

Commission for Protection of Competition pursuant to article 28 paragraph (3), in relation to article 19 paragraph (1) point 2) of the Law on Protection of Competition (Official Gazette of the Republic of Macedonia no. 145/10, 136/11, 41/14) on its session held on 28.12.2015 adopted the following

Guidelines on the assessment of horizontal concentrations for the purpose of the Law on Protection of Competition¹

I INTRODUCTION

1. Article 17 of the Law on Protection of Competition (Official Gazette of the Republic of Macedonia no. 145/10, 136/11, 41/14) (LPC) provides that the Commission for Protection of Competition (Commission) has to appraise concentrations within the scope of the LPC with a view to establishing whether or not they are compatible with the LPC. For that purpose, the Commission must assess, pursuant to Article 17 paragraph (2) and (3), whether or not a concentration would significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position, in the market or a substantial part of it.

2. Accordingly, the Commission must take into account any significant impediment to effective competition likely to be caused by a concentration. The creation or the strengthening of a dominant position is a primary form of such competitive harm. The concept of dominance is defined in article 10 of LPC

Dominant position can be defined as:

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

3. The creation or strengthening of a dominant position held by a single firm as a result of a merger has been the most common basis for finding that a concentration would result in a significant impediment to effective competition. Furthermore, the concept of dominance has also been applied in an oligopolistic setting to cases of collective dominance. As a consequence, it is expected that most cases of incompatibility of a concentration with the LPC will continue to be based upon a finding of dominance.

¹ These Guidelines are harmonized with Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004/C 31/03)

That concept therefore provides an important indication as to the standard of competitive harm that is applicable when determining whether a concentration is likely to impede effective competition to a significant degree,

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

5. The principles contained here will be applied and further developed and refined by the Commission in individual cases. The Commission may revise this Guidelines from time to time in the light of future developments.

II. OVERVIEW

6. Effective competition brings benefits to consumers, such as low prices, high quality products, a wide selection of goods and services, and innovation. Through its control of mergers, the Commission prevents mergers that would be likely to deprive customers of these benefits by significantly increasing the market power of firms. By 'increased market power' is meant the ability of one or more firms to profitably increase prices, reduce output, choice or quality of goods and services, diminish innovation, or otherwise influence parameters of competition. In this Guidelines, the expression 'increased prices' is often used as shorthand for these various ways in which a merger may result in competitive harm. Both suppliers and buyers can have market power. However, for clarity, market power will usually refer here to a supplier's market power. Where a buyer's market power is the issue, the term 'buyer power' is employed.

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

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

- (a) definition of the relevant product and geographic markets;

(b) competitive assessment of the merger.

The main purpose of market definition is to identify in a systematic way the immediate competitive constraints facing the merged entity. Guidance on this issue can be found in the Commission's Guidelines on the definition of the relevant market for the purposes of the LPC. Various considerations leading to the delineation of the relevant markets may also be of importance for the competitive assessment of the merger.

9. This notice is structured around the following elements:

(a) The approach of the Commission to market shares and concentration thresholds (Section III).

(b) The likelihood that a merger would have anticompetitive effects in the relevant markets, in the absence of countervailing factors (Section IV).

(c) The likelihood that buyer power would act as a countervailing factor to an increase in market power resulting from the merger (Section V).

(d) The likelihood that entry would maintain effective competition in the relevant markets (Section VI).

(e) The likelihood that efficiencies would act as a factor counteracting the harmful effects on competition which might otherwise result from the merger (Section VII).

(f) The conditions for a failing firm defence (Section VIII).

10. In order to assess the foreseeable impact of a merger on the relevant markets, the Commission analyses its possible anti-competitive effects and the relevant countervailing factors such as buyer power, the extent of entry barriers and possible efficiencies put forward by the parties. In exceptional circumstances, the Commission considers whether the conditions for a failing firm defence are met.

11. In the light of these elements, the Commission determines, pursuant to Article 17 of the LPC, whether the merger would significantly impede effective competition, in particular through the creation or the strengthening of a dominant position, and should therefore be declared incompatible with the LPC. It should be stressed that these factors are not a 'checklist' to be mechanically applied in each and every case. Rather, the competitive analysis in a particular case will be based on an overall assessment of the foreseeable impact of the merger in the light of the relevant factors and conditions. Not all the elements will always be relevant to each and every horizontal merger, and it may not be necessary to analyse all the elements of a case in the same detail.

III. MARKET SHARE AND CONCENTRATION LEVELS

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

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

14. The overall concentration level in a market may also provide useful information about the competitive situation. In order to measure concentration levels, the Commission often applies the Herfindahl-Hirschman Index (HHI)². The HHI is calculated by summing the squares of the individual market shares of all the firms in the market³. The HHI gives proportionately greater weight to the market shares of the larger firms. Although it is best to include all firms in the calculation, lack of information about very small firms may not be important because such firms do not affect the HHI significantly. While the absolute level of the HHI can give an initial indication of the competitive pressure in the market post-merger, the change in the HHI (known as the 'delta') is a useful proxy for the change in concentration directly brought about by the merger⁴.

Market share levels

15. Article 10 of LPC prescribes that the undertaking shall be presumed as having dominant position, if its share of the relevant market amounts to more than 40%. However, smaller competitors may act as a sufficient constraining influence if, for example, they have the ability and incentive to increase their supplies. A merger

² If appropriate, the Commission may also use other concentration measures such as, for instance, concentration ratios, which measure the aggregate market share of a small number (usually three or four) of the leading firms in a market.

³ For example, a market containing five firms with market shares of 40 %, 20 %, 15 %, 15 %, and 10 %, respectively, has an HHI of 2 550 ($40^2 + 20^2 + 15^2 + 15^2 + 10^2 = 2 550$). The HHI ranges from close to zero (in an atomistic market) to 10 000 (in the case of a pure monopoly)

⁴ The increase in concentration as measured by the HHI can be calculated independently of the overall market concentration by doubling the product of the market shares of the merging firms. For example, a merger of two firms with market shares of 30 % and 15 % respectively would increase the HHI by 900 ($30 \times 15 \times 2 = 900$). The explanation for this technique is as follows: Before the merger, the market shares of the merging firms contribute to the HHI by their squares individually: $(a)^2 + (b)^2$. After the merger, the contribution is the square of their sum: $(a + b)^2$, which equals $(a)^2 + (b)^2 + 2ab$. The increase in the HHI is therefore represented by $2ab$.

involving a firm whose market share will remain below 40 % after the merger may also raise competition concerns in view of other factors such as the strength and number of competitors, the presence of capacity constraints or the extent to which the products of the merging parties are close substitutes.

16. Concentrations which, by reason of the limited market share of the undertakings concerned, are not liable to impede effective competition may be presumed to be compatible with the LPC. Without prejudice to Articles 7 and 11 of the LPC, an indication to this effect exists, in particular, where the market share of the undertakings concerned does not exceed 25 % of the relevant market

HHI levels

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

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

- (a) a merger involves a potential entrant or a recent entrant with a small market share;
- (b) one or more merging parties are important innovators in ways not reflected in market shares;
- (c) there are significant cross-shareholdings among the market participants;
- (d) one of the merging firms is a firm with a high likelihood of disrupting coordinated conduct;
- (e) indications of past or ongoing coordination, or facilitating practices, are present;
- (f) one of the merging parties has a pre-merger market share of 40 % or more.

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

IV. POSSIBLE ANTI-COMPETITIVE EFFECTS OF HORIZONTAL MERGERS

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

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

(b) by changing the nature of competition in such a way that firms that previously were not coordinating their behaviour, are now significantly more likely to coordinate and raise prices or otherwise harm effective competition. A merger may also make coordination easier, more stable or more effective for firms which were coordinating prior to the merger (coordinated effects).

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

1. Non-coordinated effects

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

22. Generally, a merger giving rise to such non-coordinated effects would significantly impede effective competition by creating or strengthening the dominant position of a single firm, one which, typically, would have an appreciably larger market share than the next competitor post-merger. Furthermore, mergers in oligopolistic markets involving the elimination of important competitive constraints that the merging parties previously exerted upon each other together with a reduction of competitive pressure on the remaining competitors may, even where there is little likelihood of coordination between the members of the oligopoly, also result in a significant impediment to competition. The LPC clarifies that all mergers giving rise to such non-coordinated effects shall also be declared incompatible with the LPC.

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

Merging firms have large market shares

25. The larger the market share, the more likely a firm is to possess market power. And the larger the addition of market share, the more likely it is that a merger will lead to a significant increase in market power. Although market shares and additions of market shares only provide first indications of market power and increases in market power, they are normally important factors in the assessment.

Merging firms are close competitors

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

27. When data are available, the degree of substitutability may be evaluated through customer preference surveys, analysis of purchasing patterns, estimation of the cross-price elasticities of the products involved. In bidding markets it may be possible to measure whether historically the submitted bids by one of the merging parties have been constrained by the presence of the other merging party.

28. In some markets it may be relatively easy and not too costly for the active firms to reposition their products or extend their product portfolio. In particular, the Commission examines whether the possibility of repositioning or product line extension by competitors or the merging parties may influence the incentive of the merged entity to raise prices. However, product repositioning or product line extension often entails risks and large sunk costs and may be less profitable than the current line.

Customers have limited possibilities of switching supplier

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

Competitors are unlikely to increase supply if prices increase

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

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

32. Such output expansion is, in particular, unlikely when competitors face binding capacity constraints and the expansion of capacity is costly or if existing excess capacity is significantly more costly to operate than capacity currently in use.

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

Merged entity able to hinder expansion by competitors

34. Some proposed mergers would, if allowed to proceed, significantly impede effective competition by leaving the merged firm in a position where it would have the ability and incentive to make the expansion of smaller firms and potential competitors more difficult or otherwise restrict the ability of rival firms to compete. In such a case, competitors may not, either individually or in the aggregate, be in a position to constrain the merged entity to such a degree that it would not increase prices or take other actions detrimental to competition. For instance, the merged entity may have such a degree of control, or influence over, the supply of inputs or distribution possibilities that expansion or entry by rival firms may be more costly. Similarly, the merged entity's control over patents or other types of intellectual property (e.g. brands) may make expansion or entry by rivals more difficult. In markets where interoperability between different infrastructures or platforms is important, a merger may give the merged entity the ability and incentive to raise the costs or decrease the quality of service of its rivals. In making this assessment the Commission may take into account, inter alia, the financial strength of the merged entity relative to its rivals.

Merger eliminates an important competitive force

35. Some firms have more of an influence on the competitive process than their market shares or similar measures would suggest. A merger involving such a firm may change the competitive dynamics in a significant, anticompetitive way, in particular when the market is already concentrated. For instance, a firm may be a recent entrant that is

expected to exert significant competitive pressure in the future on the other firms in the market.

36. In markets where innovation is an important competitive force, a merger may increase the firms' ability and incentive to bring new innovations to the market and, thereby, the competitive pressure on rivals to innovate in that market

2.Coordinated effects

37. In some markets the structure may be such that firms would consider it possible, economically rational, and hence preferable, to adopt on a sustainable basis a course of action on the market aimed at selling at increased prices. A merger in a concentrated market may significantly impede effective competition, through the creation or the strengthening of a collective dominant position, because it increases the likelihood that firms are able to coordinate their behaviour in this way and raise prices, even without entering into an agreement or resorting to a concerted practice within the meaning of Article 7 of the LPC. A merger may also make coordination easier, more stable or more effective for firms, that were already coordinating before the merger, either by making the coordination more robust or by permitting firms to coordinate on even higher prices.

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

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

40. The Commission examines whether it would be possible to reach terms of coordination and whether the coordination is likely to be sustainable. In this respect, the Commission considers the changes that the merger brings about. The reduction in the number of firms in a market may, in itself, be a factor that facilitates coordination. However, a merger may also increase the likelihood or significance of coordinated effects in other ways. For instance, a merger may involve a firm that has a history of preventing or disrupting coordination, for example by failing to follow price increases by its competitors, or has characteristics that gives it an incentive to favour different

strategic choices than its coordinating competitors would prefer. If the merged firm were to adopt strategies similar to those of other competitors, the remaining firms would find it easier to coordinate, and the merger would increase the likelihood, stability or effectiveness of coordination.

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

Reaching terms of coordination

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

43. Generally, the less complex and the more stable the economic environment, the easier it is for the firms to reach a common understanding on the terms of coordination. For instance, it is easier to coordinate among a few players than among many. It is also easier to coordinate on a price for a single, homogeneous product, than on hundreds of prices in a market with many differentiated products. Similarly, it is easier to coordinate on a price when demand and supply conditions are relatively stable than when they are continuously changing. In this context volatile demand, substantial internal growth by some firms in the market or frequent entry by new firms may indicate that the current situation is not sufficiently stable to make coordination likely. In markets where innovation is important, coordination may be more difficult since innovations, particularly significant ones, may allow one firm to gain a major advantage over its rivals.

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

45. Coordinating firms may, however, find other ways to overcome problems stemming from complex economic environments short of market division. They may, for instance, establish simple pricing rules that reduce the complexity of coordinating on a large number of prices. One example of such a rule is establishing a small number of pricing points, thus reducing the coordination problem. Another example is having a fixed relationship between certain base prices and a number of other prices, such that prices

basically move in parallel. Publicly available key information, exchange of information through trade associations, or information received through cross-shareholdings or participation in joint ventures may also help firms reach terms of coordination. The more complex the market situation is, the more transparency or communication is likely to be needed to reach a common understanding on the terms of coordination.

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

Monitoring deviations

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

48. Transparency in the market is often higher, the lower the number of active participants in the market. Further, the degree of transparency often depends on how market transactions take place in a particular market. For example, transparency is likely to be high in a market where transactions take place on a public exchange or in an open outcry auction. Conversely, transparency may be low in a market where transactions are confidentially negotiated between buyers and sellers on a bilateral basis. When evaluating the level of transparency in the market, the key element is to identify what firms can infer about the actions of other firms from the available information. Coordinating firms should be able to interpret with some certainty whether unexpected behaviour is the result of deviation from the terms of coordination. For instance, in unstable environments it may be difficult for a firm to know whether its lost sales are due to an overall low level of demand or due to a competitor offering particularly low prices. Similarly, when overall demand or cost conditions fluctuate, it may be difficult to interpret whether a competitor is lowering its price because it expects the coordinated prices to fall or because it is deviating.

49. In some markets where the general conditions may seem to make monitoring of deviations difficult, firms may nevertheless engage in practices which have the effect of easing the monitoring task, even when these practices are not necessarily entered into for such purposes. These practices, such as, voluntary publication of information, announcements, or exchange of information through trade associations, may increase transparency or help competitors interpret the choices made. Cross-directorships,

participation in joint ventures and similar arrangements may also make monitoring easier.

Deterrent mechanisms

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

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

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

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

Reactions of outsiders

54. For coordination to be successful, the actions of non-coordinating firms and potential competitors, as well as customers, should not be able to jeopardise the outcome expected from coordination. For example, if coordination aims at reducing overall capacity in the market, this will only hurt consumers if non-coordinating firms are unable or have no incentive to respond to this decrease by increasing their own capacity sufficiently to prevent a net decrease in capacity, or at least to render the coordinated capacity decrease unprofitable.

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

3. Merger with a potential competitor

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

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

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

4. Mergers creating or strengthening buyer power in upstream markets

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

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

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

V. COUNTERVAILING BUYER POWER

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

63. The Commission considers, when relevant, to what extent customers will be in a position to counter the increase in market power that a merger would otherwise be likely to create. One source of countervailing buyer power would be if a customer could credibly threaten to resort, within a reasonable timeframe, to alternative sources of supply should the supplier decide to increase prices or to otherwise deteriorate quality or the conditions of delivery. This would be the case if the buyer could immediately switch to other suppliers, credibly threaten to vertically integrate into the upstream market or to sponsor upstream expansion or entry for instance by persuading a potential entrant to enter by committing to placing large orders with this company. It is more likely that large and sophisticated customers will possess this kind of countervailing buyer power than smaller firms in a fragmented industry. A buyer may also exercise countervailing buying power by refusing to buy other products produced by the supplier or, particularly in the case of durable goods, delaying purchases.

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

65. Countervailing buyer power cannot be found to sufficiently off-set potential adverse effects of a merger if it only ensures that a particular segment of customers, with particular bargaining strength, is shielded from significantly higher prices or deteriorated conditions after the merger. Furthermore, it is not sufficient that buyer power exists prior to the merger, it must also exist and remain effective following the

merger. This is because a merger of two suppliers may reduce buyer power if it thereby removes a credible alternative.

VI. ENTRY

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

Likelihood of entry

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

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

69. Barriers to entry can take various forms:

(a) Legal advantages encompass situations where regulatory barriers limit the number of market participants by, for example, restricting the number of licences. They also cover tariff and non-tariff trade barriers.

(b) The incumbents may also enjoy technical advantages, such as preferential access to essential facilities, natural resources, innovation and R & D, or intellectual property rights, which make it difficult for any firm to compete successfully. For instance, in certain industries, it might be difficult to obtain essential input materials, or patents might protect products or processes. Other factors such as economies of scale and scope, distribution and sales networks, access to important technologies, may also constitute barriers to entry.

(c) Furthermore, barriers to entry may also exist because of the established position of the incumbent firms on the market. In particular, it may be difficult to enter a particular industry because experience or reputation is necessary to compete effectively, both of which may be difficult to obtain as an entrant. Factors such as consumer loyalty to a particular brand, the closeness of relationships between suppliers and customers, the importance of promotion or advertising, or other advantages relating to reputation will be taken into account in this context. Barriers to entry also encompass situations where the incumbents have already committed to building large excess capacity, or where the costs faced by customers in switching to a new supplier may inhibit entry.

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

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

Timeliness

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

Sufficiency

73. Entry must be of sufficient scope and magnitude to deter or defeat the anti-competitive effects of the merger. Small-scale entry, may not be considered sufficient.

VII. EFFICIENCIES

74. Corporate reorganisations in the form of mergers may be in line with the requirements of dynamic competition and are capable of increasing the competitiveness of industry, thereby improving the conditions of growth and raising the standard of living. It is possible that efficiencies brought about by a merger counteract the effects on competition and in particular the potential harm to consumers that it might otherwise have. In order to assess whether a merger would significantly impede effective competition, in particular through the creation or the strengthening of a dominant position, within the meaning of Article 17(2) and (3) of the LPC, the Commission performs an overall competitive appraisal of the merger. In making this appraisal, the Commission takes into account the factors mentioned in Article 17(4),

including the development of technical and economic progress provided that it is to the consumers' advantage and does not form an obstacle to competition.

75. The Commission considers any substantiated efficiency claim in the overall assessment of the merger. It may decide that, as a consequence of the efficiencies that the merger brings about, there are no grounds for declaring the merger incompatible with the LPC pursuant to Article 17(3). This will be the case when the Commission is in a position to conclude on the basis of sufficient evidence that the efficiencies generated by the merger are likely to enhance the ability and incentive of the merged entity to act pro-competitively for the benefit of consumers, thereby counteracting the adverse effects on competition which the merger might otherwise have.

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

Benefit to consumers

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

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

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

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

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

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

Merger specificity

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

Verifiability

84. Efficiencies have to be verifiable such that the Commission can be reasonably certain that the efficiencies are likely to materialise, and be substantial enough to counteract a merger's potential harm to consumers. The more precise and convincing the efficiency claims are, the better the Commission can evaluate the claims. Where reasonably possible, efficiencies and the resulting benefit to consumers should therefore be quantified. When the necessary data are not available to allow for a precise quantitative analysis, it must be possible to foresee a clearly identifiable positive impact on consumers, not a marginal one.

85. Most of the information, allowing the Commission to assess whether the merger will bring about the sort of efficiencies that would enable it to clear a merger, is solely in the possession of the merging parties. It is, therefore, incumbent upon the notifying parties to provide in due time all the relevant information necessary to demonstrate that the claimed efficiencies are merger-specific and likely to be realised. Similarly, it is for the notifying parties to show to what extent the efficiencies are likely to counteract

any adverse effects on competition that might otherwise result from the merger, and therefore benefit consumers.

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

VIII. FAILING FIRM

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

88. The Commission considers the following three criteria to be especially relevant for the application of a 'failing firm defence'.

- the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another undertaking.

- there is no less anti-competitive alternative purchase than the notified merger.

- in the absence of a merger, the assets of the failing firm would inevitably exit the market.

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