.e. how markets can be expected to work) from which inferences can be made about how we would expect firms and consumers to behave under different conditions.'

Evidence

Sources of evidence provide various degrees of uncertainty. There are two main sources of evidence:

- Empirical evidence from the actual world of how consumers and firms behave from which an extrapolation can be made.
- Natural experiments that may mirror the counterfactual and therefore provide directly relevant evidence.

Market Definition

- 4.1 The notion of the market used in competition policy is quite different from the use of “market” made in general business contexts. Companies often use the term market to refer to the area where they sell their products or to refer broadly to the industry or sector where they belong.
- 4.2 At the outset, understanding market definition helps to clarify the role it plays in competition cases and in merger review. One point is immediately obvious: it is impossible to compute summary statistics (e.g. market shares) unless the scope of the market in question has been determined. For instance, a soft drink brand may have a high share of the “market” for premium branded cola, but will have a lower share of carbonated drinks of all flavours, and a low share of “cold drinks” if this is taken to include cocktails, bottled water, etc. It is, therefore, obvious that in order to discuss market statistics, market definition is logically prior.
- 4.3 An incorrect narrow market definition may lead to a wrong conclusion that the market is concentrated when it is in fact more fragmented, and that market power is present when this conclusion is not warranted because of the existence of competitive constraints by suppliers of substitute products or services. The opposite may be the case when the market boundaries are drawn too widely, and the existence of market power is masked by a picture of competition from substitute products which is not sufficiently strong to constrain market power.
- 4.4 Market definition is not an end in itself. Instead it is an aid to the competitive assessment. It provides a tool for aiding the competitive assessment by identifying those substitute products which provide the most effective constraints on the competitive behaviour of the parties under investigation. This allows the complex task of assessing competition to be broken down into two steps:
- (i) define the relevant market; and then
 - (ii) assess the nature of competition between firms within that market.

- 4.5 When we define the relevant competition policy market, we are attempting to define the set of products that impose constraints on each other's pricing or other dimension of competition (quality, service, innovation). A firm whose product faces close competing substitutes will have only a limited ability to raise its price above that of close substitutes and competition between firms will ensure that its price is driven down close to its cost. Thus, market definition for competition policy purposes is directly related to the concept of market power. Indeed, a common description of a competition policy market is one which is "worth monopolising."
- 4.6 In accordance with section 71 of the Act, the Commission assesses relevant markets, from two perspectives- the product and geographic dimensions. As a general principle, the Commission would not assume that the merging parties operate in the same relevant market(s), even when there appears to be some overlap between their products and the geographic areas in which they conduct business. In addition, the relevant market(s) being analysed for competitive effects may not necessarily correspond to the product categories or service areas established by the merging firms or their rivals for operational purposes.
- 4.7 Market definition is based on substitutability and focuses on demand responses to changes in relative prices after the merger. The ability of a firm or group of firms to raise prices without losing sufficient sales to make the price increase unprofitable ultimately depends on buyers' willingness to pay the higher price. Based on section 71(c) of the Act, the ability of competitive suppliers to respond to a price increase is also important when assessing the potential for the exercise of market power.⁸
- 4.8 Market definition is a useful tool, but not an end in itself, and identifying the relevant market involves an element of judgment. Delineating the market does not determine the outcome of the Commission's analysis of the competitive effects of the merger in any mechanistic way. In assessing whether a merger may give rise to an SPLC the Commission may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.

⁸ The Commission may examine such responses later in the analysis—either when identifying the participants in the relevant market or when examining entry into the relevant market.

- 4.9 The relevant market may not be the narrowest market that meets the hypothetical monopolist test. However, to the extent that they use them, the Commission will not normally have regard to market share and concentration thresholds calculated on anything other than the narrowest market that satisfies the hypothetical monopolist test (or SSNIP below).
- 4.10 Conceptually, a relevant market is defined as the smallest group of products, including at least one product of the merging parties, and the smallest geographic area, in which a sole profit-maximising seller (a "hypothetical monopolist") would impose and sustain a small but significant and non-transitory increase in price ("SSNIP") above levels that would likely exist in the absence of the merger. In many cases, the Commission would consider a five percent price increase to be significant and a one-year period to be non-transitory. Market characteristics may support using a different price increase or time period.
- 4.11 The market definition analysis begins by assuming a candidate market for each product of the merging parties. For each candidate market, the analysis proceeds by determining whether a hypothetical monopolist controlling the group of products in that candidate market would profitably impose a SSNIP, assuming the terms of sale of all other products remained constant. If the price increase would likely cause buyers to switch their purchases to other products in sufficient quantity to render the price increase unprofitable, the putative candidate market is not the relevant market, and the next-best substitute is added to the candidate market. The analysis then repeats by determining whether a hypothetical monopolist controlling the set of products in the expanded candidate market would profitably impose a SSNIP. This process continues until the point at which the hypothetical monopolist would impose and sustain the price increase for at least one product of the merging parties in the candidate market. In general, the smallest set of products in which the price increase can be sustained is defined as the relevant product market.
- 4.12 The same general approach applies to assessing the geographic scope of the market. In this case, an initial candidate market is proposed for each location where a merging party produces or sells the relevant products. As above, if buyers are likely to switch

their purchases to sellers in more distant locations in sufficient quantities to render a SSNIP by a hypothetical monopolist unprofitable, the location that is the next-best substitute is added to the candidate market. This process continues until the smallest set of areas over which a hypothetical monopolist would impose and sustain the price increase is identified.

Base price to be used

- 4.13 In the absence of pre-merger evidence of coordinated interaction, the prevailing price at pre-merger would constitute the base price to project the increase on. The Commission may elect not to use the prevailing price when market conditions (absent the merger) would likely result in a lower or higher price in the future. In general, the base price used to postulate a price increase is whatever is ordinarily considered to be the price of the product in the sector of the industry (e.g., manufacturing, wholesale, retail) being examined.

The danger of using an inappropriate price for defining markets is illustrated by a 1950's U.S. monopolisation case. The U.S. Supreme Court concluded that a producer of cellophane did not have market power due to the strength of substitutes for cellophane. But the Court failed to recognise that these products were only good substitutes for cellophane at the monopoly prices of cellophane already charged by the defendant, i.e., at a competitive price for cellophane, these products were not economic substitutes. (Because of the product involved, the error made by the Court has become known as the "cellophane fallacy")

See *United States v. E.I. duPont de Nemours & Co.* 351 U.S. 377 (1956).

- 4.14 There are instances where the prevailing market price might not be the appropriate base price. Where the Commission considers that prevailing prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a SSNIP imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.

- 4.15 Where the prevailing price is well above the competitive level but the likely future price is significantly closer to the competitive level (due to, for example, a likely reduction in the effective degree of coordination), using the prevailing price as the SSNIP base price may lead to erroneous assessments of the effects of the merger: where the merging firms both produce the same (or nearly the same) products it will tend to understate the actual competitive effect of the transaction by including in the market products that will not be fact substitutes for the merging firms' products at the lower likely future price. On the other hand, where the merging firm's products are only good substitutes at the (higher) prevailing price, it will tend to overstate the potential competitive effect of the transaction. In short, identifying and utilising the "correct" base price for purposes of the SSNIP test is important to the market definition analysis and for evaluating the competitive effects of the transaction.⁹
- 4.16 It is useful to consider two distinct purposes for using a base price: the first is assessing what products and firms would limit the ability of the merging firms to increase price post-merger. The second is assessing whether one or both of the merging firms have (significant) market power prior to the merger in order to evaluate whether one of the firms may already have a dominant position. For the first purpose, using the likely future price as the base price to delineate such substitutes seems appropriate. For the second purpose, avoidance of the cellophane fallacy would appear to entail using as a "base" price the competitive level.¹⁰
- 4.17 In some circumstances, sellers may identify and charge different prices to various targeted sets of buyers ("price discrimination"). Sellers are able to price discriminate when targeted buyers cannot effectively switch to other products or geographic locations and cannot engage in arbitrage with other buyers by taking advantage of price differences. When price discrimination is feasible, it may be appropriate to define relevant markets with reference to the characteristics of the buyers who purchase the product (assuming they can be delineated) or to the particular locations of the targeted buyers.

⁹ ICN Report On Merger Guidelines- Chapter 2 – April 2004 , P.10

¹⁰ *ibid*

- 4.18 The factors the Commission considers when analysing the product and geographic dimensions of market definition are set out below.

Product market definition

- 4.19 For the purpose of product market definition, what matters is not the identity of sellers, but the characteristics of the products and buyers' ability or willingness to switch from one product to another in response to changes in relative prices. A relevant product market consists of a given product of the merging parties and all substitutes required for a SSNIP to be profitable.
- 4.20 When detailed data on the prices and quantities of the relevant products and their substitutes are available, statistical measures may be used to define relevant product markets. Demand elasticities indicate how buyers change their consumption of a product in response to changes in the product's price (own-price elasticity) or in response to changes in the price of another identified product (cross-price elasticity). While cross-price elasticities do not in themselves directly measure the ability of a firm to profitably raise prices, they are particularly useful when determining whether differentiated products are substitutes for one another and whether such products are part of the same relevant market.
- 4.21 Whether or not reliable statistical evidence on demand elasticities is available, the Commission considers factors that provide evidence of substitutability, including evidence from market participants and the functional indicators highlighted below.
- 4.22 The views, strategies and behaviour of buyers are often reliable indicators of whether buyers would likely switch to other products in response to a SSNIP. For example, the Commission would examine what buyers have done in the past and what they are likely to do in the future as options become available, for instance, through advances in technology. Information from industry surveys and industry participants, such as competitors and manufacturers of the relevant product, is also taken into account. This information advances the analysis by providing details on historical developments (including the past behaviour of the merging parties and their rivals) and likely future

developments in the industry. Pre-existing documents prepared by the merging parties in the ordinary course of business can also be very useful in this regard.

- 4.23 Various functional indicators help to determine what products are considered substitutes, including end use, physical and technical characteristics, price relationships and relative price levels, as well as buyer switching costs, as discussed below. Buyers may not view products purchased for similar end uses as substitutes. Therefore, functional interchangeability is not sufficient to warrant inclusion of two products in the same relevant market. In general, when buyers place a high value on the actual or perceived unique physical or technical characteristics of a product (including warranties, post-sales service and order turnaround time), it may be necessary to define distinct relevant markets based on these characteristics.
- 4.24 Switching costs may discourage a sufficient number of buyers from purchasing products that are functionally interchangeable, thereby allowing a hypothetical monopolist to impose a SSNIP. Products are not included in the same relevant market when costs that must be incurred by buyers are sufficient to render switching unlikely in response to a SSNIP. Examples include costs for buyers to retool, re-package, undertake product testing, adapt marketing materials and strategies, terminate a supply contract, learn new procedures or convert essential equipment. Other costs include the expense (and risk) buyers must incur when a product fails to satisfy expectations, which may damage a buyer's reputation as a reseller, or require the shutdown of a production line.

Illustrative Example for Choosing the Order In Which Products Are Added To The SSNIP Candidate Market

The application of the SSNIP typically starts with the product at the core of the investigation (product A), and then, if that is not a SSNIP market, add product B etc. However, this by itself gives no guidance as to which products should be added to the SSNIP candidate market, and in what order.

In a merger case all the products of the parties that wish to merge are in consideration. For each product, the product that should be introduced next is the “next closest substitute”, this being the product that exerts greatest competitive pressure on the product (s) under investigation (or set of products if the SSNIP process is already underway).

The need for adding the next closest substitute, and not just any product, can easily be seen. Suppose we start with oranges, and oranges are not a SSNIP market. If we now add pencils to the putative market, it is unlikely that a monopoly of oranges and pencils will add any market power so we will then move to the next stage. The eventual market definition might then end up as a market for “oranges, pencils, tangerines and avocados” (assuming the SSNIP test was satisfied after the addition of grapes). Such a market definition would be absurd. However, the reason for the absurdity is not merely linguistic, but derives from the fact that pencils are not a substitute for oranges, let alone the closest substitute.

However, suppose we added mangoes and assume that mangoes are, in fact, a very weak substitute for oranges (and certainly a weaker substitute than tangerines and avocados). In that case we could easily end up with a market definition of “oranges, mangoes, tangerines, and avocados” that appeared plausible but was actually as absurd from an economic point of view as a market for “oranges, pencils, tangerines, and avocados”, since a SSNIP might already have been profitable for “oranges, tangerines, and avocados”. Again, the problem is caused by extending the putative market

Geographic market definition

- 4.25 For the purpose of geographic market definition, what matters is not the identity of the sellers, but buyers' ability or willingness to switch their purchases in sufficient quantity from suppliers in one location to suppliers in another, in response to changes in relative prices. A relevant geographic market consists of all supply points that would have to be included for a SSNIP to be profitable, assuming that there is no price discrimination (as described in paragraph 4.12 above). When price discrimination is present (and buyers and third parties are unable to arbitrage between low and high price areas), geographic markets are defined according to the location of each targeted group of buyers.
- 4.26 When defining the boundaries of geographic markets, the Commission generally relies on evidence of substitutability, including evidence from market participants and the functional indicators described below and, when available, empirical analysis.
- 4.27 The views, strategies and behaviour of buyers in a given geographic area are often reliable indicators of whether buyers would likely switch their purchases to sellers located in other geographic areas in the event of a SSNIP. For example, the Commission would examine what buyers have done in the past and what they are likely to do in the future as options become available through, for instance, advances in technology. Industry surveys and the views, strategies and behaviour of industry participants also inform the analysis by providing information on how buyers of a relevant product in one geographic area respond or have responded to changes in the price, packaging or servicing of the relevant product in another geographic area. The extent to which

merging parties and other sellers take distant sellers into account in their business plans, marketing strategies and other documentation can also be a useful indicator for geographic market definition.

- 4.28 Various functional indicators can assist in determining whether geographic areas are considered to be substitutes, including particular characteristics of the product, switching costs, transportation costs, price relationships and relative price levels, shipment patterns and foreign competition. See the table below for specific evidence requirements.

4 Types of Evidence prevalent in Geographic Market Analysis

- 1) *Evidence that buyers have shifted or have considered shifting purchases between different geographic locations in response to relative changes in price or other competitive variables;*
- 2) *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;*
- 3) *The influence of downstream competition faced by buyers in their output markets;*
- 4) *The timing and costs of switching suppliers.*

- 4.29 The general approach to geographic market definition can be summed up as:
- i. Identify the number, size, and locations of firms that compete with the merging parties (the candidate market).
 - ii. Identify the additional competition in response to a hypothetical price increase (which yields the competition market).

Alternative “Test” for Geographic Market Definition (the Elzinga-Hogarty Test)

LIFO (“Little In From Outside”) measures the importance of imports; LIFO equals 1 minus the ratio of imports to domestic consumption. As imports fall, LIFO approaches unity.

LOFI (“Little Out From Inside”), which measures exports, is defined as 1 minus the ratio of exports to domestic production. As exports fall, LOFI also approaches unity.

Elzinga-Hogarty: Rules of Thumb

A region is a geographic market if *both* LIFO and LOFI exceed a prescribed threshold. EH have proposed two thresholds: 75% (“weak” market) and 90% (“strong” market).

Intuition: When imports and exports are relatively small, then prices are determined by domestic competition.

- 4.30 Because the national economy is integrated with the global economy, geographic market definition for merger review may go beyond Nigeria's national borders. Conversely, geographic market definition can be sub-national and even local when high transportation costs, internal barriers to trade and business entry, and anti-competitive business practices limit the product and geographic market. There are a variety of reasons why buyers may be more or less willing to buy from foreign suppliers, and these factors should be considered in defining the relevant market.
- 4.31 Factors than can discourage switching to a foreign produced substitute include:
- (i) foreign exchange risk,
 - (ii) industry imposed standards,
 - (iii) government and industry initiatives to "buy local",
 - (iv) security and border restraint measures that make "just-in-time" delivery very difficult, and
 - (v) limited and undependable road, rail and port capacity and services in Nigeria and in neighbouring countries.

The Synthesised Tripod Inquiry

- 4.32 For the Commission, the application of the two tests essentially involve finding reasonably credible answers to three quite simple questions.

- (vi) Which are the most obvious, for instance, 3-4 producers of close product substitutes?

The major suppliers are usually small in number and comparatively easy to identify. This is because merging companies, business customers and industry experts might generally know the major producers; and because if there are many producers, there is no need for a merger review or other competition case, unless there is evidence of a cartel, collusion or collective/joint dominance prior to the transaction;

- (vii) Are there one or a few other producers of close product substitutes that would prevent the major producers from acting like a “hypothetical monopolist” (or cartel) in their efforts to establish and maintain a small but significant non-transitory price increase of say 5% for a period of one year?

If in the affirmative, the Commission would add these generally smaller producers to the relevant product market. If in the negative, the boundaries of the relevant product market for the merger, and the product market has been defined. The producers that are considered but not included in the relevant product market can be considered as potential entrants from neighbouring product markets in the entry conditions analysis (see below).

- (viii) Are any of the producers in the relevant product market too far away from the other producers and from most customers and too constrained by high transportation costs and other geographic and distance related factors to prevent the main producers identified in the first two questions from establishing and maintaining a SSNIP?

If in the affirmative, the Commission would remove the producer or producers from the relevant market and consider these more distant producers in neighbouring geographic markets in the entry conditions analysis.¹¹

4.33 Through answering these three questions in a reasonably credible manner, the Commission and merging parties should identify and reach an agreement on: the relevant market in both product and geographic space; and the “break” in the chain of product substitutes which establishes the boundaries of the relevant market. Focusing on customer demand responses simplifies market definition and allows both the Commission and merging parties to move quickly on to the other steps in the merger analysis.

Other Relevant Considerations

¹¹ Compared with product market definition, geographic market definition tends to depend more on qualitative information and the opinions of the merging companies, business customers and other industry experts

- 4.34 Due to peculiar features, the Commission notes that expansion and entry might be more difficult in an emerging economy such as Nigeria and therefore a comparatively small price increase of 5% may not be sufficient to generate the short-term supplier response needed for market definition. In addition, high information costs and asymmetries may prevent the news of a SSNIP (a material price increase in the real world) from being received by actual and potential producers of close product substitutes within the short time period assumed in the SSNIP test, and for business customers and final consumers to learn about the SSNIP and switch their purchases. For these and other reasons such as significant price variability, high inflation, and other market turbulence and external shocks, the Commission may in some cases consider a higher price increase (over 5%) and a longer time frame (over 1 year) for the SSNIP test.
- 4.35 For example, when inflation is in double digits and there is other turbulence in the economy, a relative/real price increase (over the general rate of inflation) of 5% over one year may be insufficient to be seen by and thereby to trigger switching to close product substitutes by business customers and final consumers. Factors such as double-digit inflation may require a SSNIP test of 10-20% or more over a longer period.

Chains of Substitution

- 4.36 Products in a market may often be linked by means of a “chain of substitution”. In certain cases, the existence of chains of substitution might lead to the definition of a relevant market where products or areas at the extreme of the market are not directly substitutable. From a practical perspective however, the concept of chains of substitution has to be corroborated by actual evidence, for instance related to price interdependence at the extremes of the chains of substitution, in order to lead to an extension of the relevant market in an individual case.

Implementing the SSNIP Test- An Example

Company X and Company Y are merging. They both supply a product called “devices with a flap”. In the market for “devices with a flap”, their combined volume market share will be 90%. However, it is not clear that this is the correct market definition. The correct market

definition may be “all devices”, in which case their combined market share is 45%. Alternatively, it may be “all devices and gadgets”, in which case their combined market share is 15%. Clearly, the correct market definition matters greatly in this case and so the Commission implements the SSNIP test.

Table 1- Current Situation

	Price (₦)	Sales	Revenue (₦)	Variable Costs (₦)	Costs (₦)	Profits (₦)
Devices with a flap	1000	1,000	1,000,000	700	700,000	300,000
Regular Devices	800	1,000	800,000	600	600,000	200,000
Gadgets	700	4,000	2,800,000	600	2,400,000	400,000
Total		6,000				900,000

The current price of devices with a flap is ₦1,000 and the variable costs of production are ₦700. Sales are 1,000. The current price of regular devices is ₦800 and variable costs are ₦600. Sales of regular devices are also 1,000. The current price of gadgets is ₦700 and the variable costs are ₦600. Sales of gadgets are currently 4,000. This information is shown in Table 1 above.

Table 1 shows that, at current prices, total sales across the three segments are 6,000 and total profits are ₦900,000

Question 1: Is “devices with a flap” the correct relevant market definition?

Now suppose that a hypothetical monopolist of “devices with a flap” raised prices by 5% to ₦1,050. Would this be a profitable price increase relative to the current situation? Table 2 summarises the outcome. It shows that “devices with a flap” is not a relevant market.

Table 2- A SSNIP Imposed on Devices with a Flap

	Price (₱)	Sales	Revenue (₱)	Variable Costs (₱)	Costs (₱)	Profits (₱)
Devices with a flap	1050	780	819,000	700	546,000	273,000
Regular devices	840	900	756,000	600	540,000	216,000
Gadgets	700	4,100	2,870,000	600	2,460,000	410,000
Total		5,780				899,000

Table 2 shows that the SSNIP imposed on devices with a flap is not profitable. Sales fall by 25% to 750 and so profits fall to ₱262,500. Table 2 also shows that of the lost 250 devices with a flap sales, 100 appear to go to regular devices, 50 to gadgets, thus increasing the profits of both these segments, and 100 sales leave the market.

Question 2: Is “all devices” the correct relevant market definition?

On the basis of Table 2, regular devices appear to be the closest substitute to devices with a flap because more of the lost devices with a flap sales went to regular devices than to gadgets. So the next question is to ask whether a SSNIP of 5% imposed on all devices would be profitable. Table 3 summarises the outcome. It is clear that “all devices” is not a relevant market.

Table 3 – A SSNIP Imposed on All Devices

	Price (₱)	Sales	Revenue (₱)	Variable Costs (₱)	Costs (₱)	Profits (₱)
Devices with a flap	1050	750	787,500	700	525,000	262,500
Standard devices	800	1,100	880,000	600	660,000	220,000
Gadgets	700	4,050	2,835,000	600	2,430,000	405,000
Total		5,900				887,500

Sales of devices with a flap now fall to only 780, rather than 750. This indicates that some customers who would switch to regular devices if the price of devices with a flap rose by 5% will not switch if the price of regular devices also rises by 5%. Sales of regular devices fall by 100 to 900 and sales of gadgets increase to 4,100. The important point to note is that total profits of all devices falls from ₦500,000 (i.e. ₦300,000 + ₦200,000) to ₦489,000 (i.e. ₦273,000 + ₦216,000) and so the SSNIP is not profitable for the hypothetical monopolist.

Question 3: Is “all devices and gadgets” the correct relevant market definition?

The next step is to ask whether a hypothetical monopolist of all devices and gadgets could profitably impose a SSNIP of 5%. Table 4 summarises the outcome. It shows that such a SSNIP would be profitable and so the correct relevant market in this case is “all devices and gadgets”. Although sales in each of the three segments have fallen, total profits have risen from ₦900,000 (i.e. ₦300,000 + ₦200,000 + ₦400,000) to ₦1,024,900 (i.e. ₦280,000 + ₦218,400 + ₦526,500). The implication is that since the correct relevant market is “all devices and gadgets”, the current combined market share of the merging parties is 15%.

Table 4 – A SSNIP Imposed on All Devices and Gadgets

	Price (₦)	Sales	Revenue (₦)	Variable Costs (₦)	Costs (₦)	Profits (₦)
Devices with a flap	1050	800	840,000	700	560,000	280,000
Standard devices	840	910	764,400	600	546,000	218,400
Gadgets	735	3,900	2,866,500	600	2,340,000	526,500
Total		5,610				1,024,900

Market Participants

4.37 When engaged in a market definition exercise, the Commission will identify participants in a relevant market to determine market shares and concentration levels. Such participants include: i) current sellers of the relevant products in the relevant geographic markets; and ii) sellers that would begin selling the relevant products in the relevant geographic markets if the price were to rise by a SSNIP. In the latter case, the

Commission considers a firm to be a participant in a relevant market when it does not require significant sunk investments to enter or exit the market and would be able to rapidly and profitably divert existing sales or capacity to begin supplying the market in response to a SSNIP (a "supply response").

- 4.38 The Commission considers situations in which competitive sellers would need to incur significant sunk investments, or would not be able to respond rapidly, in the analysis of entry (see Part 5).

Calculating Market Share

- 4.39 Having defined the market, the next task will be to grasp the market structure. A very basic summary statistic is the number of firms or participants in the market. The more firms that are active in a market, the lower the likelihood of competition concerns. For example, in a market with ten effective competitors, a merger would not normally be seen as creating an issue (unless the firms in question had a particularly high market share). By contrast, a 3-to-2 merger or 4-to-3 merger will receive attention.
- 4.40 The most significant summary statistic in any competition policy case is almost certainly market share. In merger cases, the combined market share of the merging parties and the increment in market share provide a standard starting point. For instance, merger of firms with 40% and 30% market share to create a single entity with 70% would ordinarily be seen as raising very serious competition issues. By contrast, a merger of firms with 5% and 9% market share creating a combined entity with 14% market share will ordinarily be seen as not raising competition concerns.
- 4.41 The Commission calculates market shares for all sellers who have been identified as participants in the relevant market. Market shares can be calculated in various ways, for example in terms of Naira sales, unit sales, capacity or, in certain natural resource industries, reserves, using information from a variety of sources, such as the merger parties, competitors, customers, suppliers, trade associations and market research reports.
- 4.42 When calculating market shares, the Commission uses the best indicators of sellers' future competitive significance, considering the extent to which current market shares

are likely to accurately reflect future market share patterns. For example, there may be evidence that substantial new capacity is due to come on-stream in a manufactured product market, or new licences are about to be issued in a regulated market or some firms are running out of reserves in a primary product market. Where such evidence exists, the Commission adapts current market shares accordingly.

- 4.43 In cases in which products are undifferentiated or homogeneous (i.e., have no unique physical characteristics or perceived attributes), and firms are all operating at full capacity, market shares based on Naira sales, unit sales and capacity should yield similar results. In such situations, the basis of measurement depends largely on the availability of data. When firms producing homogeneous products have excess capacity, market shares based on capacity may best reflect a firm's relative market position and competitive influence in the market. Excess capacity may be less relevant to calculating market shares when it is clear that some of a firm's unused capacity does not have a constraining influence in the relevant market (e.g., because the capacity is high-cost capacity or the firm is not effective in marketing its product).
- 4.44 When a regulated or historical incumbent firm is facing deregulation or enhanced competition, shares based on new customer acquisitions may be a better indicator of competitive vigour than are shares based on existing customers.
- 4.45 As the level of product differentiation in a relevant market increases, market share calculated on the basis of Naira sales, unit sales and capacity increasingly differ. For example, if most of the excess capacity in the relevant market were held by discount sellers in a highly differentiated market, the market share of these sellers calculated on the basis of total capacity would be greater than if they were calculated on the basis of actual unit or Naira sales. In this case, market share based on total capacity would be a misleading indicator of the relative market position of the discount sellers. In such circumstances, Naira sales may be the better indicator of the size of the total market and of the relative positions of individual firms. Because unit sales may also provide important information about relative market positions, the Commission often requests both dollar sales and unit sales data from the merging parties and other sellers.

- 4.46 The Commission generally includes the total output or total capacity of current sellers located within the relevant market in the calculation of the total size of the market and the shares of individual competitors. However, when a significant proportion of output or capacity is committed to business outside the relevant market and is not likely to be available to the relevant market in response to a SSNIP, the Commission generally does not include this output or capacity in its calculations.
- 4.47 For firms that participate in the market through a supply response, the Commission only includes in the market share calculations the output or capacity that would likely become available to the relevant market without incurring significant sunk investments.

Market Concentration

- 4.48 Under section 94(2)(c) of the Act, the level of concentration is a factor for analysis. The Herfindahl-Hirschman Index (HHI) measures: (i) the extent of market concentration before and after the transaction is completed; and (ii) the change in market structure and concentration because of the transaction. Both measures are important to deciding whether the merger should be subjected to more detailed analysis of conduct, competitive effects, entry and efficiencies.
- 4.49 By putting together information on the market participants and their market shares into a single indicator, the HHI is a more sophisticated structural analysis. In contrast to market share analysis, which focuses on the firm(s) under investigation, the HHI takes into account market shares across the entire market. It is computed as the sum of squared market shares and, therefore, places proportionately greater weight on the market shares of the larger firms. For example, a monopoly would give a HHI of 10,000 ($=100^2$), while a 20:30:50 market structure leads to a HHI of 3,800 ($=20^2 + 30^2 + 50^2$). A further measure associated with the HHI is the “delta” or “increment”, which is especially important for merger cases between competitors. The delta is the change in the HHI following a merger. This may be calculated even without knowing the market shares of the rest of the firms in the market, as two times the product of the market shares of the merging firms (prior to the merger).¹²

¹² If firms X and Y have market shares a and b , their respective contribution to the pre-merger HHI are a^2 and b^2 . After the merger, their joint contribution is $(a+b)^2 = a^2 + b^2 + 2ab$. The difference in the HHI is, therefore, $2ab$.

- 4.50 In a correctly defined market, the delta and HHI provide an indication of whether a merger is likely to raise significant competitive concerns. The MRR has specified that that competition concerns are in general unlikely with:
- a post-merger HHI below 1,000;
 - a post-merger HHI between 1,000 and 2,000 but a delta below 250; and
 - a post-merger HHI above 2,000 but a delta below 150.
- 4.51 Of course, these thresholds do not create irrebuttable presumptions. Some mergers above the thresholds would not create competition concerns, whilst other mergers below the thresholds would create competition concerns. It must also be recognised that the HHI does not provide a full picture of the competitive situation. At one level, it does not take into account important features of a market such as barriers to entry, or the extent of spare capacity or capacity constraints, that can fundamentally affect the competitiveness of a market for a given market structure.
- 4.52 As such, it is a safe harbour and does not provide a rigid screen to determine whether or not a merger is likely to result in a substantial prevention or lessening of competition. It allows the Commission determine whether to intensify its analysis of the competitive impact of a merger. The HHI thresholds may also be a useful self-assessment guide for merging parties who are considering a voluntary notification where the merger falls below the thresholds for compulsory notification set out in the Threshold Regulations and in minority shareholding cases.

Illustrative Example: HHI

How Does HHI Work?

The HHI formula is calculated by squaring the market share for each firm (usually not more than 50 firms) and then summing the squares.

Here's an example:

If there are four superstores in your town: Fola's, Obi's, Sani's and Ovie's. Market share is broken down as follows:

Fola's: 50%
Obi's: 25%
Sani's: 15%
Ovie's: 10%

$$HHI = 50^2 + 25^2 + 15^2 + 10^2 = 3,450$$

In a perfectly competitive market, HHI approaches zero. If there are thousands of restaurants in a city, but the top 50 each have 0.1% of the market share. The HHI is $0.1^2 \times 50 = 0.5$.

- 4.53 Compared with concentration ratios which add together the shares of the four (CR4) or six (CR6) largest firms¹³ before and after the merger in the relevant market, the HHI provides a more complete picture of pre-merger and post-merger market structure and concentration through adding together the squares of the individual firms' market shares. This gives greater weight to the larger market shares and in particular the market share of the dominant firm/merged entity after a merger.
- 4.54 To provide an obvious example, a merger of the second and third largest producers in a pre-merger relevant market of five producers with shares of 30%, 28%, 22%, 15% and 5% removes an important competitor but has no effect on the CR4. In contrast, the HHI increases quite dramatically by more than 50% from 2418 to 3650 - through capturing the establishment of a more dominant firm in the post-merger market.
- 4.55 The Commission recognises that HHI is criticised because market share information for smaller suppliers (that at times are in the informal sector) is often not available. However, this information is generally not critical because small shares have little effect on the HHI and on the changes in market shares that result from the merger. In addition, market definition in many emerging market economies such as Nigeria's might indicate high levels of market concentration with few competitors in many relevant markets. Under these circumstances, the ability of smaller fringe suppliers to respond to a SSNIP and discipline the pricing decisions of the major suppliers may be limited because of capacity, financing, lower quality products that are poor substitutes for most customers, and other constraints. Fringe suppliers therefore would not be in the relevant market but rather would be considered in the analysis of entry and product repositioning (discussed below).

¹³ This is referred to as the four-firm concentration ratio or CR4 and the six-firm concentration ratio or CR6, respectively.

- 4.56 What is evident overall is that, simple indices calculated from market shares themselves – contingent on a market definition – can give some useful guidance and insights into predicting the possible price effects of a merger. That is, the HHI is not just an arbitrary structural rule, but it is a formula that has – in some circumstances – a relationship to economic fundamentals.
- 4.57 Mergers that go above the HHI threshold are not necessarily anti-competitive. Under these circumstances, the Commission examines the various factors identified under Section 92(2) of the Act to determine whether such mergers would likely create, maintain or enhance market power, and thereby prevent or lessen competition substantially.

Interpreting market shares and concentration data.

- 4.58 There is no simple answer as to how high (or low) concentration measures need to be to prompt (or dismiss) concerns about the impact of a merger on competition. The same applies to the combined market share of the merged entity.
- 4.57 Safe harbours can be useful, for instance, since they may increase the predictability of merger control and allows the Commission to allocate investigation resources to cases which are more likely to result in consumer harm. Even where the merging parties' combined market shares appear reasonably low, for example below 25 per cent, a merger may still raise a competition issue. For example, supplier A (14 per cent share) merges with supplier B (10 per cent), leaving only two suppliers, the merged entity AB (24 per cent) and C (76 per cent). The post-merger HHI is 6,352 and the delta is 280. In this example the high value of the HHI statistics may indicate the possibility that the impact of this merger on a market that is already highly concentrated can raise some competition issues. By contrast, competition concerns may arise even with a relatively low post-merger HHI, for example, where the merging firms (say, with 20 per cent and 15 per cent shares) are the two largest in a fragmented market (say, all other suppliers are 3 per cent or less) or where they have some characteristic that is not enjoyed by the other players in the market. These examples show that market shares and HHI measures provide only an initial indicator of potential competition concerns.

PART 5- STRENGTH OF COMPETITION TEST (OTHER MERGER FACTORS)

- 5.1 Subsequent to the Commission's analysis in Part 4 which is essentially quantitative and structural in nature, this Part propounds the bases upon which the Commission shall undertake further analysis under Section 94(2) of the Act after its analysis of market definition, share and concentration falls short of a clearance.
- 5.2 The factors considered in this Part constitute aspects of what the Commission refers to as the "strength of competition" test.¹⁴ It should be noted that although Section 94(2)(c) of the Act identifies "levels of concentration" as a constituent factor in the test, the Commission would as a matter of logical flow

Actual and potential import competition (Section 94(2)(a))

- 5.3 Actual or potential direct competition from imported goods or services can provide an important competitive discipline on domestic firms. Where the Commission can be satisfied that import competition — or the potential for import competition — provides an effective constraint on domestic suppliers, it is unlikely that a merger would result in a substantial prevention or lessening of competition.
- 5.4 While the current or historic levels of imports may indicate the competitive role of imports in the relevant market, the Commission will consider the potential for imports to expand if the merged firm attempted to exercise increased market power post-merger.
- 5.5 Imports are most likely to provide an effective and direct competitive constraint in circumstances where all of the following conditions are met:
- independent imports (that is, imports distributed by parties that are independent of the merger parties) represent at least 10 per cent of total sales in each of the previous three years;

¹⁴ This derives from language in Section 94(2) of the Act where the Commission is required to assess the strength of competition in the relevant market.

- there are no barriers to the quantity of independent imports rapidly increasing that would prevent suppliers of the imported product from competing effectively against the merged firm within a period of one to two years (for example, government regulations, the likelihood and impact of anti-dumping applications on imports, customer-switching costs or the need to establish or expand distribution networks);
- the (actual or potential) imported product is a strong substitute in all respects (that is, quality, range, price, etc.) for the relevant product of the merged firm, taking into account factors including the need to meet any relevant Nigerian or industry standards, any increase in the complexity of customers' logistical arrangements, increased transport times and costs, and the risk of adverse currency exchange rate fluctuations;
- the price of actual or potential landed imports, including any tariffs or other import-specific taxes and charges, (that is, the import parity price) is close to the domestic price of the relevant product that would prevail in the absence of the merger;
- importers are able to readily increase the supply volume of the product they import with minimal or no increase in the price paid;
- the merged firm and other major domestic suppliers do not have a direct interest in, are not controlled by, and do not otherwise interact with, actual or potential import suppliers.

Barriers to Import Expansion

5.6 The ability of imports to expand (import supply elasticity) will be a key consideration in the Commission's competition analysis. If the supply of imports is either unable to respond, or only able to respond slowly, to an increase in demand by Nigerian consumers, imports are unlikely to effectively counteract any increased market power of the merged firm. For example, where there are production capacity or supply constraints, or where imports targeted to niche segments would not be profitable on a wider scale given their cost structures, import competition is unlikely to be sufficient to prevent a SPLC.

5.7 The barriers to import expansion that the Commission considers when assessing the supply elasticity of imports include:

- the existence of capacity constraints overseas and the resulting impact on the potential for expansion of imports into Nigeria
- the level and impact of transport costs and logistics (particularly the impact of transport costs as a percentage of the value of the good or service being imported)
- the cost and delay associated with the need to establish or expand effective distribution networks
- the cost and delay associated with any specialised facilities required by importers to supply domestic customers
- the level and effect of tariffs, quotas and other government regulations (both in Nigeria and the country of origin)
- the likelihood and impact of anti-dumping applications on imports
- the presence of exclusive licensing arrangements on imports
- the existence of impediments to customers choosing imports rather than the domestic product post-merger, such as switching costs, lock-in contracts, compatibility problems, importance of a Nigerian agent and local service and supply, or consistency and timeliness of supply.

Qualitative Information and Evidence for import competition

5.8 The following are examples of the types of information the Commission may require to determine the competitive constraint provided by imports:

- which products are imported into the relevant market/s
- who undertakes the importation and their relative share of the market/s
- estimates of the actual and potential level of import competition in the market/s
- historical importation figures
- details of any barriers to entry to importing, including access to distribution facilities, transport costs and customs restrictions
- details of the price of imports as opposed to domestic production in the relevant market/s and an explanation of any divergence in these prices

- the extent to which imports provide a constraint on domestic suppliers, including the merger parties, in the relevant market/s post-merger.

Ease of Entry

5.9 The entry of new firms into a market can provide an important source of competitive constraint on incumbents. A key component of the Commission's analysis of competitive effects is whether timely entry by potential competitors would likely occur on a sufficient scale and with sufficient scope to constrain a material price increase in the relevant market. In the absence of impediments to entry, a merged firm's attempt to exercise market power, either unilaterally or through coordinated behaviour with its rivals, is likely to be thwarted by entry of firms that:

- are already in the relevant market and can profitably expand production or sales;
- are not in the relevant market but operate in other product or geographic markets and can profitably switch production or sales into the relevant market; or
- can profitably begin production or sales into the relevant market *de novo*.

Conditions of entry

5.10 Entry is only effective in constraining the exercise of market power when it is viable. When entry is likely, timely and sufficient in scale and scope, an attempt to increase prices is not likely to be sustainable as buyers of the product in question are able to turn to the new entrant as an alternative source of supply.

Timeliness

5.11 The Commission's assessment of the conditions of entry involves determining the time that it would take for a potential entrant to become an effective competitor in response to a material price increase that is anticipated to arise as a result of the merger. In general, the longer it takes for potential entrants to become effective competitors, the less likely it is that incumbent firms will be deterred from exercising market power. For that deterrent effect to occur, entrants must react and have an impact on price in a reasonable period of time. In the Commission's analysis, the beneficial effects of entry on prices in this market must occur quickly enough to deter or counteract any material

price increase owing to the merger, such that competition is not likely to be substantially harmed.

- 5.12 The evaluation of whether entry will be timely necessarily varies with each specific merger and the dynamics of the market. While the Commission's starting point for timely entry is entry within one to two years, the appropriate timeframe will depend on the particular market under consideration. When determining whether potential entry is likely to be timely the Commission considers the barriers outlined in paragraph 5.20, as well as factors such as the frequency of transactions, the nature and duration of contracts between buyers and sellers, lead times for production and the time required to achieve the necessary scale.

Likelihood

- 5.13 When determining whether future entry is likely to occur, the Commission generally starts by assessing firms that appear to have an entry advantage. While other potential sources of competition may also be relevant, typically the most important sources of potential competition are the following:

- fringe firms already in the market;
- firms that sell the relevant product in adjacent geographic areas;
- firms that produce products with machinery or technology that is similar to that used to produce the relevant product;
- firms that sell in related upstream or downstream markets;
- firms that sell through similar distribution channels; and
- firms that employ similar marketing and promotional methods.

- 5.14 A history of entry into and exit from a particular market provides insight into the likelihood of entry occurring in a timely manner and on a sufficient scale to counteract an exercise of market power by a merged firm. It is, however, not the sole determinant of whether this would likely occur.

- 5.15 The Commission has to be satisfied that actual or threatened entry post-merger is not just possible but likely in response to an attempted exercise of market power by the merged firm. The likelihood of entry generally depends on the profitability of entering

the market. The Commission will assess whether a new entrant could expect to make a commercial return on its investment taking into account the price effects the additional output may have on the market and the likely responses of the incumbent firms and other costs/risks associated with entry. The Commission evaluates profitability at post-entry prices, taking into account the effect that new supply would have on market prices. These prices are often the pre-merger price levels. For instance, if a competitor was able to enter a market only on a scale that is below the minimum viable scale, the Commission would not consider such entry to be likely, since the entrant would be unable to achieve the annual level of sales necessary to achieve profitability at post-entry prices.

Sufficiency

- 5.16 When considering whether entry is likely to be on a scale and scope to provide an effective competitive constraint, the Commission would examine what would be required from potential competitors who choose to enter. The Commission will also consider any constraints or limitations on new entrants' capacities or competitive effectiveness. Entry by firms that seek to differentiate themselves by establishing a niche to avoid direct competition with the merged firm may also not be sufficient to constrain an exercise of market power.
- 5.17 Entry must be of sufficient scale with a sufficient range of products to provide an effective competitive constraint. In differentiated product markets, the sufficiency of entry will critically depend on the ability and incentive of entrants to supply a sufficiently close substitute to that of the merged firm. Entry at the fringe of the market is unlikely to constrain any attempted exercise of market power by incumbents if incumbents are unlikely to lose significant sales to those fringe entrants. Therefore, individual entry that is small-scale, localised or targeted at niche segments is unlikely to be an effective constraint post-merger.
- 5.18 Sufficiency does not require in all circumstances that one new entrant alone duplicates the scale and all the relevant activities of the merged firm. Timely entry by multiple firms may be sufficient if the combined effect of their entry would defeat or deter the exercise of increased market power by the merged firm.

- 5.19 The Commission's assessment of the timeliness, likelihood and sufficiency of entry will depend on the circumstances of each particular merger under consideration. However, the underlying test is always whether the potential for entry provides an effective competitive constraint that would prevent a significant and sustainable increase in the market power of market participants post-merger.

Types of barriers to entry

- 5.20 In assessing the potential for entry to act as a competitive constraint, the Commission considers the costs of entry and incumbency advantages under three categories.

- (i) Legal or regulatory barriers, including but not limited to:
 - licensing conditions, tariffs, explicit restrictions on the number of market participants and other government regulations;
 - legally enforceable intellectual property rights;
 - environmental regulations that raise the costs of entry or limit the ability for customers to switch suppliers.
- (ii) Structural or technological barriers, including but not limited to:
 - the existence of sunk costs, which increase the risks of, and costs associated with, failed entry and include factors such as product development, advertising or promotion to establish a sufficient reputation in the market and construction of specialised facilities — the high risk and costs associated with failed entry may deter new entry
 - substantial economies of scale, which may limit the viability of entry below a certain minimum efficient scale.
 - high customer switching costs, such as search costs, transaction costs and market specific behaviour (including customer inertia to switching suppliers)
 - mature markets or markets with declining levels of demand growth
 - access to key production or supply assets, important technologies or distribution channels
 - the existence of significant network effects.
- (iii) Strategic barriers that arise because of actions or threatened actions by incumbents to deter new entry, including but not limited to:

- risk of retaliatory action by incumbents against new entry, such as price wars or temporarily pricing below cost
- creation and maintenance of excess capacity by incumbents that can be deployed against new entry
- creation of strategic customer switching costs through contracting, such as exclusive long-term contracts and termination fees
- brand proliferation by incumbents, which may crowd out the product space leaving insufficient opportunities for new firms to recover any sunk entry costs.

Information and Evidence to Prove Entry

5.21 The onus rests with the merging parties to demonstrate that entry will be timely, likely and sufficient. In assessing whether entry might act as an effective competitive constraint post-merger, the Commission will consider all relevant information including, but not limited to the following:

- The history of past entry such as consideration of the costs of such entry, the length of time previous new entrants traded in the market, and the effect of such entry on the intensity of competition in the market.
- Evidence of planned entry by firms in adjacent or complementary markets or by other firms outside the market.
- Evidence indicating the level of investment (particularly any sunk costs) required to enter the market and operate at the minimum efficient scale necessary to achieve a reasonably competitive level of costs.
- Evidence indicating the time period over which entry costs would have to be recovered in order to assess whether entry would be profitable post-merger at competitive prices.
- Evidence of the ability of producers that are not competitors to switch production to competing products or services and achieve success in the market.

- Evidence of the extent of brand loyalty by customers.
- Evidence of switching costs (such as product compatibility issues, product bundling, contract termination charges) that may prevent buyers in the relevant market/s from changing suppliers or sellers in the relevant market/s from changing buyers, in the short to medium term
- The length of contracts between suppliers and customers.
- Evidence of the ability and incentive of customers to sponsor entry.
- Evidence of any growth or decline in the market.
- Evidence of a strategy to block or restrict entry through the acquisition of a competitor by an incumbent.
- Evidence of network effects that impede entry.
- the extent of brand loyalty in the relevant market/s
- the existence and nature of any long-term supply contracts in the relevant market/s

History of Collusion

5.22 A history of collusion or coordination in the market is also relevant to the Commission's analysis, because previous and sustained collusive or coordinated behaviour indicates that firms have successfully overcome the hurdles to effective coordinated behaviour in the past. The detailed discussion on conditions conducive to coordination and collusion are discussed in paragraph 6.

Countervailing Power

5.23 In its review, the Commission would, in addition to supply-side competitive constraints, assess whether one or more buyers are able to constrain the ability of a seller to exercise market power. This may occur when, for example,

- they can self-supply through vertical integration into the upstream market;
- the promise of substantial orders can induce expansion of an existing smaller supplier and/or can sponsor entry by a potential supplier not currently in the market;
- they can refuse to buy other products produced by the seller;
- they can refuse to purchase the seller's products in other geographic markets where the competitive conditions are different; or
- they can impose costs on the seller (for example, by giving less favourable retail placement to the merged entity's products).

5.24 The Commission does not presume that a buyer has the ability to exercise countervailing power merely by virtue of its size. There must be evidence that a buyer, regardless of size, will have the ability and incentive to constrain an exercise of market power by the merged firm. Evidence of prior dealings between the buyer and one or more of the merging parties that tends to demonstrate the buyer's relative bargaining strength is of particular relevance. The Commission also considers the extent to which the merger affects the buyer's ability and incentive to exercise countervailing power. When a merger eliminates a supplier whose presence contributed significantly to a buyer's historical bargaining strength, the buyer may no longer be able to exercise countervailing power after the merger.

5.25 When price discrimination is a feature of the relevant market, it may be possible for some but not all buyers to counter the effects of an exercise of market power. For example, a merged firm may be able to increase prices to buyers that do not have the option to vertically integrate their operations, while other buyers with this option may be able to resist such a price increase. Where only a subset of buyers is able to counter a price increase or other exercise of market power, the Commission will generally find that countervailing power is insufficient to prevent the merged firm from exercising market power in the relevant market.

5.26 In assessing whether countervailing power is likely to prevent a substantial lessening of competition by constraining any attempt by the merged firm to increase market power, the Commission considers the following factors, among others:

- Whether the threat to bypass is credible on commercial grounds Evidence of this will often include the size of the buyer's purchases and the efficient scale of production of the product. For sponsored entry to be commercially viable, the entrant will have to operate at an efficient scale of production. If the purchases of the sponsoring firm are insufficient to underpin such a production scale, the Commission needs to be convinced that the entrant could readily find other sales in the relevant market.
- Whether the buyer is likely to bypass the supplier. Evidence of this could include plans or other documents suggesting such a strategy is commercial, as well as instances and circumstances when the buyer or other buyers of the relevant input have previously sponsored entry or vertically integrated. The Commission places greater weight on evidence that such strategies form part of the firm's business model. Also, if the relevant input does not account for a significant proportion of the buyer's total input costs, sponsored entry or backward integration may be less likely.
- The proportion of the downstream market able to wield a credible threat. For the countervailing power to offset or limit any market power arising from a merger, it will usually not be sufficient if only one buyer or category of customers is able to bypass the merged firm post-merger. For example, the merged firm may be able to increase prices charged to smaller buyers that are unable to bypass the supplier while larger buyers with countervailing power are able to avoid the increase. A significant proportion of customers must be shielded from the effects of market power if countervailing power is to prevent a substantial lessening of competition in the relevant market/s.

Information and Evidence for Countervailing Power

5.27 The following are examples of the types of information the Commission may require to ascertain the degree of countervailing power in the relevant market/s:

- the relative strength of bargaining power possessed by customers of the products in the relevant market/s
- the extent to which it is possible for customers to bypass the merger parties by importing or producing the product themselves, vertically integrating, or using an alternative supplier.

Dynamic characteristics of the market¹⁵

- 5.28 Dynamic changes may result from a range of factors including market growth, innovation, product differentiation and technological changes. The analysis of the effects of dynamic changes in the market is closely linked with analysis of the other merger factors discussed in this chapter. The changes in the market will be considered from two perspectives:
- the extent to which the dynamic features of the market affect the likely competitive impact of the merger
 - whether the merger itself impacts on the dynamic features of the market.
- 5.29 Whether a market is growing or declining can have significant implications for the competitiveness of the market in the future. Markets that are growing rapidly may offer both greater scope for new entry and the erosion of market shares over time.
- 5.30 Similarly, markets that are characterised by rapid product innovation may be unstable so that any increased market power gained through a merger is transitory. In general, a merger is less likely to substantially lessen competition in a market that is rapidly evolving.
- 5.31 When considering how a merger will influence future competition in a dynamic market, the Commission places more weight on robust evidence about likely future developments in the relevant market. The Commission will give significantly less weight to predictions about the future state of competition that are speculative or have little chance of developing for some considerable time in the future.
- 5.32 The MRR stipulates that Commission will consider changes in the market from two perspectives:
- (a) the extent to which the dynamic features of the market affect the likely competitive impact of the merger
 - (b) whether the merger itself impacts on the dynamic features of the market.¹⁶

¹⁵ Refers to the merger factor in section 94(2)(e) of the Act.

¹⁶ Regulation 49 of the Merger Review Regulations 2020

Vertical Integration in the market¹⁷

- 5.33 It is recognised that some horizontal mergers can be affected by vertical integration or vertical relationships in the market — for example, horizontal competition issues may be exacerbated by vertical aspects of a merger and vice versa. Where a merger involves both horizontal and vertical competition issues, the Commission will assess the merger based on the combined horizontal and vertical impact on competition.
- 5.34 The nature and extent of vertical relationships between firms in separate areas of activity along a vertical supply chain can affect the competitive implications of consolidation in any one of those areas. For example, a horizontal merger can increase the likelihood of coordination in cases where downstream integration increases the visibility of pricing. Generally, horizontal mergers involving a vertically integrated firm are unlikely to lessen competition provided effective competition remains at all levels of the vertical supply chain post-merger.

Information and Evidence to Prove Vertical integration

- 5.35 The following are examples of the types of information the Commission may require to ascertain whether vertical integration is likely to be relevant to the competition assessment:
- whether the merger will result in vertical integration between firms involved at different functional levels of the relevant market/s
 - whether the merger is likely to increase the risk of limiting the supply of inputs or access to distribution, such that downstream or upstream rivals face higher costs post-merger or risks of full or partial foreclosure of key inputs or distribution channels
 - the extent of existing vertical integration, noting in particular where either merger party currently operates as a customer or supplier to competitors in the relevant market/s.

¹⁷ Section 94(2)(f) of the Act

Failing Firm¹⁸

5.36 The impact that a firm's exit can have in terms of matters other than competition is generally beyond the scope of the assessment contemplated by section 94(2)(g) of the Act. Probable business failure does not provide a defence for a merger that is likely to prevent or lessen competition substantially. Rather, the loss of the actual or future competitive influence of a failing firm is not attributed to the merger if imminent failure is probable and, in the absence of a merger, the assets of the firm are likely to exit the relevant market. Merging parties intending to invoke the failing firm rationale are encouraged to make their submissions in this regard as early as possible.

5.37 A firm is considered to be failing if:

- it is insolvent or is likely to become insolvent;
- it has initiated or is likely to initiate voluntary bankruptcy proceedings; or
- it has been, or is likely to be, petitioned into bankruptcy or receivership.

5.38 In assessing the extent to which a firm is likely to fail, the Commission typically seeks the following information:

- the most recent, audited, financial statements, including notes and qualifications in the auditor's report;
- projected cash flows;
- whether any of the firm's loans have been called, or further loans/line of credit advances at viable rates have been denied and are unobtainable elsewhere;
- whether suppliers have curtailed or eliminated trade credit;
- whether there have been persistent operating losses or a serious decline in net worth or in the firm's assets;
- whether such losses have been accompanied by an erosion of the firm's relative position in the market;
- the extent to which the firm engages in "off-balance-sheet" financing (such as leasing);

¹⁸ Section 94(2)(g) of the Act

- whether the value of publicly-traded debt of the firm has significantly dropped;
- whether the firm is unlikely to be able to successfully reorganise pursuant to Nigerian or foreign bankruptcy legislation, or through a voluntary arrangement with its creditors.

5.39 These considerations are equally applicable to failure-related claims concerning a division or a wholly-owned subsidiary of a larger enterprise. However, in assessing submissions relating to the failure of a division or subsidiary, particular attention is paid to transfer pricing within the larger enterprise, intra-corporate cost allocations, management fees, royalty fees, and other matters that may be relevant in this context. The value of such payments or charges is generally assessed in relation to the value of equivalent arm's-length transactions.

5.40 Matters addressed in financial statements are ordinarily considered to be objectively verified when these statements have been audited or prepared by a person who is independent of the firm that is alleging failure. The Commission's assessment of financial information includes a review of historic, current and projected income statements and balance sheets. The reasonableness of the assumptions underlying financial projections is also reviewed in light of historic results, current business conditions and the performance of other businesses in the industry.

Removal of an Effective and Vigorous Competitor

5.41 A firm that is an effective and vigorous competitor¹⁹ often plays an important role in pressuring other firms to compete more intensely with respect to existing products or in the development of new products. A firm does not have to be among the larger competitors in a market in order to be an effective and vigorous competitor. Small firms can exercise an influence on competition that is disproportionate to their size. Mergers involving a vigorous and effective competitor are more likely to result in a significant and sustainable increase in the unilateral market power of the merged firm or increase the ability and incentive of a small number of firms to engage in coordinated conduct. Vigorous and effective competitors may drive significant aspects of competition, such as pricing, innovation or product development, even though their own market share may be modest. These firms tend to be less predictable in their behaviour and deliver benefits

¹⁹ Mavericks are one type of effective and vigorous competitor

to consumers beyond their own immediate supply, by forcing other market participants to deliver better and cheaper products. They also tend to undermine attempts to coordinate the exercise of market power.

- 5.42 A merger that removes a vigorous and effective competitor may therefore remove one of the most effective competitive constraints on market participants and thereby result in a substantial lessening of competition. This often depends on (i) the significance of the effective competitor in the market and (ii) the extent to which the merged entity will compete less vigorously than the effective firm prior to the merger.²⁰
- 5.43 While the removal of a vigorous and effective competitor through a merger is likely to prevent or lessen competition to some degree, it may not, in itself, provide a sufficient basis for a decision to challenge the merger. Additionally, when a firm removed through a merger is not a vigorous or effective competitor (e.g., owing to financial distress, or declining technologies or markets), this fact is relevant to, but not determinative of, a decision not to challenge a merger.
- 5.44 Other things being equal, a horizontal merger that results in the establishment or strengthening of a maverick producer is less likely to have adverse unilateral or coordinated effects. One implication for emerging economies such as Nigeria is that larger and more diversified companies, conglomerates and business groups with good access to capital, technology and inputs, and substantial diversification experience might be well positioned to: (i) enter or expand in relevant markets, (ii) become an effective and vigorous competitor after internal expansion or a merger is completed, and thereby (iii) reduce the risk and duration of a material price increase and other unilateral or coordinated effects.
- 5.45 Mavericks can also have pro-competitive effects throughout a supply chain. For example, a disruptive maverick input supplier or input purchaser/final product customer whose disruptive conduct and e.g. refusal to follow and participate in a tacit collusion arrangement at the input or business customer stage of the supply chain can make

²⁰ (Maverick behaviour is also relevant in the context of coordinated effects as discussed in paragraph 6.39, and also in the context of non-horizontal mergers as discussed in paragraph 6.47.)

coordinated and other forms of anticompetitive conduct more difficult in the acquiring firm's or dominant firm's stage of production in the supply chain.

PART 6: ANTI-COMPETITIVE EFFECTS AND THEORIES OF HARM

Types of Merger

- 6.1 These Guidelines discuss three types of merger — in each, the merger may involve firms that are either actual or potential competitors:
- iv. horizontal mergers — involving actual or potential suppliers of substitutable goods or services;
 - v. vertical mergers — involving firms operating or potentially operating at different functional levels of the same vertical supply chain; and
 - vi. conglomerate mergers — involving firms that interact or potentially interact across several separate markets and supply goods or services that are in some way related to each other, for example, products that are complementary in either demand or supply.
- 6.2 Each type of merger has the potential to affect competition in a different way and will therefore be analysed differently. While some competition issues and theories of competitive harm are presented separately in these guidelines, the Commission will adopt an approach tailored to the particular nature of the merger.
- 6.3 It is also important to note that although horizontal, vertical and conglomerate mergers can all potentially give rise to competition concerns, it is recognised that vertical and conglomerate mergers are generally less likely than horizontal mergers to raise competition concerns.
- 6.4 This Part elaborates on the effects analysis- the probable harm that would be occasioned post-merger.

Theory of Harm and Effects

- 6.5 Not all mergers give rise to competition concerns though in some cases the different types of mergers may lead to specific harmful effects. The Commission will generally

consider the basic theories of harm. Broadly, there are three main reasons why mergers may lead to an SPLC:

- i. Unilateral effects- these may arise in horizontal mergers where the merger involves two competing firms and removes the rivalry between them, allowing the merged firm profitably to raise prices (see paragraphs 6.6 to 6.38).
- ii. Coordinated effects- these may arise in both horizontal and non-horizontal mergers where the merger enables or increases the ability for several firms within the market (including the merged firm) jointly to increase price because it creates or strengthens the conditions under which they can coordinate (see paragraphs 6.39 to 6.46).
- iii. Vertical or conglomerate effects- these may arise principally in non-horizontal mergers where the merger creates or strengthens the ability of the merged firm to use its market power in at least one of the markets, thus reducing rivalry (see paragraphs 6.47 to 6.66). However, these effects can, in some circumstances, also arise in horizontal mergers.

Unilateral Effects

6.6 One of the main ways in which mergers can lessen competition is through unilateral effects. Mergers have unilateral effects when they remove or weaken competitive constraints in such a way that the merged firm's unilateral market power is increased. That is, as a result of the merger the merged firm finds it profitable to raise prices, reduce output or otherwise exercise market power it has gained, and can do so, even given the expected response of other market participants to the resulting change in market conditions.²¹

6.7 The basic theory of unilateral effects is summed up below:

- (a) the merger increases the incentive for one or both of the merging parties to increase price(s);

²¹ This may be contrasted to coordinated effects arising from a merger where it may be profitable for the merged firm to raise prices, reduce output or otherwise exercise market power because it considers that the responses of its rivals will be directly influenced by its own actions. This may manifest as either tacit or explicit collusion.

- (b) if the merged entity increases price(s) then non-merging parties increase price as well (through what is called a “second round” effect) and the higher price equilibrium can be sustained in the absence of explicit or tacit collusion because the merger weakens the competitive constraints faced by each merging party; and
- (c) substantial reductions in marginal cost can outweigh the incentive for the merged firm to increase prices, inducing the merged entity to lower price (in which case non-merging firms lower their prices too).

6.8 Unilateral effects can occur in various market environments, defined by the primary characteristics that distinguish the firms within those markets and determine the nature of their competition. Three types of market environment are described below.

Firms in differentiated product industries

- 6.9 In markets in which products are differentiated, a merger may create, enhance or maintain the ability of the merged firm to exercise market power unilaterally when the product offerings of the merging parties are close substitutes for one another. In such circumstances, the Commission assesses how the merger may change the pricing incentives of the individual firms.
- 6.10 Any firm considering increasing the prices for its products faces a trade-off between higher profits on the sales that it continues to make following the price increase and the profits that it loses on sales that it no longer makes following the price increase, as buyers switch to other firms and/or other products. Any sales that were previously lost to the firm's merging partner will be captured by the merged firm ("diverted sales"). Thus, the incentives to raise prices after the merger are greater the more closely the products of the merging firms compete with each other, and the larger the profit margins on these diverted sales.
- 6.11 The closeness of competition between the merging firms' products may be measured by the diversion ratio between them.²² The value of the diverted sales from one merging firm depends on the volume of diverted sales and the profit margin on the diverted sales.

²² See the Text Box below

The greater the value of the diverted sales, the greater the incentive the merged firm has to raise prices. The incentive to raise prices following the merger will typically be greater when-

- (a) the products of the merging firms are close substitutes for a significant number of buyers,
- (b) the merger removes a vigorous and effective competitor from the market, or when buyers are not very sensitive to price increases.

6.12 These are not the only circumstances, however, when the Commission may be concerned with potential unilateral effects post-merger. Even when the merging firms are found to have an incentive to increase price after the merger, the likelihood of the merger preventing or lessening competition substantially also depends on the responses of buyers and rival firms.

6.13 In addition to considering the value of sales currently diverted to rivals, the Commission evaluates the likely competitive responses of rivals, including whether rivals in the market are likely to expand production, reposition their products or extend their product line to discipline unilateral market power that would otherwise occur as a result of the merge. The Commission also considers existing sellers that may only occupy a particular niche within the relevant market and whether they provide an alternative for a sufficient number of buyers. In addition, the likelihood and likely impact of entry is considered.

6.14 When assessing the extent of competition between the products of the merging firms, the Commission examines, among other possible factors, past buyer-switching behaviour in response to changes in relative prices, information based on buyer preference surveys, win-loss records, and estimates of own-price and cross-price elasticities.

Firms in homogeneous product industries

6.15 A post-merger price increase may be profitable if the merger were to remove a seller to whom buyers would otherwise turn in response to a price increase. In markets in which

products are relatively undifferentiated (that is, they are homogeneous), such a price increase is more likely to be profitable in the following circumstances:

- the greater the share of the relevant market the merged firm accounts for;
- the lower the margin on the output that the merged firm withholds from the market to raise price;
- the less sensitive buyers are to price increases; and
- the smaller the response of other sellers offering close substitutes.

6.20 The response of other sellers will be smaller when they have insufficient capacity to increase sales to replace the output withheld by the merged firm post-merger, or substantial amounts of capacity are committed to other buyers under long-term contracts, and capacity cannot be expanded quickly and at relatively low cost. Therefore, the Commission would examine, among other factors, whether capacity constraints limit the effectiveness of remaining sellers by impeding their ability to make their products available in sufficient quantities to counter an exercise of market power by the merged firm.

Bidding and bargaining markets

6.21 In some markets, sellers may interact with buyers through bidding or bargaining for the right to supply. Buyers may negotiate with multiple sellers as a means of using one seller to obtain a better price from another seller. Such interactions may take the form of a pure auction or involve repeated rounds of negotiation with a select group of sellers. A merger between two sellers will prevent buyers from playing these two sellers off against each other to obtain a better price.

6.22 The extent to which this loss of competition will affect the price paid by the buyer depends on how close the merging firms are to each other relative to other bidders and potential suppliers in meeting the buyer's requirements. When there are many bidders or potential suppliers that are equally or similarly situated as the merging parties, a merger involving two sellers is unlikely to prevent or lessen competition substantially.

Other Relevant Considerations

6.23 In the cases of both homogeneous and differentiated product markets, if the main competitive constraints pre-merger was the other party to a merger, in removing this

constraint, may make it profitable for the merged entity to raise prices unilaterally. The removal from the market of a competitive force can also result if an enterprise merges either with a potential (rather than actual) competitor, for example, a recent entrant or an enterprise with a modest market share but expected to grow into a significant competitive force.

- 6.24 In an extreme case, no actual or potential rivals remain after the merger (a merger to monopoly situation). In other cases, the main rival has been eliminated and a merger results in a market characterised by a single enterprise with significant market power and numerous smaller competitors able to supply only a small proportion of total market demand (that is there is no strong “competitive fringe” in the market²³).
- 6.25 In other situations where unilateral effects occur, other market participants may respond in a pro-competitive way and (at least partially) attempt to offset the merged firm’s behaviour. Alternatively, it may be more profitable for other market participants to simply support the merged firm’s conduct — for example, if a merged firm exercises unilateral market power by raising the price of its products, other firms supplying substitutes may respond by also raising their prices, thereby exacerbating the competitive impact of the unilateral exercise of market power. As this example illustrates, a unilateral exercise of market power may make it profitable for both the merged firm and its competitors to raise prices.
- 6.26 In determining whether unilateral effects arise and whether they are likely to result in a SPLC, the Commission considers all of the merger factors contained in s. 94(3) of the Act and any other relevant factors described in Part 4. In particular, it considers whether the broader actual and potential competitive constraints — such as new entrants, imports or countervailing power — will limit any increase in the unilateral market power of each remaining market participant. These factors are discussed in more detail in Part 5.

23 The term “competitive fringe” is often used to describe a group of relatively small enterprises in a market containing larger enterprises.

- 6.27 From the point of view of merger analysis, the Commission considers the likely post-merger environment and assesses the strength of existing competition, barriers to expansion and product repositioning, switching costs, dynamic effects.

Existing Competition

- 6.28 Closeness of competition: Are the firms each other's closest competitors, while other firms in the market are relatively distant competitors?

Barriers to expansion or product repositioning:

- 6.29 Are the non-merging firms constrained such that they could not (or would not have the incentive to) increase output in response to attempts by the merged party to increase prices, for instance, due to capacity constraints (or dependency on the inputs and outputs from the merging parties)?
- 6.30 Can rivals re-position their (or introduce new) products (to become close competitors) without substantial sunk costs and in a timely manner?

Switching costs:

- 6.31 Would consumers face substantial difficulties or costs switching to alternative suppliers if the merged party attempted to increase price?

Dynamic effects:

- 6.32 Does the merger eliminate an effective competitive force that:
- (a) would have grown rapidly (e.g. due to its lower cost base); or
 - (b) had innovations in the pipeline that would have been brought to market?
- 6.33 Even if the merger involves one party whose market share is relatively low, could that low market share understate the true competitive constraint exerted on the other party due to such "dynamic" effects being likely? In particular, an important issue is whether one of these firms is a so-called "maverick" that plays (or is likely soon to play) an unusually pro-competitive role in the industry, acting to constrain the pricing of all firms to a greater extent than indicated by its market share.

- 6.34 Equally, even if the merger involves firms with large shares, are there smaller firms which (soon will) offer a constraint that is substantially greater than their current market share might suggest? For example, is there another firm in the market that could be described as a maverick that, despite its small size, is able to effectively constrain the pricing of much larger firms?

Empirical tests for Unilateral Effects

- 6.35 There are many empirical tests available. The Commission might consider the balance of evidence from many empirical tests. The tests considered are:

- Diversion ratios:

Diversion ratios are important in assessing closeness of competition between merging parties. Diversion ratios measure the proportion of sales captured by different substitute products when the price of a product is increased. For example, suppose 100 fewer units of product X are sold when X's price increases by a small amount (e.g, 5%), and 30 and 70 of these units are captured by products Y and Z, respectively. Here, the diversion ratio from X to Y is 30%, and the diversion ratio from X to Z is 70%. This indicates that product Z is the closest substitute for product X.

Diversion ratios can also be combined with margin data to perform price pressure tests (UPP, GUPPI and IPR).

- Survey evidence:

Actual evidence on switching behaviour, particularly in response to previous changes in price, could be important evidence on closeness of competition. Survey design must elicit information on actual behaviour than how respondents state they might act in a hypothetical situation put forward by the surveyor.

- Residual spend analysis:

Data on residual spend by consumers can indicate the extent to which they multi-source, and can be used to imply their second preferences. These can then be compared to market share figures to see how well the latter indicate the closeness of competition between firms.

- “Impact analysis”:

An analysis of how purchasers respond to temporary outages in production, temporary promotions, new entry and exit can be highly informative (provided that we can control for other factors that may also affect the variables of interest).

Minority Shareholdings

- 6.38 One firm acquiring a minority shareholding (even if not a controlling stake) in another firm in the same market can give rise to unilateral effects similar to that of a standard merger.

Coordinated effects

- 6.39 In addition to unilateral effects, mergers can lessen competition through coordinated effects. Mergers have coordinated effects when they assist firms in the market in implicitly or explicitly coordinating their pricing, output or related commercial decisions. A merger may do so simply by reducing the number of firms among which to coordinate, by removing or weakening competitive constraints or by altering certain market conditions that make coordination more likely. Coordinated effects may occur in addition to unilateral effects so that the merged firm is able to achieve even higher prices than it would on its own. In some cases, coordinated effects, either alone or in conjunction with unilateral effects, may amount to a substantial lessening of competition.
- 6.40 Following the structural changes a merger brings about for a market, competitors may find it more beneficial than previously to come to an implicit understanding among themselves to refrain from competing. The Act penalises collusion between enterprises,

for example to fix prices, share out markets or allocate customers. During a merger investigation, the Commission will consider whether the merger will result in such a high market concentration that unlawful coordination becomes likely. However, any type of merger may in more subtle ways enable or increase the ability of several enterprises within a relevant market (including the merged enterprise) to coordinate their competitive behaviour.

Coordinated conduct

6.41 Mergers have coordinated effects when they alter the nature of interdependence between rivals such that coordinated conduct is more likely, more complete or more sustainable. Interdependence arises when a market is characterised by a small number of firms (an oligopoly or a duopoly), with each firm anticipating the response of the other firms and devising their commercial strategies accordingly. If the oligopolistic structure of a market persists over time — for instance, because barriers to entry and expansion shield incumbents from new competitors — the repeated nature of the competitive interaction can result in a range of coordinated conduct, from muted competition through to tacit or explicit agreement between firms not to compete. Although firms may have the ability to engage in effective competition, they may not have the incentive if they recognise that any short-term benefits from competing will likely be eroded by lost sales once other firms respond. Coordinated conduct can in some cases involve contravention of other provisions of the Act.

Factors Conducive to Coordination

6.42 Among the issues to be considered in assessing market conditions conducive to coordination are:

- (a) Market concentration- Where there are fewer undertakings in a market, it is easier and more convenient to coordinate behavior rather than where the undertakings within the market are disparate and large in number.
- (b) The stability of the market- coordination will be facilitated by stable demand and supply conditions compared to more volatile market conditions (for example, with respect to prices, innovation or ease of entry and exit in the market).

- (c) Frequency and regularity of business – a regular pattern of transactions (e.g., in terms of timing and size) makes it easier to plan, monitor and detect deviations from the terms of coordination.
- (d) The degree of symmetry between enterprises in the market.²⁴
- (e) Homogeneity of products or services – prices for close or perfect substitutes will be easier to coordinate than prices for imperfect substitutes.
- (f) Homogeneity of undertakings – undertakings with similar characteristics (e.g., market shares, cost structures, levels of vertical integration) will be more likely to have similar, and hence sustainable, incentives to coordinate than dissimilar firms.
- (g) The availability of information- transparent focal points for coordination lends itself readily where there is unambiguous information upon which to plan, monitor and detect deviations from the terms of coordination (e.g., prices, output, capacity, customers served, territories served, discounts, new product introductions, etc.).
- (h) Cross-shareholdings and/or other linkages which may facilitate coordination – the exchange of information will be easier for connected firms than for unconnected firms.

6.43 The existence or non-existence of market conditions, such as have been identified above, may indicate scope (or lack of scope) for coordinated behaviour. The Commission's analysis will include an assessment of conditions conducive to coordination, including those listed above, and the impact of the merger on those

²⁴ A market with symmetric undertakings is one that have identical products and cost conditions, then the degree to which price exceeds marginal cost is inversely related to the number of firms. Thus, as the number of firms increases, the equilibrium approaches what it would be under perfect competition. More generally, it can be shown that for the industry the degree to which price exceeds marginal cost is directly proportional to the Herfindahl-Hirschman Index of concentration. As concentration rises, industry performance deviates more from the norm of perfect competition. Glossary of Industrial Organisation Economics and Competition Law, compiled by R. S. Khemani and D. M. Shapiro, commissioned by the Directorate for Financial, Fiscal and Enterprise Affairs, OECD, 1993.

conditions. Neither the existence nor the nonexistence of one or more of the above conditions is conclusive as an indicator of coordinated effects and consumer harm.

Incentives for Coordination

- 6.44 The incentive for participating firms (i.e., participating in coordinated behaviour) to compete less intensively than in a competitive market is the prospect of increased profits as implied by the terms of coordination. The larger the increase in profit, the greater will be the incentive for coordination.
- 6.45 In addition to the incentive to participate, however, each participating firm might also be drawn to deviate from the terms of coordination, i.e., to “cheat”, at the expense of other participating firms. For example, if Competitor A deviates and other competitors act in accordance with the terms of coordination, then Competitor A will benefit from increased sales revenue.²⁵ In contrast, as a consequence of Competitor A’s cheating, those competitors honouring the terms of coordination will lose sales revenue.
- 6.46 As such, the strength of the incentive to participate in coordination depends not only on the prospect of increased profits, but also on the practicability of detection and sanction by the other participating firms of deviations from the terms of coordination. The Commission will consider all available evidence, including internal documents, to determine the extent to which a merger increases the incentives of competitors to engage in coordinated behaviour. In the absence of credible contrary evidence, previous overt or tacit coordinated behaviour will be considered an indicator of possible or likely coordination post-merger.

Non-horizontal (vertical and conglomerate) Effects

- 6.47 In the majority of cases, non-horizontal mergers will raise no competition concerns. However, where insufficient competitive constraints remain in the relevant market post-merger, some non-horizontal mergers will raise competition concerns when the merged

²⁵ Game theory indicates that coordination among firms might be inherently unstable. Each individual member has an incentive to cheat in order to make higher profits in the short run. Cheating may lead to the collapse of a cartel. With the collapse, firms would revert to competing, which would lead to decreased profits.

firm is able to increase its unilateral market power. One way in which this can occur is through the merged firm ‘foreclosing’ rivals, but non-horizontal mergers can also increase unilateral market power in other ways. In some cases, a non-horizontal transaction, either alone or in conjunction with a horizontal transaction, may amount to a substantial lessening of competition in a market.

Foreclosure

- 6.48 Recognising that not all forms of foreclosure are anti-competitive, the Commission will only be concerned with non-horizontal mergers where the merged firm has the ability and incentive to use its position in one market to anti-competitively foreclose rivals in another market in a way that lessens competition.
- 6.49 In determining whether foreclosure is likely to increase the unilateral market power of the merged firm, the Commission will consider the following three issues:
- the merged firm’s ability to foreclose
 - any incentive the merged firm may have to foreclose
 - the likely effect of any such foreclosure.
- 6.50 The particular anti-competitive foreclosure strategies that a vertically integrated merged firm might adopt will depend on the circumstances of each case, but some examples include:
- charging a higher price for an important input into the production processes of downstream (non-integrated) rivals
 - limiting,³¹ or denying access by, downstream (non-integrated) rivals to important inputs (thereby forcing them, for example, to use more expensive or inferior quality alternatives)
 - limiting, or denying access by, upstream (non-integrated) rivals to a sufficient customer base
 - raising the cost of access by upstream (non-integrated) rivals to a sufficient customer base.
- 6.51 For conglomerate mergers, competitive concerns related to foreclosure arise where they enable the merged firm to alter its operations or product offerings in a way that can

limit or raise the cost of rival firms' access to a sufficient customer base and in some circumstances deny rival firms access to customers altogether. Specific examples of where merged firm's rivals may be foreclosed if the merged firm chooses to bundle or tie complementary products, are when:

- no product can be purchased or used separately
- at least one product cannot be purchased or used separately, or
- customers receive additional benefits when they purchase or use the merged firm's products together (for example, due to discounts, rebates or design features).

i. Enabling Price Discrimination

6.52 Firms with control over a range of products sold to the same customers may also be able to use this range of products to price discriminate (charging different types of customer different prices). There is no inherent economic inefficiency here – indeed if output is increased it is likely to benefit customers on average – but it may in some cases result in a transfer of value from consumers to producers. Therefore, effects of this type, while not of concern for the economy as a whole, may be of concern to Commission.

ii. Exclusionary Motives

6.53 Of course, vertical and conglomerate mergers may also be driven by the desire to use market power in one market to drive out competition in another. There are several mechanisms by which these exclusionary effects can occur.

6.54 First, the merger could lead to input foreclosure, by which the upstream division of the merged firm refuses to sell, degrades quality, or raises the input prices charged to targeted (or all) rivals of the downstream division of merged firm, and thereby gives the downstream division the power to raise its price. The upstream division alternatively might threaten to deny access or degrade quality in order to increase its bargaining power to negotiate a higher input price. Second, a merger could lead to customer foreclosure, by which the downstream division of the merged firm reduces or stops purchasing inputs from the other upstream firms, which then can disadvantage those

firms and provide the upstream division of the merged firm with the power to raise its price.

- 6.55 Alternatively, the downstream division of the merged firm might threaten to refuse to purchase in order to induce the independent input suppliers to raise the prices that they charge to its downstream rivals. These two types of foreclosure can function independently or can reinforce one another in combination. For example, if customer foreclosure leads to downstream rivals paying higher input prices, that effect will cause input foreclosure. Other markets also might be affected. For example, if downstream rivals are disadvantaged by input foreclosure and there are economies of scope with another product, the downstream division of the merged firm may gain the power to raise prices in that other product market, even though manufacturing that other product that does not use the input sold by the upstream division. This concern may be particularly relevant for high-technology markets.
- 6.56 Third, the merger could provide the downstream division of the merged firm with access to sensitive competitive information of its competitors from the upstream division of the merged firm, which the downstream firm can use to more rapidly respond to or even preempt competitive moves by these competitors, and deter such competitive moves as result.

Information required for Foreclosure Analysis

- 6.57 In analysing both input and customer foreclosure concerns, the following general market information would be relevant:
- Pre-merger market structure and competition in input and output markets.
 - Impact of the merger on market structure and incentives in the input and output markets.
 - Ability and incentive of non-merging input suppliers and downstream competitors to continue to compete, if foreclosed by merging firm.
 - Behavior and market impact of other integrated firms.
 - Existence, structure (including any exclusionary provisions), and competitive effects of other vertical contracts by the parties or other firms in the markets.

- 6.58 Beyond the general analysis of the markets, the following information also could aid in the evaluation of the potential upstream and downstream effects of input foreclosure:
- Identification of downstream rivals likely targeted for a foreclosure strategy of either raising price, refusing to sell, or degrading quality.
 - Ability of the targeted downstream rivals to substitute to other equally cost-effective input suppliers and the capacity and incentives of those input suppliers, including any impact of any reduced input purchases by the downstream division of the merged firm.
- 6.59 Determination of whether the other input suppliers would have the unilateral incentives to raise their prices, or the incentive and ability to raise prices in coordination with one another, if the upstream division of the merged firm were to engage in an input foreclosure strategy.
- 6.60 The resulting extent to which downstream rivals' costs would be raised (or quality decreased) if the upstream division of the merged firm refuses to sell its input or raises its input price to the targeted downstream rivals.

Evaluative Factors

- 6.61 These are the factors the commission will analyse:
- Evaluation of whether there are downstream firms (including vertically integrated competitors) that have alternative access to inputs from other upstream firms or upstream entry so that they will not be disadvantaged by (or targeted for) any foreclosure that occurs.
 - Evaluation of the residual competitive constraints provided by these non-targeted downstream competitors.
 - Evaluation of competitive constraints provided by other products that do not use the inputs supplied by the upstream division of the merged firm and its competitors.
 - Information relevant to estimating the rate at which variable cost increases of the upstream and downstream are passed through as higher prices.

- Information from natural experiments relevant to estimating diversion ratios resulting from foreclosure.
- Input pricing and sales conduct of other integrated firms in the market and evaluation of any impact on downstream prices.
- Evaluation of the market impacts, if any, of other vertical contracts that involve exclusivity or favouritism.
- Evaluation of whether the other input suppliers would have the unilateral incentives to raise their prices, or the incentive and ability to raise prices in coordination with one another, if the upstream division of the merged firm were to engage in an input foreclosure strategy.
- The resulting extent to which downstream rivals' costs would be raised (or quality decreased) if the upstream division of the merged firm refuses to sell its input or raises its input price to the targeted downstream rivals.

6.62 Beyond the general analysis of the market structure of the downstream and upstream markets, certain information relevant to evaluating these unilateral pricing concerns would include the following:

- If the downstream firm raised price and lost a certain percentage of its sales, the fraction of those sales that would be diverted to other firms which would purchase inputs from the upstream division of the merged firm in order to satisfy their incremental demand.
- The likely increased input purchases from the diverted sales obtained by the upstream division.
- The incremental profit margin of the upstream division of the merged firm and the resulting incremental profits earned by the upstream division of the merged firm on those increased input purchases from the diverted sales.
- The incremental profit margin of the downstream division of the merged firm.
- The potential for repositioning by other downstream firms.
- The potential for rapid entry and longer-term entry into the downstream market.
- Evaluation of the pricing behavior of other integrated firms.

Examples of Problematic Non-Horizontal Mergers

6.63 Examples of situations in which products are related such that the Commission may assess whether a merger gives rise to an SPLC on the basis of non-horizontal effects include where there is a:

- vertical merger between an upstream supplier and a downstream customer which purchases the supplier's goods, either as an input into its own production or for resale;
- diagonal merger between an upstream supplier and a downstream competitor of the customers that purchase the supplier's goods; and
- conglomerate merger of two suppliers of goods which do not lie within the same market, but which are nevertheless related in some way; for example because they are complements (so that a fall in the price of one good increases the customer's demand for another); or because there are economies of scale in purchasing them (so that customers buy them together).

6.64 Similarly, conglomerate mergers between makers of complementary goods may give rise to concerns of foreclosure, which may have the effect of preventing competition. Despite the differences in the variety of circumstances in cases, the Commission will typically frame its analysis of non-horizontal mergers by reference to the following three questions:

- (a) Ability: Would the merged firm have the ability to harm rivals, for example through raising prices or refusing to supply them?
- (b) Incentive: Would it find it profitable to do so?
- (c) Effect: Would the effect of any action by the merged firm be sufficient to reduce competition in the affected market to the extent that, in the context of the market in question, it gives rise to an SPLC?

6.65 In practice, the analysis of these questions may overlap and many of the factors may affect more than one question. Therefore, the Commission's analysis of ability, incentive and effect may not be in distinct chronological stages but rather as overlapping analyses. So as to reach an SPLC finding, all three questions must be answered in the affirmative.

6.66 Overall, the Commission's approach to non-horizontal mergers are outlined below:

- (i) Vertical and conglomerate mergers will generally generate pricing efficiencies by internalising the externalities that can otherwise harm consumer welfare. Therefore, there is a sound argument for a presumption in favour of vertical and conglomerate mergers.
- (ii) Vertical and conglomerate mergers can also facilitate price-discrimination. To the extent that this is the case, it should not be presumed to be anti-competitive. Price discrimination can in some cases increase output and enhance consumer welfare.
- (iii) However, not all vertical and conglomerate mergers are benign. Some may raise the possibility of foreclosure or raising rivals' costs, thus damaging competition and leading to higher prices for consumers.
- (iv) In principle these types of foreclosure/raising rivals costs strategies are anti-competitive and could, therefore, be pursued by the Commission, post-merger. However, there may be cases where in practice (e.g. because of the difficulty of establishing dominance) the Commission will be reluctant to wait to "see what happens", and will prefer to try to prevent the problem before it arises, if the costs of the merger prohibition or remedies are not seen to be large.
- (v) Vertical arithmetic provides a useful empirical approach to the assessment of foreclosure concerns, and although it is a relatively complex and data-intensive analysis if carried out thoroughly it seems clear that the Commission will make use of this approach.
- (vi) If significant competitive concerns remain after a full investigation, supply commitments would be considered as possible solutions to any competitive harm. However, in some cases divestments may be required.

PART 7:

THE TRADE-OFF EXCEPTION (PHASE 2 REVIEW)

Overview

- 7.1 Section 94(1)(b), (3) & (4) of the Act provide an exception to the positive determination of a substantial prevention or lessening of competition. When a merger substantially prevents or lessens competition, Section 94(1)(b), (3) & (4) of the Act create a trade-off framework in which efficiency gains and public interest considerations are evaluated against the anti-competitive effects that are likely to result. Broadly, the Commission's approach will be to expeditiously identify those few transactions that may raise substantial competition concerns and provide quick clearance for remaining transactions to provide commercial certainty and allow parties to achieve any efficiencies as quickly as possible. Consistent with that approach, a thorough assessment of efficiency claims will be unnecessary in the vast majority of the Commission's merger reviews.
- 7.2 As an initial matter, when determining the relevant anti-competitive effects for the purpose of performing the trade-off, the Commission recognises the significance of all of the objectives set out in the statutory objective clause contained in Section 1 of the Act.
- 7.3 At Phase 2, the Commission will make an assessment of whether the efficiency gains that are likely to be brought about by a merger will be greater than and will offset the anti-competitive effects arising from that merger. The parties must be able to validate efficiency claims to allow the Commission ascertain the nature, magnitude, likelihood and timeliness of the asserted gains, and to credit (or not) the basis on which the claims are being made. Conjunctively, the Commission will also assess the public interest grounds or bases in any such case.

Process

- 7.4 By incorporating an explicit exception for efficiency and public interest gains, the legislature has indicated that the assessment of the competitive effects of the merger under section 94(2) of the Act is to be separated from the evaluation of efficiency gains under section 94(3). This is the rationale for the Phase two review under the Merger Review Regulations.

- 7.5 That said, where merging parties undertake a self-assessment that indicates a likelihood of SPLC, merging parties are encouraged to make their efficiency submissions to the Commission as early as possible in the merger review process. This facilitates an expeditious assessment of the nature, magnitude, likelihood and timeliness of the efficiency gains and of the trade-off between relevant efficiency gains and anti-competitive effects. Having detailed information regarding efficiency claims at an early stage of the process will facilitate the preparation of focused follow-up information requests and/or the targeted use of other information-gathering mechanisms and, subject to confidentiality restrictions, enable the Commission to test the claims during its market contacts regarding the merger. Submissions regarding anticipated efficiency gains may also assist the Commission in understanding the rationale underlying the proposed transaction.
- 7.6 In other instances, merging parties may choose to wait for a definitive conclusion as to whether or not the merger is likely to result in an SPLC before providing detailed information about efficiencies. This approach typically lengthens the Commission's review process since the assessment of efficiencies claims is iterative, and the provision of a submission is only the first step in this assessment. While merging parties might seek to hold back a submission until the Commission has made determinations regarding the scope of the potential remedy or narrowed the scope of a merger that is under review, this will come at the cost of time that could have otherwise been spent engaging on the efficiencies claims.

Efficiency Test

- 7.7 Mergers can generate significant efficiencies by permitting a better utilisation of existing assets, enabling the combined firm to achieve lower costs than either firm could have achieved alone. Efficiencies may increase rivalry in the market so that no adverse competitive effects would result from a merger. For example, this could

happen where two of the smaller firms in a market gain such efficiencies through merger that they can exert greater competitive pressure on larger competitors.²⁶

7.8 Efficiencies include cost savings, more intensive use of existing capacity, economies of scale or scope, or demand-side efficiencies such as increased network size or product quality. They might also encompass pro-competitive changes in the merged entity's incentives, for example by capturing complementarities in R&D activity, which in turn might increase incentives to invest in product development in innovation markets.²⁷

7.9 Although the Act specifically mentions technological efficiency, it identifies other pro-competitive advantage. The Commission will analyse the three accepted categories of efficiencies in its setoff analysis:

- allocative efficiency- the degree to which goods and services within the economy are distributed according to consumer preferences.
- technical (productive) efficiency- the state where the optimal combination of inputs results in the maximum amount of output at minimal costs.
- dynamic efficiency: the optimal introduction of new products and production processes over time.

Types of efficiencies generally included in the trade-off:

A. Gains in productive efficiency

7.10 Productive efficiencies result from real cost savings in resources, which permit firms to produce more output or better-quality output from the same amount of input. In many cases, such efficiencies can be quantifiably measured, objectively ascertained, and supported by engineering, accounting or other data, subject to a discount, as

²⁶ ICN Merger Guidelines Workbook April 2006 Page 61

²⁷ *ibid*

appropriate, for likelihood in practice. Timing differences in the realisation of these savings are accounted for by discounting to the present value.

7.11 Productive efficiencies include the following:

- cost savings at the product, plant and multi-plant levels;
- savings associated with integrating new activities within the firm; and
- savings arising from transferring superior production techniques and know-how from one of the merging parties to the other.

7.12 Information regarding gains in efficiency that relate to cost savings should be broken down according to whether they are one-time savings or a recurring savings. When considering cost savings, the Commission will examine claims related to the following:

- economies of scale: savings that arise from product- and plant-level reductions in the average unit cost of a product through increased production;
- economies of scope: savings that arise when the cost of producing more than one product at a given level of output is reduced by producing the products together rather than separately;
- economies of density: savings that arise from more intensive use of a given network infrastructure;
- savings that flow from specialisation, the elimination of duplication, reduced downtime, a smaller base of spare parts, smaller inventory requirements and the avoidance of capital expenditures that would otherwise have been required;
- savings that arise from plant specialisation, the rationalisation of various administrative and management functions (e.g., sales, marketing, accounting, purchasing, finance, production), and the rationalisation of research and development activities; and
- savings that relate to distribution, advertising and raising capital.

B. Gains in dynamic efficiency

7.13 The Commission will examine claims that the merger has or is likely to result in gains in dynamic efficiency, including those attained through the optimal introduction of new products, the development of more efficient productive processes, and the improvement of product quality and service. When possible, the assessment of dynamic efficiencies

is conducted on a quantitative basis. This is generally the case if there is information presented by the parties to suggest that a decrease in production costs as a result of an innovation in production technology or an increase in demand for the parties' products as a result of product innovation (leading to a new or improved product) is likely. To supplement quantitative information or where quantitative information is absent, the Commission conducts a qualitative assessment.

- 7.14 The specific environment of the industry in question will be important in the Commission's analysis of the competitive effects of a merger on innovation. The assessment will require specific industry information. Historical information on the effect of previous mergers in the industry on innovation may be insightful. Such information may relate to a merger's impact on the nature and scope of research and development activities, innovation successes relating to new or existing products or production processes, and the enhancement of dynamic competition. In addition, and only when applicable, the Commission encourages parties to provide detailed explanations regarding plans to utilise substitute or complementary technologies so as to increase innovation.

C. Deductions to gains

- 7.15 Once all efficiency claims have been valued, the costs of retooling and other costs that must be incurred to achieve efficiency gains are deducted from the total value of the efficiency gains that are considered. For instance, integrating two complex, ongoing operations with different organisational cultures can be a costly undertaking and ultimately may be unsuccessful. Integration costs are deducted from the efficiency gains.

Types of efficiencies generally excluded from the trade-off

- 7.16 Not all efficiency claims qualify for the trade-off analysis. The Commission will exclude the following:
- gains that would likely be attained in any event through alternative means (examples include internal growth, a merger with a third party, a joint venture, a specialisation agreement, and a licensing, lease or other contractual arrangement);

- gains that are redistributive in nature (examples include gains anticipated to arise from increased bargaining leverage that enables the merging parties to extract wage concessions or discounts from suppliers that are not cost-justified, and tax-related gains);
- gains that are achieved outside Nigeria (examples include productive efficiency gains arising from the rationalisation of the parties' facilities located outside Nigeria that do not benefit the Nigerian economy); and
- savings resulting from a reduction in output, service, quality or product choice.

Evidentiary Requirements

- 7.17 To facilitate the Commission's review of efficiency claims, parties should provide detailed and comprehensive information that substantiates the precise nature, magnitude, likelihood and timeliness of their alleged efficiency gains, as well as information relating to deductions from gains in efficiency, such as the costs associated with implementing the merger. The information should specifically address the likelihood that such gains would be achieved.
- 7.18 To enable the objective verification of anticipated efficiency gains, efficiency claims should be substantiated by documentation prepared in the ordinary course of business, wherever possible. This includes plant and firm-level accounting statements, internal studies, strategic plans, integration plans, management consultant studies and other available data. The Commission may also require physical access to certain facilities and will likely require documents and information from operations-level personnel who can address, among other matters, how their business is currently run and areas where efficiencies would likely be realised.

Burden on the parties

- 7.19 The parties' burden includes proving that the gains in efficiency-
- are likely to occur. In other words, the parties must provide a detailed explanation of how the merger or proposed merger would allow the merged firm to achieve the gains in efficiency. In doing so, the parties must specify the steps they anticipate taking to achieve the gains in efficiency, the risks involved in achieving these gains and the time and costs required to achieve them.

- are brought about by the merger or proposed merger (i.e., that they are merger-specific). The test under section 92(3) is whether the efficiency gains would likely be realised in the absence of the merger. Thus, if certain gains in efficiency would likely be achieved absent the merger, those gains are not counted for the purposes of the trade-off.
- are greater than and offset the anti-competitive effects. The parties must provide a quantification of the gains in efficiency and a detailed and robust explanation of how the quantification was calculated. They should also, to the extent relevant, provide any information on qualitative efficiencies. While the burden is ultimately on the parties to establish that the gains in efficiency are greater than and offset the anti-competitive effects, in appropriate cases and when provided in a timely manner with the parties' evidence substantiating their case, the Commission will undertake its own assessment of the trade-off before deciding to approve or prohibit the merger at Phase Two.

Public Interest Gains

7.20 In addition to efficiency gains, Section 94(3)(b), (4) of the Act requires the Commission to consider public interest grounds to justify a merger that is likely to substantially prevent or lessen competition.

7.21 As an initial matter, Section 94(3)(b) of the Act requires the public interest grounds to be assessed under Section 94(4) of the Act to be substantial in nature. In all instances the public interest claim must be specific to the merger.

Ground One- Particular Industrial Sector or Region²⁸

7.22 There are considerations that are specific to certain sectors or industries. These considerations may be relevant as public interest considerations in mergers. Some examples are-

- Energy- 'security of supply', 'stable provision of energy'
- Media- 'plurality of the media'

²⁸ Section 94(3)(b) of the Act

- Finance- ‘prudential rules’, ‘stability of the financial system’
- Defence- ‘national security’, ‘national defence’.

7.23 When assessing the substantiality of the effect on a particular industrial sector or region, the Commission will, in general, consider the following factors:

- the importance and strategic nature of the relevant products to the sector or region, and of the sector or region to the broader economy;
- the importance to a sector or region of the identified social projects and upliftment programs proposed by the firms;
- the extent of the effects on the sector and related sectors in the entire value chain;
- whether the merger impedes or contributes towards any specific industry goal that have public interest relevance in that sector or region; and/or
- the importance of a firm to the sector or region and the benefits that flow from that firm to that sector or region.

Ground Two: Employment²⁹

7.24 In determining whether employment is a substantial public ground, the Commission will consider, among other, the overall nature of the transaction, including the extent of overlap and duplication in the merging parties’ activities, the rationale of the transaction, the intention of the parties relating to employment and the target business as well as any plans to create further employment opportunities within the merged entity and whether there is any planned retrenchment.

7.25 As a secondary consideration, the Commission will also consider the likely indirect effect of the merger on the general level of employment in a particular industrial sector or region. In assessing this effect, the Commission will consider whether the merger impacts on the level of employment post-merger due to, among others, job creation or

²⁹ Section 94(4)(b) of the Act

loss of job opportunities, duplications, cost-cutting measures, cancellation of supply/distribution arrangements, and/or relocation of offices, plants and facilities.

7.26 In general, the Commission will accept those retrenchments or employment opportunities declared by the merging parties to arise from the merger, as being merger specific. The substantiality assessment will in general involve the consideration of the following factors, where applicable:

- the number of employees that are likely to be affected relative to the affected workforce;
- the affected employees' skill levels. The Commission will consider information on the affected employees' qualification, experience, job grade, job description and position within the organisation in determining the skill level;
- the likelihood of the employees being able to obtain alternative employment in the short term considering various factors. In this regard, the Commission may assess the possibilities for redeployment within the merged entity, the natural attrition rate within the merging parties, the type of skills and their transferability to other industries and businesses, the economics of the region and the opportunities for re-employment in the region;
- the nature of the sector relevant to the employment effect, including whether the sector employs largely unskilled employees, the unemployment rate in the sector, whether the sector is experiencing a trend of retrenchments, whether the sector is a mature or declining sector; and whether the sector is an emerging sector which would suggest future employment opportunities; and
- The predominant nature of employment by the acquiring firm for example, whether the parties employ seasonal or permanent employees, and/or are engaged in a business that involves bidding or contracting.

7.27 The Commission will consider substantiality on a case by case basis and may exclude management employees from the affected number of employees should it view these employees as having alternative employment prospects in the short term. The Commission will consider as substantial a large number of job opportunities created for unskilled or semi-skilled employees in particular markets or sectors vulnerable to job losses.

Ground Three- the Ability of National Industries to Compete in International Markets³⁰

7.28 In determining whether this is a substantial public ground, the Commission will consider:

- The nature of competition and the market position of the firm in the domestic economy;
- The ability of firms to compete in regional and global markets;
- Whether a change in productive capacity is required in order for the merged firm to compete globally against other firms;
- The policy considerations that are relevant to the sector;
- the strategy of the merging firms in relation to international competition; and
- the impact on local consumers for both intermediate and final products.

7.29 When assessing the substantiality of any effect of a merger on a national industry's ability to compete in international markets, the Commission will consider, amongst other factors:

- the role and importance of the national industry in the Nigerian market;
- the role and importance of the national industry or sector in the international market/s;
- the relative structure and size of the national industry or sector by international standards;
- the extent of the effect on the sector should the national industry's ability to compete in international market/s be hindered; and
- whether the merger impedes on any related public policy goals and relevant industrial policies in relation to the national industry in question;
- a significant increase in the real value of exports or a significant substitution of domestic products for imported products.

³⁰ ³⁰ Section 94(4)(c) of the Act

- 7.30 Where the ability of national industries to compete in international markets will result in significant positive economic effects/benefits that flow back to the domestic economy, the Commission is likely to consider these to be substantial. These effects could include further investment in the domestic economy, job creation opportunities, the introduction of improved/advanced technologies and better quality/service, amongst others.
- 7.31 To assist this analysis, firms operating in markets that involve international trade should provide the Commission with information that establishes that the merger will lead them to increase output owing to greater exports or import substitution.

Ground Four- the ability of small and medium scale enterprises (SMEs) to become competitive³¹

- 7.32 In analysing this provision, the Commission will determine whether the merger has an effect on any of the following factors that may have an effect on the ability of SMEs to compete, among others:
- entry conditions or expansion opportunities within a market including raising or lowering barriers to entry or expansion;
 - prevents or grants access to key inputs; pricing and supply conditions with respect to volume, discounts, quality, and services that are defensible having regard to prevailing market circumstances;
 - denies or grants access to suppliers;
 - prevents or allows training, skills empowerment and development in the industry; and
 - denies or grants access to funding for business development and growth.
- 7.33 Further, the Commission will amongst other factors consider
- dynamic competition, innovation and growth in the market;

³¹ ³¹ Section 94(4)(b) of the Act

- whether such impediment limits the growth and expansion of SMEs and their participation in the relevant market or adjacent markets. In addition, whether their ability to compete allows them to expand in the relevant market or adjacent markets; and
- whether any effect on SMEs has a secondary effect on other public interest factors such as employment and the industrial/sector or region.

7.34 A positive assessment may be given where a merger has the effect of promoting dynamic competition by significantly allowing the development and expansion of SMEs that will exert a competitive constraint in relevant markets.

The trade-off

7.35 To satisfy the section 94(3)(a) trade-off, the efficiency and public interest gains must both "be greater than and offset" the relevant anti-competitive effects.

7.36 The "greater than" aspect of the test requires that the efficiency gains be more extensive or of a larger magnitude than the anti-competitive effects. The "offset" aspect requires that efficiency gains compensate for the anti-competitive effects. The additional requirement to "offset" makes it clear that it is not sufficient for parties to show that efficiency gains merely, marginally or numerically exceed the anti-competitive effects to satisfy the section 94 trade-off.

7.37 Both the efficiency gains and the anti-competitive effects can have quantitative (measured) and qualitative aspects to them, and both the "greater than" and "offset" standards apply to all anti-competitive effects. To enable appropriate comparisons to be made, timing differences between measured future anticipated efficiency gains and measured anti-competitive effects should be addressed by discounting to the present value.

7.38 Merging parties intending to invoke the efficiencies exception are encouraged to address how they propose that qualitative and quantitative gains and effects be evaluated for the purpose of performing the "greater than and offset" aspect of the trade-off; and to explain how and why the gains "compensate for" the anti-competitive effects.

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