

CCCS GUIDELINES ON THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

1	INTRODUCTION	59
2	SUMMARY OF THE SUBSTANTIVE ASSESSMENT FRAMEWORK	60
3	WHAT IS A MERGER?	61
4	THE SUBSTANTIAL LESSENING OF COMPETITION TEST	65
5	ASSESSMENT OF A MERGER	69
6	ASSESSMENT OF A NON-HORIZONTAL MERGERS	79
7	ADDRESSING A SUBSTANTIAL LESSENING OF COMPETITION	83
8	REMEDIES	86
9	EXCLUSIONS AND EXEMPTIONS	89
10	ANNEX A: GLOSSARY	91
11	ANNEX B: FLOWCHART: GENERAL FRAMEWORK FOR SUBSTANTIVE ASSESSMENT OF MERGERS	92
12	ANNEX C: EXAMPLES OF SITUATIONS THAT GIVE RISE TO JOINT CONTROL	93

1

INTRODUCTION

- 1.1 These guidelines set out the analytical framework the Competition and Consumer Commission of Singapore (“CCCS”) applies in assessing mergers and acquisitions and are intended to assist merger parties in conducting a self-assessment, as well as other interested parties that may be affected by a merger.
- 1.2 The merger provisions of the Competition Act (Cap. 50B) (“the Act”) will apply to mergers that have infringed, or anticipated mergers that if carried into effect will infringe, the section 54 prohibition, unless they are excluded or exempt under the Act. A merger infringes the section 54 prohibition if it has resulted, or may be expected to result, in a substantial lessening of competition (“SLC”). The focus of CCCS’s analysis is on evaluating the impact of the merger in Singapore and how competition between the merger parties and their competitors may change as a result of the merger.
- 1.3 For ease of reference, the term “merger situation” is used in these guidelines to refer to both mergers and anticipated mergers.
- 1.4 In addition to these guidelines, the following guidelines published by CCCS are also relevant to the framework for merger control:
 - *CCCS Guidelines on Merger Procedures 2012*: These set out the procedures for notifying a merger situation to CCCS for a decision and for investigations of merger situations by CCCS.
 - *CCCS Guidelines on Market Definition*: These explain the methodology CCCS may use to define the relevant product market and geographic market.
 - *CCCS Guidelines on the Powers of Investigation in Competition Cases 2016*: These explain CCCS’s use of its statutory powers to investigate suspected anticompetitive behaviour under the Act. These powers also apply to merger situations pursuant to section 62 of the Act.
 - *CCCS Guidelines on Enforcement of Competition Cases 2016*: These explain CCCS’s powers to give directions and to impose financial penalties. These powers also apply to merger situations.
 - *CCCS Guidelines on Appropriate Amount of Penalty in Competition Cases 2016*: These explain the basis on which CCCS will calculate penalties for infringements of the section 34, 47 and 54 prohibitions.
- 1.5 The following regulations and orders are also relevant to the framework for merger control:
 - *The Competition Act (Chapter 50B) Competition (Notification) Regulations 2007*: These regulations relate, *inter alia*, to applications to CCCS for a decision in respect of merger situations.
 - *The Competition Act (Chapter 50B) Competition (Fees) Regulations 2007*: These regulations state, *inter alia*, the fees that are payable in respect of merger situations that are notified to CCCS for decision.
 - *The Competition Act (Chapter 50B) Competition (Financial Penalties) Order 2007 and The Competition Act (Chapter 50B) Competition (Financial Penalties)(Amendment) Order 2010*: These orders relate, *inter alia*, to the calculation of the level of any financial penalty that CCCS can impose, including in the context of a section 54 infringement arising from merger situations.
- 1.6 All of the above guidelines, regulations and orders are available on CCCS’s website. Interested parties should read the relevant guidelines, regulations and orders to better understand the merger framework. CCCS’s issued merger decisions, which are also available on CCCS’s website, also provide useful information on how it has assessed mergers in the past.
- 1.7 The guidelines are not a substitute for the Act, the regulations and orders. They may be varied from time to time should the need arise. In applying the guidelines, the facts and circumstances of each case will be considered. The examples in the guidelines are for illustration. They are not exhaustive, and do not set a limit on the investigation and enforcement activities of CCCS. Persons in doubt about how they and their commercial activities may be affected by the Act may wish to seek legal advice.
- 1.8 A glossary of terms used in these guidelines is attached at **Annex A**.

2 SUMMARY OF THE SUBSTANTIVE ASSESSMENT FRAMEWORK

- 2.1 CCCS assesses whether a merger situation is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger situation proceeds (the scenario with the merger situation), with the likely state of competition if the merger situation does not proceed (the scenario without the merger situation, often referred to as the counterfactual). CCCS conducts this assessment by identifying what would happen if the merger situation does not go ahead, namely, the appropriate counterfactual. CCCS also assesses what would happen if the merger situation does go ahead and develops theories of harm that could arise. This is discussed in further detail in Part 4.
- 2.2 An analytical tool used to assess competitive effects is market definition, which provides a framework to help identify and assess the close competitive constraints a merged firm would likely face. CCCS defines markets in the way that best isolates the key competitive constraints on the parties to a merger situation. In many cases this may not require CCCS to precisely define the boundaries of a market. Part 5 discusses market definition in greater detail.
- 2.3 CCCS analyses the extent of competition in each relevant market both with and without the merger situation to determine whether the acquisition is likely to substantially lessen competition. Generally, CCCS assesses the following factors when considering whether this is likely to be the case.
- Market shares and concentration - the number and size of firms in a market can be an indicator of competitive pressure pre and post-merger.
 - Barriers to entry and expansion - the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased and also competition from potential competitors which involves assessing barriers to entry and whether entry is likely, timely and sufficient in extent.
 - Countervailing buyer power – the potential for a business to be sufficiently constrained by a purchaser's ability to exert a substantial influence on negotiations.
- 2.4 CCCS will assess the above factors when assessing the non-coordinated effects of the merger situation, which arise when there is a loss of competition between the merger parties and the merged entity finds it profitable to raise prices and/or reduce output or quality. In so doing, CCCS will consider the extent to which the merger parties are close competitors. The above factors are also considered in assessing whether a merger situation raises or leads to increased scope for “coordinated effects”, which arise if the merger situation raises the possibility of firms in the market coordinating their behaviour to raise prices, reduce quality or output.
- 2.5 A comparison of the extent of competition both with and without the merger situation enables CCCS to assess the degree by which the merger situation might lessen competition. If the lessening of competition is likely to be substantial, the merger situation may infringe the section 54 prohibition. In the event that CCCS finds that a merger situation has or is likely to result in an SLC in a market, CCCS will consider the presence of any economic efficiencies in markets in Singapore that could outweigh the SLC arising from the merger situation. In such cases, CCCS will also consider any possible merger remedies that could remedy, mitigate or prevent the SLC or any adverse effects resulting from the SLC.
- 2.6 A flowchart summarising how the various factors fit can be found in **Annex B**.

3 WHAT IS A MERGER?

Introduction

- 3.1 Section 54(2) of the Act provides that a merger situation occurs where:
- two or more undertakings, previously independent of each other, merge;
 - one or more persons or other undertakings acquire direct or indirect control of the whole or part of one or more other undertakings; or
 - one undertaking acquires the assets (including goodwill), or a substantial part of the assets, of another undertaking, with the result that the acquiring undertaking is placed in a position to replace or substantially replace the second undertaking in the business (or the part concerned of the business) in which the second undertaking was engaged immediately before the acquisition.

An undertaking that buys or proposes to buy a majority stake in another undertaking is the most obvious example of a merger. However, the transfer or pooling of assets may also give rise to a merger. The Act also provides that the creation of a joint venture to perform, on a lasting basis, all the functions of an autonomous economic entity, shall constitute a merger falling within section 54(2)(b) of the Act.

- 3.2 The determination of whether a merger exists for the purposes of section 54 of the Act is based on qualitative rather than quantitative criteria, focusing on the concept of control. These criteria include considerations of both law and fact. It follows, therefore, that a merger may occur either on a legal or on a *de facto* basis.
- 3.3 Parties will be able to notify their merger situations to CCCS for a decision. Anticipated mergers may be notified only if they may be made known to the public. However, to assist parties with the planning and consideration of mergers, in particular at the stage when the merger parties are concerned with preserving the confidentiality of the transaction, parties may obtain confidential advice from CCCS on whether or not a merger is likely to raise competition concerns in Singapore, subject to the merger meeting certain conditions. More information on the process of obtaining confidential advice is available in the *CCCS Guidelines on Merger Procedures 2012*.¹

Mergers between Previously Independent Undertakings

- 3.4 A merger within the meaning of section 54(2)(a) of the Act occurs when two or more independent undertakings amalgamate into a new undertaking and cease to exist as separate legal entities. A merger may also occur when an undertaking is absorbed by another, with the latter retaining its legal identity while the former ceases to exist as a legal entity.

Acquisition of Control

- 3.5 Section 54(2)(b) of the Act provides that a merger occurs in the case of an acquisition of control. Such control may be acquired by one undertaking acting alone or by two or more undertakings acting jointly. The control acquired may be over one or more other undertakings or over the whole or part of the assets of an undertaking. These assets include brands or licences.
- 3.6 Control may be acquired over an undertaking when the acquiring party becomes the holder of the rights, contracts or other means that entitle the holder to exercise decisive influence over the activities of that undertaking (see section 54(4) of the Act).
- 3.7 There may, however, be situations where the formal holder of a controlling interest differs from the party having the real power to exercise the rights conferred by that interest. An example would be where Party X uses Party Y to acquire a controlling interest in an undertaking and to exercise the rights conferred by that interest. In such a situation, control is acquired by Party X, who is behind the operation and who in fact enjoys the power to control the undertaking, even though it is Party Y who is the formal holder of the rights (see section 54(4)(b) of the Act). The evidence needed to establish such indirect control may include factors such as the source of financing for the acquisition, or family links.

¹ Paragraphs 3.18 - 3.29.

THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

- 3.8 Control over an undertaking is defined by section 54(3) of the Act to exist if decisive influence may be exercised over the activities of that undertaking by reason of any rights, contracts or other means. The existence of control is determined by whether decisive influence is capable of being exercised, rather than the actual exercise of such influence. In determining whether decisive influence exists, CCCS will consider all the relevant circumstances and not only the legal effect of any instrument, deed, transfer, assignment or other act.
- 3.9 Assessment of whether decisive influence is capable of being exercised requires a case-by-case analysis of the entire relationship between the merger parties and is dependent on a number of legal and/or factual elements. In making this assessment, CCCS will have regard to all the circumstances of the case. The variety of commercial arrangements entered into by undertakings makes it difficult to state what will (or will not) give rise to decisive influence.

Legal Control

- 3.10 Generally, CCCS considers that decisive influence is deemed to exist if there is ownership of more than 50% of the voting rights. Where the ownership is between 30% and 50% of the voting rights of the undertaking, there is a rebuttable presumption that decisive influence exists. "Voting rights" refers to all the voting rights attributable to the share capital of an undertaking which are currently exercisable at a general meeting.² However, these thresholds are only indicative and control could potentially be established at levels below these thresholds if other relevant factors provide strong evidence of control. Examples of these factors are referred to in paragraph 3.17 below. Other forms of voting rights will also be taken into account in assessing control.

De Facto Control

- 3.11 Besides establishing legal ownership through the acquisition of property rights and securities, the presence of dependency by one undertaking on another may also confer *de facto* control. As there are no precise criteria for determining when an acquirer gains "de facto" control of an undertaking's activities, a case-by-case approach in the light of the particular circumstances will be adopted.
- 3.12 Generally, in assessing whether a party has *de facto* control over an undertaking, CCCS may consider whether any additional agreements with the undertaking allow the party to influence the undertaking's activities that affect its key strategic commercial behaviour. These might include the provision of consultancy services to the undertaking or might, in certain circumstances, include agreements between undertakings that one will cease production and source all its requirements from the other.
- 3.13 Pure economic relationships may also play a significant role in certain circumstances in determining whether *de facto* control exists. For example, in very important long-term supply agreements, the supplier may be able to exercise decisive influence over a customer by creating a situation of economic dependence. Further, financial arrangements may confer decisive influence where the conditions are such that an undertaking becomes so dependent on the lender that the lender gains decisive influence over the undertaking's activities (for example, where the lender could threaten to withdraw loan facilities if a particular activity is not pursued, or where the loan conditions confer on the lender the ability to exercise rights over and above those necessary to protect its investment, say, by options to take control of the undertaking or veto rights over certain strategic decisions). CCCS is likely to be concerned with such financial arrangements only when the loan takes on a larger strategic purpose which goes beyond that of protecting the lender's interest, and has an effect on competition.
- 3.14 Transactions by venture capitalists and private equity investors may also raise possible competition concerns, particularly if they result in coordination of conduct among firms within their portfolios in the same market in which they have stakes and are able to influence their commercial behaviours.
- 3.15 The examples cited in **Annex C** to illustrate situations which may give rise to joint control also serve to illustrate when *de facto* control may exist.
- 3.16 An option to purchase or convert shares cannot, in and of itself, confer control unless the option will be exercised in the near future according to legally-binding agreements. However, the likely exercise of such an option can be taken into account as an additional factor which, together with other factors, may lead to the conclusion that control exists.

² These thresholds generally correspond to the thresholds for mandatory offers prescribed in the Singapore Code on Take-overs and Mergers.

Minority Shareholdings

- 3.17 Control may also be acquired in the case of a minority shareholder if the shareholding confers decisive influence with regard to the activities of an undertaking. This can be established on a legal and/or *de facto* basis. Legally, it can occur where minority shareholders have additional rights which allow them to veto decisions that are essential for the strategic commercial behaviour of the undertaking, such as the budget, business plans, major investments, the appointment of senior management or market-specific rights. The latter would include decisions on the technology to be used where technology is a key feature of the merged undertaking. In markets characterised by product differentiation and a significant degree of innovation, a veto right over decisions relating to new product lines to be developed may also be an important element in establishing control.
- 3.18 A minority shareholder may also be deemed to have sole control on a *de facto* basis. This is the case, for example, where a minority shareholder is highly likely to achieve control over decisions made at any shareholders' meeting, due to patterns of attendance and voting at such meetings and the fact that the remaining shares are widely dispersed. In such a situation where it is highly unlikely that all the other shareholders will be present or represented at the shareholders' meeting, the determination of whether or not control exists in a particular case may be based on the attendance of other shareholders in previous years. Where, on the basis of the number of shareholders attending the shareholders' meeting, a minority shareholder has a stable majority of the votes at this meeting, then the minority shareholder may be taken to have decisive influence and thus control.
- 3.19 In situations where acquisition of a minority shareholding confers decisive influence, and hence control of an undertaking, it could amount to a merger within the meaning of section 54(2) of the Act that is reviewable by CCCS.

Joint Ventures

- 3.20 Joint ventures, as broadly defined, refer to collaborative arrangements by which two or more undertakings devote their resources to pursue a common objective.
- 3.21 In practice, joint ventures encompass a broad range of operations, from merger-like arrangements to cooperation for particular functions such as research and development ("R&D"), production, or distribution.
- 3.22 Section 54(5) of the Act defines that a joint venture constitutes a merger if it performs, on a lasting basis, all the functions of an autonomous economic entity. Joint ventures³ which satisfy these requirements bring about a lasting change in the structure of the undertakings concerned.
- 3.23 A joint venture must thus fulfil the following criteria before falling within the definition of a merger under section 54 of the Act:
- it must be subject to joint control;
 - it must perform all the functions of an autonomous economic entity; and
 - it must do so on a lasting basis.

Joint Control

- 3.24 The creation of a joint venture may fall within the scope of the merger provisions where the joint venture is one entailing joint control by two or more parent undertakings (see section 54(2)(b) of the Act). (Please refer to the paragraphs under the heading "Acquisition of Control" above, for a discussion of the concept of "control".)
- 3.25 Joint control over an undertaking exists where two or more parties have the possibility of exercising decisive influence over that undertaking. Decisive influence in this context includes the power to block actions which determine the strategic commercial behaviour of an undertaking. Unlike sole control, which confers the power upon a specific shareholder to determine the strategic decisions in an undertaking, joint control is characterised by the possibility of a deadlock resulting from the power of two or more parent companies to reject proposed strategic decisions. It follows, therefore, that these shareholders must reach a consensus in determining the commercial activities of the joint venture.
- 3.26 Please refer to **Annex C** for examples of situations that give rise to joint control.

³A joint venture which may not constitute a merger under section 54(2)(b) may be subject to section 34 of the Act.

Performing the Functions of an Autonomous Economic Entity

- 3.27 Performing all the functions of an autonomous economic entity essentially means that a joint venture must operate on a market and perform the functions normally carried out by undertakings operating on that market. In order to do so, the joint venture must have a management dedicated to its day-to-day operations and access to sufficient resources, including finance, staff and assets (tangible and intangible), in order to conduct on a lasting basis its business activities within the area provided for in the joint venture agreement.
- 3.28 A joint venture does not perform all the functions of an autonomous economic entity if it only takes over one specific function within the parent companies' business activities without access to the market. This is the case, for example, for joint ventures limited to R&D or production. Such joint ventures are auxiliary to their parent companies' business activities. This is also the case where a joint venture is essentially limited to the distribution or sales of its parent companies' products and, therefore, acts principally as a sales agency. However, the fact that a joint venture makes use of the distribution network or outlet of one or more of its parent companies normally will not disqualify it from being considered as performing all the functions of an autonomous economic entity, as long as the parent companies are acting only as agents of the joint venture.
- 3.29 The fact that the joint venture relies almost entirely on sales to its parent companies or purchases from them for an initial start-up period may still be consistent with the joint venture performing all the functions of an autonomous economic entity. Such arrangements during the start-up period may be necessary in order for the joint venture to establish itself on a market. The essential question is whether, in addition to these sales, the joint venture is geared to play an active role on the market. In this respect, the relative proportion of these sales compared with the total production of the joint venture is an important factor. Another factor is whether sales to the parent companies are made under normal commercial conditions.
- 3.30 Where the joint venture is making purchases from its parent companies, it may not be performing all the functions of an autonomous economic entity if little value is added to the purchased products or services at the level of the joint venture itself. In such a situation, the joint venture may be closer to a joint sales agency.
- 3.31 However, where a joint venture is active in a trade market and performs the normal functions of a trading company in such a market, it will normally be considered to perform all the functions of an autonomous economic entity rather than an auxiliary sales agency. A trade market is characterised by the existence of companies which specialise in the selling and distribution of products without being vertically integrated, in addition to those which are integrated, and where different sources of supply are available for the products in question. In addition, many trade markets may require operators to invest in specific facilities such as outlets, stockholding, warehouses, depots, transport fleets and sales personnel. In order to perform all the functions of an autonomous economic entity in a trade market, an undertaking must have the necessary facilities and be likely to obtain a substantial proportion of its supplies not only from its parent companies, but also from other competing sources.

Lasting Basis

- 3.32 The joint venture must be intended to operate on a lasting basis. The fact that the parent companies commit to the joint venture the resources to carry out the functions described above in paragraph 3.27 above normally demonstrates that this is the case.
- 3.33 Agreements setting up a joint venture often provide for certain contingencies, for example, the failure of the joint venture or fundamental disagreement between the parent companies. This may be achieved by the incorporation of provisions for the eventual dissolution of the joint venture itself or the possibility for one or more parent companies to withdraw from the joint venture. Such provisions do not prevent the joint venture from being considered as operating on a lasting basis.
- 3.34 The same is normally true where the agreement specifies a period for the duration of the joint venture which is sufficiently long in order to bring about a lasting change in the structure of the undertakings concerned, or where the agreement provides for the possible continuation of the joint venture beyond this period.
- 3.35 On the other hand, the joint venture will not be considered to operate on a lasting basis where it is established for a short, finite duration. This would be the case, for example, where a joint venture is established in order to construct a specific project such as a power plant, but will not be involved in the operation of the plant once its construction has been completed.

Exceptions

- 3.36 Section 54(7) of the Act sets out four exceptional situations where the acquisition of a controlling interest does not constitute a merger under the Act:
- control is acquired by a person acting in his capacity as a receiver or liquidator or an underwriter;
 - all of the undertakings involved in the merger are, directly or indirectly, under the control of the same undertaking. In particular, a merger between a parent and its subsidiary company, or between two companies which are under the control of a third company, will not be subject to the merger provisions if, prior to the acquisition or merger, the subsidiary concerned has no real freedom to determine its course of action in the market and, although having a separate legal personality, enjoys no economic independence. Internal restructuring within a group of companies will therefore not constitute a merger;
 - the acquisition of control results from a testamentary disposition or an intestacy. In other words, the controlling interest is obtained after the death of the original owner by operation of the probate or intestacy laws. Likewise, if the controlling interest is obtained as a result of a right of survivorship in a joint tenancy, it will not constitute a merger; or
 - control is acquired by parties whose normal activities include carrying out transactions and dealing in securities for their own account or for the account of others,⁴ under the following circumstances:
 - the control is constituted by the holding of securities in the acquired undertaking on a temporary basis; and
 - any exercise by the acquiring party of the voting rights in respect of the securities is:
 - for the purpose of arranging the disposal of the acquired undertaking or its assets or securities, where the disposal is to take place within twelve (12) months of the acquisition of control (or such longer period as the Commission determines);⁵ and
 - not with a view to determining the strategic commercial behaviour of the acquired undertaking.

4

THE SUBSTANTIAL LESSENING OF COMPETITION TEST

- 4.1 Competition is a process of rivalry between firms seeking to win a customer's business. This process of rivalry, where it is effective, impels firms to deliver benefits to customers in terms of price, quality and choice. For instance, rivalry creates incentives for firms to reduce price, increase output, improve quality, enhance efficiency or introduce new and better products because it provides the opportunity for successful firms to take business away from competitors and poses the threat that firms will lose business to others if they do not compete. The strength (or weakness) of the incentive for rivalry can depend not only on the presence of competitors, and the credible prospect of customer switching, but also on the anticipated entry of potential competitors.
- 4.2 When the level of rivalry is reduced (for example, because of the creation, maintenance or increase in market power arising from a merger transaction or coordinated behaviour between firms), the effectiveness of this process may diminish, to the likely detriment of customers. When a merger leads to a significant effect on rivalry over time, and reduces the competitive pressure on firms to improve their offerings to customers or become more efficient or innovate, an SLC is likely to arise.
- 4.3 However, not all merger situations give rise to competition issues. CCCS believes that many mergers are either pro-competitive (because they positively enhance levels of rivalry) or are competitively neutral. Some merger situations may lessen competition but not substantially, because sufficient post-merger competitive constraints exist to ensure that competition (or the process of rivalry) continues to discipline the commercial behaviour of the merged entity. Only mergers that substantially lessen competition and have no net economic efficiencies will infringe the Act.

⁴E.g. credit or other financial institutions or insurance companies may engage in such activities in the normal course of business.

⁵ Extension may be granted by CCCS where the acquiring undertaking can show that the disposal was not reasonably possible within the one (1) year period.

What is a Substantial Lessening of Competition?

- 4.4 An SLC test is applied by comparing the extent of competition in the relevant market with and without the merger.
- 4.5 The determination of whether there is an SLC is a judgement on the degree to which competition is affected and depends on the facts and circumstances of each merger. There is no precise threshold, whether in qualitative or quantitative terms as to what constitutes a substantial lessening. However, a merger is more likely to substantially lessen competition if it leads to a significant and sustainable reduction of rivalry between firms over time to the likely detriment of customers. For example, a merger will substantially lessen competition if it creates, maintains or enhances market power.
- 4.6 Market power may generally be described as the ability to sustain price profitably above competitive levels (or where a customer has market power, the ability to obtain prices lower than their competitive levels). For instance, this might occur through the elimination of an effective source of competition which weakens the rivalry among the players left in the market after the merger.
- 4.7 Firms with market power may, instead of raising price, also simply opt not to compete as aggressively as they otherwise might. In so doing, they allow costs to rise, reduce quality, restrict the diversity of choice and/or slow the rate of innovation.
- 4.8 A merger situation can lead to an SLC if it creates, maintains or enhances the following types of market power:
- raises or leads to “non-coordinated effects” – which arise when there is a loss of competition between the merging parties and the merged entity finds it profitable to raise prices and/or reduce output or quality;
 - the merger raises or leads to increased scope for “coordinated effects” – which arise if the merger raises the possibility of firms in the market coordinating their behaviour to raise prices, reduce quality or output.

Further elaboration of non-coordinated and coordinated effects can be found in paragraphs 5.20 to 5.30 and 5.33 to 5.45 respectively under Part 5.

- 4.9 A lessening of competition does not need to be felt across an entire market, or relate to all dimensions of competition in a market for the effect to be substantial. A lessening of competition that adversely affects a significant section of the market may be enough to amount to an SLC.
- 4.10 In applying the SLC test, CCCS will not only examine the competitive effects on the immediate customers of the merged entity but also effects on subsequent, intermediate and final customers. For example, a merger between parties operating upstream of the retail level may affect the downstream retailers or the final end-customers.

Different Types of Mergers

- 4.11 There are different types of merger situations, each of which affects competition in different ways. A brief explanation of the different types is provided below.
- Horizontal Mergers:
 - These are mergers between undertakings that operate in the same economic market. Horizontal mergers can reduce competitive pressure on the merged entity to the extent that the merged entity could unilaterally impose a profitable post-merger price increase or otherwise behave anti-competitively. In response, other firms in the market might unilaterally raise their prices, without any collusion among participants. Also, a merger might increase the likelihood (or stability) of coordination, either tacit or explicit, between the firms remaining in the market.

Horizontal mergers can also involve competing buyers of a product or service. For example, a merger between two competing distributors would not only be a merger between two competing suppliers to retailers, but it would also result in the merged entity being a larger buyer of products from a manufacturer. CCCS's assessment of horizontal mergers is explained in further detail in Part 5.

- Mergers between competing buyers:
Similar to a merger between competing suppliers, a merger between competing buyers may also create or enhance the merged firm's ability, unilaterally or in co-ordination with other firms, to exercise market power when buying products or services. This is known as "monopsony power".

For example, the merged firm may have the ability to profitably depress prices paid to suppliers to a level below the competitive price for a significant period of time such that the amount of input sold is reduced. That is, the price of the input is depressed so low that (some) suppliers no longer cover their supply costs and so withdraw supply (or related services) from the market. Such an outcome would reduce the amount of product being supplied.

- Non-horizontal Mergers:
 - Vertical mergers:
These are mergers between undertakings which operate at different levels of the production or supply chain of an industry. Although vertical mergers are often pro-competitive, they may in some circumstances reduce the competitive constraints faced by the merged entity by foreclosing a substantial part of the market to competitors⁶ or by increasing the likelihood of post-merger collusion. This risk is, however, unlikely to arise except in the presence of existing market power at one level in the production or supply chain at least, or in markets where there is already significant vertical integration or restraints. An example of a vertical merger would be a merger between a manufacturer and a wholesaler.
 - Conglomerate mergers:
These are mergers between undertakings in different markets. Conglomerate mergers will rarely lessen competition substantially but might, in some cases, reduce competition, for example, through the exercise of portfolio power. An example would be a merger between two manufacturers producing products complementary to each other.

CCCS's assessment of vertical and conglomerate mergers is explained in further detail in Part 6.

Theories of Harm

- 4.12 In conducting a merger assessment and applying the SLC test, CCCS may develop a theory or theories of harm. Developing theories of harm provides a framework for assessing potential changes arising from the merger, including impact or expected harm from the loss of rivalry between the merging firms and also, for assessing the appropriate merger remedies in the event a merger leads to SLC concerns.
- 4.13 In formulating theories of harm, CCCS will consider how rivalry might be affected post-merger. For example, a merger between two competing firms may harm the rivalry process in terms of price, the quantity sold, service quality, product range, product quality and innovation. CCCS will also seek to understand the commercial rationale for the merger. However, the development of a theory or theories of harm will be based on objective assessment of the circumstances surrounding the transaction and not the subjective intentions of the merging parties.

Identification of the Appropriate "Counterfactual"

- 4.14 In applying the SLC test, CCCS will evaluate the prospects for competition in the future with and without the merger situation. The competitive situation without the merger is referred to as the "counterfactual". The SLC test will be applied prospectively, that is, future competition will be assessed with and without the merger.
- 4.15 The counterfactual is an analytical tool used to determine whether the merger gives rise to an SLC. The description of the counterfactual is affected by the extent to which events or circumstances and their consequences are foreseeable. The relevant counterfactual is forward looking. Since the counterfactual may be either more or less competitive than the prevailing conditions of competition, the selection of the appropriate counterfactual may increase or reduce the prospects of an SLC.
- 4.16 In most cases, the best guide to the appropriate counterfactual will be prevailing conditions of competition, as this may provide a reliable indicator of future competition without the merger. However, in some cases, status quo may not always be the appropriate counterfactual. CCCS may need to take into account likely and imminent changes in the structure of competition in order to reflect as accurately as possible the nature of rivalry without the merger. For example, in cases where one of the parties is genuinely failing, pre-merger conditions of competition might not prevail even if the merger were prohibited as the failing party may exit the market in the event that the merger does not occur. In such cases, the counterfactual might need to be adjusted to reflect the likely failure of one of the parties and the resulting loss of rivalry. This is generally known as the failing firm defence.

⁶For example, this may arise from the merged entity's refusal to supply, enhanced barriers to entry, facilitation of price discrimination and increase in rivals' costs.

Failing Firm

- 4.17 To qualify for the failing firm defence, the following conditions have to be met:
- first, the firm must be in such a dire situation that without the merger, the firm and its assets would exit the market in the near future. Firms on the verge of judicial management may not meet this criterion, whereas firms in liquidation will usually do so;
 - second, the firm must be unable to meet its financial obligations in the near future and there must be no serious prospect of re-organising the business, for example, a liquidator has been appointed pursuant to a creditor's winding up petition; and
 - third, there should be no less anti-competitive alternative to the merger. Even if a sale is inevitable, there may be other realistic buyers whose acquisition of the firm and its assets would produce a more competitive outcome. Any offer to purchase the assets of the failing firm at a commercially reasonable price, even if the price is lower than that which the acquiring party is prepared to pay, will be regarded as a reasonable alternative offer. It may also be better for competition that the firm fails and the remaining players compete for its customers and assets than for them to be transferred wholesale to a single purchaser.
- 4.18 The party relying on the failing firm defence would thus need to provide evidence that:
- the undertaking is indeed about to fail imminently under current ownership (including evidence that trading conditions are unlikely to improve);
 - all re-financing options have been explored and exhausted; and
 - there are no other credible bidders in the market (by demonstrating that the firm has made good faith and verifiable efforts to elicit reasonable alternative offers of acquisition).
- 4.19 A non-exhaustive list of evidence that CCCS may consider when assessing failing firm scenarios could include:
- timelines of critical events and decisions of the failing firm;
 - internal documents, such as briefing and board papers for the Board and/or senior management;
 - audited financial statements, including notes and qualifications in the auditor's report;
 - projected cash flows, projected operating or losses, projected net worth;
 - credit status;
 - reduction in the firm's relative position in the market; and
 - changes in the firm's share price or publicly-traded debt of the firm.
- 4.20 A similar argument can be made for "failing divisions". The following conditions will need to be met. First, upon applying appropriate cost allocation rules, the division must have a negative cash flow on an operating basis. Second, absent the acquisition, the assets of the division would exit the relevant market in the near future if not sold. Evidence to demonstrate negative cash flow and the prospect of exit from the relevant market will need to be provided. Third, the owner of the failing division must also ensure that there are no alternative credible bidders in the market, and that all possible options have been explored.

Other Possible Counterfactual Scenarios

- 4.21 A non-exhaustive list of examples of counterfactuals other than status quo could include:
- where there are concurrent merger transactions that are likely to occur or are occurring in the same relevant market, regardless of whether these transactions may or may not have been notified to CCCS;
 - where a firm is about to enter or exit the market. Similarly, CCCS may also take into account committed expansion plans by existing competitors. For example, one of the merging firms may have been planning to develop a product to compete with the other merging firm; and/or
 - where changes to the regulatory structure of the market, such as market liberalisation, or tighter environmental constraints, will change the nature of competition.
- 4.22 However, there may be instances where there could be multiple counterfactuals. In these instances, CCCS will generally adopt the most likely scenario as the counterfactual.
- 4.23 CCCS will consider all available evidence to decide on the relevant counterfactual. In doing so, CCCS will assess the credibility of the counterfactual proposed by the merging firms and may request for supporting evidence. Such evidence must be consistent with the firm's own internal pre-merger assessments.

- 4.24 The focus of CCCS's analysis is on the effects that the merger situation has on competition. Competition concerns that do not result from the merger situation under consideration and are likely to exist in the counterfactual are outside CCCS's remit in merger assessment. However, they may be matters which are appropriate for CCCS to consider in relation to the section 34 prohibition and/or section 47 prohibition.

5 ASSESSMENT OF A MERGER

- 5.1 The focus of CCCS's analysis is on evaluating how the competitive constraints on the merger parties and their competitors might change as a result of the merger. The starting point is to define the relevant market, then review the changes in the market structure resulting from the merger.

Market Definition

- 5.2 Proper examination of the competitive effects of a merger rests on a sound understanding of the competitive constraints under which the merged entity will operate. The scope of those constraints, if any, is identified through a market definition analysis. It is important to emphasize that market definition is not an end in itself. It is a conceptual framework for analysing the direct competitive pressures faced by the merged entity.
- 5.3 Relevant economic markets have two main dimensions: products (or services) scope and geographic scope. CCCS has published the *CCCS Guidelines on Market Definition*, which explain its methodology for identifying the scope of relevant product and geographic markets in cases under the section 34 prohibition and section 47 prohibition. Given that broadly similar methodology is used to define markets in merger cases, reference should be made to those guidelines. It is important to note a fundamental difference between the nature of the competitive analysis undertaken in assessing the likely competitive effects of a merger and that generally undertaken in the case of anti-competitive agreements or abuses of dominance. In assessing a merger, the main competitive concern is whether the merger will result in an increase in prices above the prevailing level. As a result, in defining the market for merger purposes, the relevant price level is the current price rather than the competitive price.
- 5.4 It must be emphasised that the calculation of market shares is highly dependent on market definition. Parties should be aware that CCCS may not necessarily accept their identification of the relevant market.
- 5.5 Market definition focuses attention on the areas of overlap in the merger parties' activities. This is particularly the case in differentiated product markets, where the merger parties' products or services may not be identical, but may still be substitutes for each other. In this context, the analytical discipline of market definition is helpful in identifying the extent of the immediate competitive interaction between the parties' products. Once the overlap in the merger parties' products or services has been identified, along with the market in which those products or services compete, CCCS can focus attention on the competitive assessment.
- 5.6 In analysing market definition, the same evidence may be relevant and contribute to both the definition of relevant markets and the assessment of the competitive effects of the merger. Merger review is often an iterative process in which evidence with respect to the relevant market and market shares is considered alongside other evidence of competitive effects, with the analysis of each informing and complementing the other.
- 5.7 In cases where it may be apparent that the merged entity will not possess any market power or that the merger will not maintain or enhance its market power within any sensible market definition, it may not be necessary to establish a market definition.
- 5.8 Market definition depends on the specific facts, circumstances, and evidence of the particular merger under assessment or investigation. Decisions relating to market definition in previous merger decisions by CCCS may provide limited guidance.

Market Shares and Concentration

- 5.9 Where CCCS has defined a relevant market or markets, the level of concentration in that market(s) can be an indicator of competitive pressure within that market(s). Market concentration generally depends on the number and size of the participants in the market. A merger which increases the level of concentration in a market may reduce competition by increasing the unilateral market power of the merged entity and/or increasing the scope for coordinated conduct among the competitors in the market post-merger.

THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

- 5.10 A merged entity with substantial market power may be able to increase prices or decrease quality or output without being threatened by competitors. It may also undertake strategic behaviour such as predation, which may in turn affect market structure and market power. A reduction in the number of firms in the market may also increase the scope for coordinated conduct, as it becomes easier for competitors to reach agreement on the terms of coordination, signal intentions to one another and monitor one another's behaviour.
- 5.11 The two principal measures used by CCCS in examining market structure are market shares and concentration ratios. Since market shares may be more readily available than other information, they are a relatively low-cost means for businesses to screen out mergers which are not likely to result in an SLC. It must be emphasised that the calculation of market shares is highly dependent on market definition.
- 5.12 Market shares are usually measured by sales revenue. Other measures, such as production volumes, sales volumes, capacity or reserves, may be used as appropriate. Current market shares may be adjusted to reflect expected and reasonably certain future changes, such as a firm's likely exit from the market or the introduction of additional capacity.
- 5.13 Comparison of the merged entity's market shares with those of other players in the market may give an indication of rivalry and potential market power and whether the other players are able to provide any competitive constraint. Historic market shares can also provide useful insights into the competitive dynamics of a market: for example, volatile market shares might suggest that there has been effective competition. That said, continuing high market shares are not always indicative of market power.
- 5.14 Concentration ratios ("CR") measure the aggregate market share of a few of the biggest firms in a market. For example, CR3 refers to the combined market share of the three largest firms. These are absolute measures of concentration, taking no account of differences in the relative size of the firms that make up the leading group.
- 5.15 CCCS is generally of the view that competition concerns are unlikely to arise in a merger situation unless:
- the merged entity will have a market share of 40% or more; or
 - the merged entity will have a market share of between 20% to 40% and the post-merger CR3 is 70% or more.
- 5.16 The thresholds set out in the preceding paragraph are simply indicators of potential competition concerns but they do not give rise to a presumption that such a merger will lessen competition substantially. Market shares, per se, does not provide deep insight into the nature of competition between firms in a market, that is whether they compete on price, service or innovation. Further investigation is required to determine whether a merger will substantially lessen competition. Similarly, an SLC could potentially be established at thresholds below that set out in the preceding paragraph if other relevant factors provide strong evidence of any SLC.

Assessment of a Horizontal Merger

- 5.17 A horizontal merger is a merger between two firms active (or potentially active) in the same market at the same level of business (for example, between two manufacturers, two distributors or two retailers). When horizontal mergers occur, competition may be affected in a number of ways. This loss of a competitor (actual or potential) can change the competitive incentives of the merger parties, their rivals and their customers. This will lead to changes in the intensity of competition.
- 5.18 There are two conceptually distinct means by which a horizontal merger might be expected to result in an SLC: non-coordinated effects and coordinated effects. Although they are conceptually distinct, it is possible that a merger might raise both types of concern. Non-coordinated effects arise when two close competitors merge and find it profitable to raise prices and there are no other or limited competitive constraints on the merged entity to prevent it from raising prices. Co-ordinated effects may arise when the merger increases the incentive for some or all of the firms in the market to collude to increase prices and such collusion is sustainable due to no or little competition from other sources.
- 5.19 In assessing whether a merger situation would be likely to have the effect of an SLC in the relevant market, CCCS would assess the following:
- The extent to which the merger parties are close competitors;
 - Competition from existing competitors operating in the relevant market. This includes assessing the extent to which existing competitors can expand their sales and prevent the merged entity from raising prices;
 - Competition from potential competitors which involves assessing barriers to entry and whether entry is likely, timely and sufficient in extent; and

- The degree of countervailing buyer power of customers, such that some or all customers are able to prevent the merged entity from raising prices.

Each of these factors is discussed in further details in this section. An overview of CCCS's analytical framework is also available in **Annex B**.

Assessment of Non-coordinated Effects⁷

- 5.20 A horizontal merger between competing firms can have the likely effect of an SLC through non-coordinated effects (also known as unilateral effects). Non-coordinated effects may arise when a firm merges with an existing competitor that would otherwise provide a significant competitive constraint. In such cases, as part of its merger assessment, CCCS may focus its assessment on the closeness of competition between the merging parties.
- 5.21 When a firm merges with its closest competitor, the merged entity could find it profitable to raise prices (or reduce output or quality) because of the loss of competition between the merged entities. Pre-merger, any increase in the price of the acquiring firm's products would have led to a reduction in sales. However, post-merger, any sales lost as a result of a price increase in the acquiring firm's products will be partially recaptured by increased sales of the acquired undertaking's products,⁸ such that the lost sales are not completely foregone. In addition, the acquiring firm may find it profitable to also raise the price of the acquired firm's products since some of the lost sales will be recaptured through higher sales of the acquiring firm's products.
- 5.22 Non-coordinated effects may also arise when an existing firm merges with a potential or emerging competitor. In such situations, the merged entity may be able to preserve the market power of the existing firm that would have otherwise been threatened by the potential or emerging competitor.
- 5.23 When CCCS assesses whether a merger situation is likely to give rise to non-coordinated effects, CCCS will consider whether the profitability of any price increase is likely to be defeated by competitors repositioning their products in the market, or expanding their sales and having sufficient capacity, by customers being able and/or willing to switch from one competitor to another easily, or by new competitors entering the market.
- 5.24 Non-coordinated effects may occur in any markets and may include markets:
- where the products or services are relatively similar ("homogeneous products") such that customers are largely indifferent about which firm they source from;
 - where the product or service is characterised by differences in characteristics ("differentiated products") such as product quality, branding, after sales service, geographic location and product availability; or
 - in which suppliers compete for customers through a bidding process.
- 5.25 In markets involving homogeneous products, the competition analysis will focus on the strategic interaction between rivals competing on output or capacity. In such cases, it is possible for the merging firms to affect price by varying the quantity of product they produce or make available to the market. For instance, non-coordinated effects may arise where the merged entity has a large market share and sets its post-merger output significantly below the level of output that would have prevailed without the merger and, despite the response of competitors, bring about a higher price than would have prevailed without the merger. The merged entity may find it profitable to restrict output:
- if any of the remaining competitors do not have sufficient capacity (or ability to expand capacity) to replace the output the merged firm removes;
 - the merged entity has a large share of the market;
 - its customers are relatively insensitive to price increases. That is, customers will not buy fewer products when price increases; and/or
 - it would not forego much profit by selling less output.

⁷ The term "non-coordinated effects" is used instead of "unilateral effects" to emphasize that the analysis will cover the change in the market structure and the resulting impact of the merger on the behaviour of other firms in the market.

⁸ In assessing whether a price increase would be profitable, it may also be necessary to take into account whether any reduction in sales would adversely affect a firm's cost base and so render the price increase unprofitable (for example, because economies of scale will be lost).

THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

- 5.26 In markets involving differentiated products, non-coordinated effects may arise where a merger between firms previously supplying close substitutes is likely able to cause an increase in the price of either or both of the close substitutes. In this case, consideration will be given to the nature and proportion of substitution that would occur. For example, if more customers switch to product B after an increase in the price of product A, than to product C or product D, then product B is a closer competitor to product A as compared to products C and D. In such cases, if the merged entity now produces both products A and B, then the sales that firm X would have lost to firm Y pre-merger if it had raised prices may now be retained by the merged entity. This reduces the cost of increasing prices and increases the merged entity's incentive to increase prices. The larger the volume of sales diverted between the merging firms, the greater the incentive to increase prices. Similarly, the larger the profit margins on these diverted sales, the greater the incentive to increase prices.
- 5.27 In markets that involve a bidding process, a merger between two competing suppliers could reduce the alternatives available to a customer and reduce the ability for a customer to negotiate between both firms in order to obtain a better price through the bidding process. The loss of two competing choices could enhance the merged entity's ability to profitably increase prices.
- 5.28 The factors listed under each market highlighted in paragraphs 5.25 to 5.27 above are non-exhaustive examples of what CCCS may consider in each market but the same factors can be applied in other markets as well. To summarise, non-coordinated effects may arise where the market(s) concerned possess some of the following characteristics:
- there are few firms in the affected market(s);
 - the merger parties have large market shares. The larger the market share of the merged entity, the more likely it is that a merger will lead to a significant increase in market power. Although market shares and increases in market shares provide only an indication of market power and an increase in market power, they are normally important factors in the assessment;
 - the merger parties are close rivals. The higher the degree of substitutability between the merging firms' products, the more likely it is that the merging firms will raise prices significantly. If the merging firms represent, for a substantial number of customers, the "next best alternative" to each other's products, those customers would be prevented from switching to the best rival product, in the event of a post-merger price increase;
 - customers have little choice of alternative suppliers, whether because of the absence of alternatives, switching costs, or the ability of suppliers to price discriminate;
 - it is difficult for rivals to react quickly to changes in price, output, or quality, for example, through product repositioning or supply-side substitution;
 - there is little spare capacity in the hands of the merged entity's competitors that would allow them to expand to supply customers in the event that the merged entity reduces output, and there is little prospect of expansion of existing capacity. Spare capacity is likely to be considered in greater detail in those markets which have homogenous products;
 - there is no strong competitive fringe capable of sustaining sufficient levels of post-merger rivalry; or
 - one of the merger parties is a recent new entrant or a strong potential new entrant that may have had a significant competitive effect on the market since its entry or which was expected to grow into an effective competitive force. Its elimination may thus mean an important change in the competitive dynamics.
- 5.29 The above factors are intended to provide a broad indication of the circumstances under which CCCS may consider the risk of such anti-competitive effects to be high. They should, however, not be taken as a checklist of factors or characteristics that must all be present before non-coordinated anti-competitive effects are likely to arise.
- 5.30 Though the profits from non-coordinated effects are generally captured by the merger parties, rival firms can also benefit from reductions in competitive pressure as a result of a merger. Even if rival firms pursue the same competitive strategies as they did prior to the merger, they may be able to increase their prices in the wake of a merger. In such cases, the firms in the market are not tacitly or explicitly coordinating their competitive behaviour; they are simply reacting independently to expected changes in one another's commercial behaviour. Such instances of anti-competitive effects are still termed non-coordinated by merger analysts since they are based on the independent actions of firms. The change in the structure of the market may result in other firms behaving differently and reacting to an increase in prices in the market by raising their own prices.

Assessment of Mergers between Competing Buyers

- 5.31 Similar to a merger between competing suppliers, a merger between competing buyers may also create or enhance “monopsony power”, i.e., the merged firm’s ability, unilaterally or in co-ordination with other firms, to exercise market power when buying products or services.
- 5.32 For such merger situations, CCCS will first assess whether it involves two competing buyers of a product or service. CCCS will then assess the competition effects of the merger in those relevant markets in which the merger parties are buyers. CCCS will conduct this assessment by considering the following:
- the number of other buyers purchasing the product(s) or service(s) in the relevant market;
 - the market shares of the merger parties and the other buyers, based on the share of products purchased;
 - the extent to which a new buyer or an existing buyer would increase its purchases if prices of the product or service decreased; and/or
 - the possibility of suppliers exiting the market or reducing production, or investment in new products and processes, in response to any price decrease.

Assessment of Coordinated Effects

- 5.33 A merger situation may also lessen competition substantially by increasing the possibility that, post-merger, some or all firms in the same market may find it profitable to coordinate their behaviour by raising prices, or reducing quality or output. This is in contrast to non-coordinated effects, where the merged entity acts on its own to affect price, quality and output.
- 5.34 This does not necessarily mean explicit collusion (which is generally an infringement of the section 34 prohibition). Given certain market conditions, and without any explicit agreement, tacit collusion may arise merely from an understanding that it will be in the firms’ mutual interests to coordinate their decisions. CCCS’s analysis of coordinated effects will include both the incentive to explicitly or tacitly collude, post-merger. A common feature of all types of collusion is a set of formal or informal rules by which each participating firm generally understands how it should behave and how it can expect other participating firms to behave.
- 5.35 Coordinated effects may arise where a merger reduces competitive constraints from actual or potential competition in a market, thus increasing the probability that competitors will collude or strengthening a tendency to do so. For example, coordinated effects are not likely if there continues to be competition from non-participating competitors and/or if the threat of entry is credible.
- 5.36 If a merger removes a particularly aggressive or destabilising competitor, it may make coordinated behaviour more likely.
- 5.37 Coordinated effects can arise as a result of a merger, even if not all competitors in a given market are involved. The number and proportion of competitors sufficient to give rise to coordinated effects will vary according to the relevant circumstances.
- 5.38 The creation of a joint venture merger may also increase the probability that post-joint venture, the economically independent parents of the joint venture may tacitly or explicitly coordinate their behaviour so as to raise prices, reduce quality or output, or curtail output in markets outside the joint venture market. In such cases, the coordination that takes place outside the approved joint venture will be assessed in accordance with the criteria in section 34(1) of the Act and paragraph 9 of the Third Schedule to the Act (“the Third Schedule”), with a view to establishing whether or not the behaviour poses competition concerns.
- 5.39 In order for tacit or explicit coordination to be successful or more likely as a result of a merger, three conditions should be met or be created by a merger:
- participating firms should be able to align their behaviour in the market;
 - participating firms should have the incentive to maintain the coordinated behaviour. This means, for example, that any deviation from the coordination should be detectable, and the other participating firms should be able to inflict credible “punishment” on the deviating firm through retaliatory behaviour; and
 - the coordinated behaviour should be sustainable in the face of other competitive constraints in the market.

- 5.40 CCCS will examine whether each of these three conditions which are favourable to coordination may be expected to arise by virtue of a merger situation. In its assessment, CCCS will also consider the structure of the market, its characteristics, and any history of coordination in the market concerned.

Ability to Align Behaviour in the Market

- 5.41 In order to coordinate their behaviour, firms need to have an understanding on how to do so. This need not involve an explicit agreement on what price to charge, market share quotas or the quality of products to be attained. Nor is it necessary for the firms concerned to coordinate prices around the monopoly price, or for the coordination to involve every single firm in the market. However, it is sometimes possible for firms to find a “focal” point around which to coordinate behaviour. For example, firms may find it in their interests to similarly increase their prices, without explicit coordination, in response to a price increase by a market leader. CCCS may consider the following when assessing the ability for firms to align their behaviour:
- the level of concentration in the market. In some markets it may be easier to coordinate behaviour when there are a smaller number of competitors;
 - the degree of homogeneity of the firms’ products. Prices for close or perfect substitutes will be easier to coordinate than prices for imperfect substitutes. Complex products and differences in product offerings and cost structures tend to make it more difficult for firms to reach profitable terms of coordination;
 - the degree of similarity of firms (e.g. with respect to their size, market shares, cost structures, business strategies and attitudes to risk). Such firms are more likely to reach a consensus to co-ordinate than dissimilar firms;
 - the degree of market transparency. The more transparent the market, the easier it is for firms to monitor one another;
 - the existence of institutions and practices that may aid coordination (e.g. information sharing agreements, trade associations, regulations, meeting- competition or most-favoured-customer clauses, cross-directorships, participation in joint ventures etc.). For instance, the exchange of information will be easier for connected firms than for unconnected firms;
 - the stability of the market. If demand and supply is stable, coordination will be easier than if the market faces volatile market conditions like innovation, or the entry and exit of firms.

It should be noted that not all of these factors need to exist in order for the firms to be able to align their behaviour in the market post-merger.

Incentives to Maintain Coordinated Behaviour

- 5.42 The incentive for firms participating in coordinated behaviour is to compete less intensively than in a competitive market in exchange for increased profits. The larger the increase in profit, the greater will be the incentive for coordination. Further, the strength of the incentive to co-ordinate also depends on the credibility of the detection and punishment by other participating firms of deviation from the terms of coordination.
- 5.43 Though coordination is in the collective interest of the firms involved, it is often in each firm’s short-term individual interest to “cheat” on the coordination by cutting price, increasing market share, or selling outside of “accepted” territories. If coordinated behaviour is to be maintained, such “cheating” should be observable directly or indirectly. For coordination to be sustainable, the market concerned should be sufficiently transparent such that firms can monitor pricing and other terms of coordination with a view to detecting cheating in a timely way and responding to it. Firms should have credible ways of “punishing” any deviation from the tacit coordination, for example, by rapidly cutting prices or expanding output. It should be pointed out that it may be sufficient that participating firms have a strong incentive not to deviate from the coordinated behaviour, rather than that there is a particular punishment mechanism. CCCS may consider the following when assessing possible incentives for firms to maintain their coordinated behaviour:
- the degree of market transparency. The more transparent the market, the easier it is for firms to monitor one another and detect deviations from the terms of coordination;
 - the existence of institutions and practices that may aid coordination (e.g. information sharing agreements, trade associations, regulations, meeting- competition or most-favoured-customer clauses, cross-directorships, participation in joint ventures etc.). Such connections make it easier to monitor and detect cheating;
 - the stability of demand and costs. Unpredictable changes in demand or costs may make it more difficult for firms to decipher whether a change in volume sold, for instance, is due to the cheating actions of another firm or due to demand changes in the market as a whole;

- whether there is any evidence of a long-term commitment to the market by firms. The presence of the long-term commitments by the firms may be seen as a way for firms to signal to each other the intentions to maintain the aligned behaviour;
- whether the firms face any short-term financial pressures. Short-term financial pressures may encourage firms to depart from any common patterns of long-term behaviour making it difficult to sustain coordinated behaviour;
- the degree of excess capacity in the market (e.g. a high level of excess capacity will make coordination more difficult if some firms have a strong incentive to utilise their excess capacity). However, in other instances, excess capacity may make coordination easier because firms could use the spare capacity as a credible threat to participating firms thinking of deviating from the coordinated behaviour;
- whether there is multi-market contact, i.e., the presence of the same firms in several markets. Where firms compete in more than one market, it is easier for them to maintain a tacit understanding because the costs of deviating from the agreement are greater. For example, deviation from the understanding in one market could be met by rival firms retaliating not only in that market but also in the other markets in which they compete.

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

Sustainability of Coordinated Behaviour

- 5.44 Overall, the conditions of competition in the market should be conducive to coordination in order to sustain the relevant behaviour. Typically, this means that the market should be sufficiently mature, stable and with limited potential competition, such that the coordination is not likely to be disrupted. For example, a strong fringe of smaller competitors (or perhaps a single maverick firm) or a strong customer (with buyer power) might be enough to render coordination impossible. CCCS may consider the following when assessing the sustainability of the firms' coordination behaviour:
- whether any significant entry barriers exist. The presence of significant entry barriers limits likely entry by potential entrants who may disrupt coordination between incumbents and render any coordination unsustainable;
 - presence of strong countervailing buyer power. Customers can threaten to enter the market themselves or sponsor market entry, thereby introducing new players into the market and disrupt any coordination;
 - the stability of market shares over time. This is an indication of whether the market is stable due to market conditions, such that coordination is likely to be sustained;
 - the extent to which small firms on the fringe of the market (e.g. those producing specialist "niche" products) might embark on large-scale or more developed production;
 - the extent to which there is strategic intervention by interested third parties such as customers and suppliers. Coordination aimed at reducing overall capacity in the market will only work if non-coordinating firms are unable or have no incentive to respond to this decrease by increasing their own capacity. Increase in capacity by the non-coordinating firms may either prevent a net decrease in capacity or at least render the coordinated capacity decrease unprofitable for the coordinating firms; and
 - whether there is scope for, or pressure on, firms to bring new products into the market. Pressure to innovate means that current products are likely to become obsolete more quickly, hence reducing the profitability of collusion.
- 5.45 CCCS will seek to assess whether, in the circumstances of the case, the above factors interact with the structural changes resulting from the merger to make coordinated effects a likely outcome of the merger. When considering the likelihood of future coordination, CCCS will also consider any existing relationship between the firms and the past history of market conduct - for example, whether the market has been characterised by price-fixing or vigorous price competition - and how such conduct is likely to be affected by the merger situation.

Assessment of Barriers to Entry and Expansion

Entry

- 5.46 Entry by new competitors may be sufficient in likelihood, scope and time to deter or defeat any attempt by the merger parties or their competitors to exploit the reduction in rivalry flowing from the merger (whether through coordinated or non-coordinated strategies).
- 5.47 New entry and the threat of entry can represent important competitive constraints on the behaviour of merger parties. If entry is particularly easy and likely, then the mere threat of entry may be sufficient to deter the merger parties from raising their prices, since any price increase or reduction in output or quality would incentivise new entry to take place.

THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

- 5.48 For new entry (actual or threatened) to be considered a sufficient competitive constraint, three conditions must be satisfied: The entry must be likely, sufficient in extent and timely.
- 5.49 The likelihood of entry depends on whether firms can profitably enter the market in light of any entry conditions. This could depend on the revenue that a firm expects to earn, post entry prices, costs and quantities, or the return the firm might otherwise earn using its resources elsewhere (opportunity cost), or the relative risk of entry compared to alternative investments.
- 5.50 In assessing the likelihood of entry CCCS will consider the experience of any firm (or firms) that have entered or withdrawn from the relevant market or markets in recent years and evidence of planned entry by third parties. The type of market may also be relevant, as a mature market with stable or declining demand may mean that profitable entry is difficult. The firm would have to win its competitor's existing customers, rather than being able to target new customers coming into the market. Alternatively, in markets with growing/rapid demand it is possible, that any barriers to entry are less likely to have a lasting effect. Similarly, in markets characterised by innovation, product cycles may be shorter, which may decrease the probability that some barriers will have a lasting effect. CCCS would also gather information on the costs involved in entry.
- 5.51 Entry barriers allow an undertaking to profitably sustain supra-competitive prices in the long term. Barriers to entry can take a variety of forms, including structural, regulatory and strategic barriers. These are explained in further detail below. In assessing the extent of any barriers to entry, CCCS will take the following considerations into account:
- Regulatory barriers provide incumbents with absolute cost advantages over potential entrants which may make successful entry less likely. Such barriers include situations where government regulations such as licensing, intellectual property rights, preferential access to essential facilities, environmental regulations, planning consent requirements, or regulations governing standards and quality, limit the number of competitors that are able to enter a market.
 - Structural barriers arise from the technologies, resources or inputs a firm would need to enter or expand. These include the following:
 - The costs of entering a market are more likely to deter entry if a significant proportion of those costs are sunk, i.e. the costs cannot be recovered if the entrant fails and is forced to exit. Sunk costs are the costs of entering a market that are not recoverable when exiting, and may include set-up costs (such as market research, finding an office location and getting planning permission). Costs associated with investment in specific assets, research and advertising or other promotion costs may also be considered sunk costs.
 - Economies of scale arise where average costs fall as the level of output rises.⁹ In some circumstances, such scale economies can act as a barrier to entry, particularly where the fixed costs are sunk. As a result, a new entrant may be deterred from attempting to match the costs of the incumbent by entering on a large scale, because of the risk that it would be unable to recover its sunk costs.
 - Economics of scope arise when average costs fall when more than one product is produced. Economies of scope may require an entrant to produce a minimum range of products in order to be an effective competitive constraint on the merged entity.
 - The costs of entry must be considered against the expected revenues from sales and the time period over which costs might be recovered, to assess whether firms wanting to enter the market will find entry profitable and whether or not it may be difficult for them to raise the necessary funds to enter the market. In assessing whether entry would be profitable, CCCS will generally refer to pre-merger prices since this is the price at which the merged entity would need to be constrained to avoid an indication of an SLC.
 - The costs faced by customers in switching to a new supplier are also important in determining whether new entry would be an effective and timely competitive constraint.
 - Difficulties in accessing key production or supply assets, important technologies, or distribution channels.
 - Direct or indirect network effects¹⁰ may make customers reluctant to switch, thereby making it more difficult for new entrants to gain a sufficient customer base to be profitable. In markets characterised by network effects, a likely entrant will need to take the risk of developing new infrastructure but may not succeed in creating the necessary demand to make it profitable.

⁹ Economies of scope, where average costs fall as more types of products are supplied, may have similar implications as economies of scale.

¹⁰ Direct network effect occurs when an increase in the usage of a product increases the demand for that product. Indirect network effect occurs when an increase in the usage of a product increases the demand for another complementary product.

- Strategic barriers may arise when incumbent firms have advantages over new entrants because of their established position (first-mover advantages). These advantages can flow, for example, from the experience and reputation which incumbents have built up, or from the loyalty which they may have attracted from customers and suppliers. Incumbent firms may sometimes behave strategically by responding to the threat of entry, for example by lowering price or by investing in excess capacity or additional brands to deter entry. Such firms could increase customer switching costs, for example, by establishing long term contracts (with exclusivity clauses, automatic renewals, rights of first refusal) or establishing strong customer loyalty through points programmes, thereby making it difficult for new entrants to gain a sufficient customer base to be profitable or to gain access to essential inputs. Incumbent firms could also signal through present or past conduct that entry would provoke an aggressive response.

5.52 CCCS's analysis of entry conditions also includes considering whether the merged entity would face competition from imports or supply-side substitution, to the extent that these have not already been taken into account in market definition. What is important is that competitive constraints posed by imports and possible supply-side substitutes are considered in the analysis (whether they are considered under the heading of market definition or that of entry). Given the open nature of Singapore's economy, the competitive constraints posed by imports are likely to be an important factor in analysis.

Extent of Entry

5.53 Any new entry should be of sufficient scope to constrain any attempt to exploit increased post-merger market power. Small-scale entry may be insufficient to prevent an SLC, even when the entry may provide the basis for later expansion. For entry to be sufficient it must be likely that incumbents would lose significant sales to new entrants.

5.54 Sufficient scale will depend in part on the characteristics of the market under review. For instance, for a differentiated product, the sufficiency of entry will depend in part on whether the products supplied by the entrant or existing competitors are a sufficiently close substitute to the product supplied by the merged firm. Entry that is small-scale, localised or targeted at niche segments is unlikely to be an effective constraint post-merger.

5.55 Sufficiency does not require that one entrant alone duplicates the size and scale of the merged entity. It is possible that new entry or expansion of existing competitors is sufficient in extent but remains smaller than either of the merging firms pre-merger.

Timely Entry

5.56 Any such prospective new entry, in response to any exercise of market power by the merged entity, would have to be sufficiently timely and sustainable to provide lasting and effective post-merger competition. The assessment of whether entry would be sufficiently timely would depend on the facts of each specific merger and the particular characteristics of the market(s) in question. For instance, the appropriate timeframe may vary from market to market. In some markets where products are supplied and purchased on a long-term contractual basis, customers may not immediately be exposed to the detrimental effects stemming from a potential SLC. In such cases, the competition assessment would have to take into account the renewal dates of these contracts. As an indication, CCCS has in previous merger cases considered entry within two (2) years as timely entry.

5.57 When determining whether potential entry is likely to be timely, CCCS may consider the barriers listed in paragraph 5.51 above, 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. Not all of these factors need to be assessed to determine the timeliness of potential entry. Nor should this be considered an exhaustive list.

5.58 The effect of a merger on the likelihood of new entry might itself contribute to an SLC if it increases barriers to entry or reduces/eliminates the competitive constraint represented by new entry. This might arise, for example, where the acquired entity was or was genuinely perceived to be one of the most likely entrants.

Expansion

- 5.59 The ability of rival firms in the market to expand their capacity quickly can also act as an important competitive constraint on the merger parties' behaviour. When considering the likelihood of such expansion in response to price increases, CCCS will similarly consider the factors which have been set out for new market entry.

Assessment of Countervailing Buyer Power

- 5.60 The ability of a merged entity to raise prices may be constrained by the countervailing power of its customers. There are different ways in which a powerful customer might be able to discipline supplier pricing:
- most commonly, customers can simply switch, or credibly threaten to switch their demand or a part thereof to another supplier, especially if the customers are well-informed about alternative sources of supply;
 - even where customers have no choice but to purchase the supplier's products, the customers may still be able to constrain prices if they are able to impose substantial costs on the supplier, for example, by refusing to buy other products produced by the supplier or by delaying purchases;
 - customers may be able to impose costs on the supplier through their own retail practices, for example, by positioning the supplier's products in less favourable parts of their shops;
 - customers might threaten to enter the market themselves, sell own-label products or sponsor market entry by covering the costs of entry, for example, through offering the new entrant a long-term contract;¹¹ or
 - customers can intensify competition among suppliers through establishing a procurement auction or purchasing through a competitive tender.
- 5.61 Overall, the key questions are whether customers will have a sufficiently strong post-merger bargaining position and how much it will change as a result of the merger.
- 5.62 CCCS recognises that in a market, not all customers will possess significant countervailing buyer power. In such circumstances, CCCS will examine whether the countervailing buyer power of some customers will be sufficient to prevent an SLC in the market post-merger. It may not be sufficient if the countervailing buyer power only ensures that a particular segment of customers, with strong buyer power, is shielded from significantly higher prices or deteriorated conditions post-merger.
- 5.63 That customers are large will not be sufficient in itself to conclude that buyer power is strong. For example, even large customers may have limited scope to exercise buyer power against suppliers of "must have" brands. Customers will also be constrained in their ability to exercise buyer power if there are no alternative suppliers to whom they could turn. To maintain competitive constraints, customers should have an incentive to exercise their potential buyer power (because they may not always do so if other customers would also benefit).
- 5.64 It is also possible that in some markets, there are different customers at each level of the supply chain. For example, a manufacturer's customers may be distributors, and the distributor's customers may be the end-customers of the product or service. In such situations, additional consideration is required. For instance, if the merged firm's immediate customer is a reseller, its ability to exercise buyer power may be limited by the willingness of the reseller's customers to buy the products of alternative suppliers. Even if a reseller is able to buy from alternative suppliers this may not be credible if the products of the alternative supplier are not considered by the reseller's customers as a suitable replacement.
- 5.65 CCCS will consider the following types of information in assessing the countervailing buyer power of customers:
- examples of customers switching between the merger parties pre-merger, and/or switching to alternative suppliers pre-merger;
 - the proportion of revenue attributed to large customers of the merger parties;
 - evidence and examples of past negotiations (on price, quality of product or service) between customers and the merging parties;

¹¹ As such threats to change the market structure often involve making investments and incurring sunk costs, it may be possible for incumbent suppliers to raise prices to some extent before such threats become credible. Thus, where the sunk costs of sponsoring entry are large, countervailing buyer power is unlikely to act as a strong competitive constraint. Customers may also have a limited incentive to sponsor entry because the benefit of their investment is shared with their rivals and customers.

- whether the buyer has a large volume order such that it can or has sponsored entry for a potential supplier not currently in the market;
- evidence that customers have considered vertical integration or sponsoring new entry and that such a strategy is commercially viable; and
- evidence that customers have regularly and successfully resisted attempts by a supplier(s) to raise prices or otherwise harm competition pre-merger, coupled with evidence that the merger would not change this.

Assessment of Efficiencies that Increase Rivalry

- 5.66 Mergers can generate efficiencies and can increase rivalry to the extent that it is likely to prevent an SLC occurring in a market. For example, efficiencies can enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products for customers. For example, a merger between two smaller and weaker competitors to form a more effective competitor may generate efficiencies that increase rivalry by exerting greater competitive pressure on its larger competitors.
- 5.67 Where efficiency gains are claimed to have a positive effect on rivalry, their impact is assessed as an integral part of the SLC analysis. The key question is whether the claimed efficiency will enhance rivalry among the remaining players in the market. Such efficiencies could occur where a merger between two smaller firms stimulates the combined firm to invest more in R&D and increase rivalry in the market through innovation, or where efficiencies make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm.
- 5.68 Possible efficiencies may include cost savings (fixed or variable), more intensive use of existing capacity, economies of scale or scope, or demand-side efficiencies such as increased network size or product quality. Such efficiencies can also be considered in assessing those merger situations where there is likely to be an SLC. This is discussed in further detail in Part 7.
- 5.69 CCCS is of the view that there must be compelling evidence to show that efficiency gains will lead to increased rivalry and will prevent an SLC. Such evidence must show that the efficiencies would:
- be timely, likely and sufficient to prevent an SLC arising (having regard to the effect on rivalry that would otherwise result from the merger); and
 - be merger specific, i.e. a direct consequence of the merger, judged relative to what would happen without it.
- 5.70 Such evidence might, for example, include the quantum and source of projected cost savings, which are contained in pre or post-announcement merger planning and strategy documents, to be complemented by objective factual and accounting information to verify the proposed cost saving claims. External consultancy reports pre or post-dating the merger may also be helpful in this context. A similar discussion on the assessment of net economic efficiencies can be found in Part 7.

6

ASSESSMENT OF NON-HORIZONTAL MERGERS

- 6.1 A non-horizontal merger is one where the relevant markets in which the parties operate are distinct. In other words, there is no overlap of directly competing products. Such a merger does not produce any change in the level of concentration in the relevant market. However, while non-horizontal mergers are less likely than horizontal mergers to create competition concerns, they may still do so in a number of cases. Like horizontal mergers, CCCS will assess whether the non-horizontal merger is likely to lead to an SLC in a market(s).
- 6.2 There are two broad classes of non-horizontal mergers, namely, vertical mergers and conglomerate mergers. The analytical framework applied in assessing these non-horizontal mergers and the potential theories of harm are explained in further detail below.

Vertical Mergers

- 6.3 Vertical mergers are mergers between firms that operate at different but complementary levels in the chain of production and/or distribution. The complementary nature of products or services would mean that a higher price for one product reduces the demand for both. For example, a merger between a manufacturer (known as the upstream firm) and retailer (known as the downstream firm) would be considered to be a vertical merger.

THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

- 6.4 Some mergers may be both horizontal and vertical in nature, e.g. where the merging firms are not only in a vertical relationship but are also actual or potential horizontal competitors at either upstream or downstream level, or where there are overlaps in their activities in some but not all markets. In such cases, CCCS will examine both the horizontal and vertical aspects of the merger.
- 6.5 The integration of complementary products and services within a single firm, through acquisition, can be pro-competitive for a variety of reasons:
- efficiencies may arise because an effort to increase the sales of one product will benefit sales of the other, and more effort will be exerted to increase sales if both are sold within a single firm;
 - when a price reduction in one product increases the demand for both products, integration increases the incentives to reduce price, as the integrated firm now captures the benefits of the increased demand for the complementary product as well; or
 - many complements are purchased together by customers, so that integration may give rise to benefits in terms of one-stop shopping.
- 6.6 Acquisitions leading to vertical integration are generally efficiency-enhancing. Benefits of vertical integration could include:
- reduced production costs, e.g., reduced overhead and transaction costs, better production and distribution methods;
 - increased innovation; and/or
 - lower prices and/or increased supply of products from a reduced profit margin, i.e., prices will no longer include the previous mark-up on purchases by the downstream firm from the upstream firm.
- 6.7 The analytical framework applied to assess vertical mergers is similar in some aspects to the framework applied to horizontal mergers, namely, CCCS would:
- develop a theory of harm;
 - define the relevant markets, which could relate to different parts of the supply chain of the affected products and service, namely, separate markets for upstream and downstream activities;
 - develop an appropriate counterfactual scenario;
 - assess competition in each of the relevant markets and compare it with the counterfactual scenario. This includes an assessment of the competitive constraints on the merged entity like buyer power and barriers to entry.
- 6.8 However, the competition concerns arising in vertical mergers are likely to be different to the concerns raised in horizontal merger. For instance, vertical mergers do not involve a direct loss of competition between firms in the same market and are unlikely to result in an SLC in a market, unless market power exists at one of the affected parts of the supply chain.
- 6.9 The potential theories of harm raised by a vertical merger may involve:
- market foreclosure (e.g. by raising rivals' costs of access to a necessary input of customers or refusing to supply them completely); and/or
 - increasing the ability and incentive of parties to collude in a market.
- 6.10 These potential theories of harm are discussed in further detail below.

Market Foreclosure

- 6.11 A vertically-integrated firm may be able to foreclose rivals from either an upstream market for selling inputs or a downstream market for distribution or sales. Foreclosure does not only refer to a vertically-integrated firm excluding a non-vertically integrated firm from a market (although this may be the case), but may include a range of behaviour:
- If the merged entity is an important downstream customer for a product that it also supplies upstream, it may be able to dampen competition from rival suppliers of that product in certain circumstances. It can do so by, for example, sourcing its future needs entirely from its own production facility, which may jeopardise the continued existence of alternative upstream suppliers of the product.

- If a merged entity supplies a large proportion of an important input to a downstream process where it also competes, it may be able to dampen competition from its rivals in the downstream market, for example, by diverting its production of the input entirely to its own downstream process (input foreclosure).
- If the merged entity refuses to supply a product to its downstream rivals, or by only selling the input to its rivals at a price that makes them uncompetitive, this might also foreclose competition. This might be particularly relevant where firms in the downstream market need to stock a full range of products to be competitive; hence, the disruption in the supply of any product could undermine their competitiveness.
- If the merged entity controls an important channel of distribution to a downstream market, it might be able to reduce competition from its rivals by refusing to provide them with access to that means of distribution, or by granting access only at discriminatory prices that favour the merged entity's own business, thus placing rivals at a cost disadvantage.

6.12 CCCS will be concerned where, in any of the above situations, competitors lack a reasonable alternative to the vertically-integrated firm. In such a situation, competitors may either be deprived of access of inputs or customers altogether or might be allowed to obtain the product or the facility only at unfavourable prices, thereby lessening rivalry in the market.

6.13 In assessing whether a vertical merger could have foreclosure effects, it is also important to consider whether the merged entity would have the *ability* and/or *incentive* to foreclose its competitors and the likely effect of that foreclosure on competition. In certain cases where foreclosure may not be profitable, the merged entity may have the ability to foreclose competition in some ways but lack the incentive to do so.

- *Ability to foreclose competition:* A firm is generally only able to foreclose competitors if it has market power at one or more level(s) of the supply chain. If a firm does not have market power, its competitors could switch to other suppliers or purchasers. This would mean that the firm is unlikely to have the ability to foreclose its competitors.
- *Incentives to foreclose competition.* A firm will only rationally foreclose competitors if it is profitable to do so. For example, if a firm forecloses access to an input, the firm must weigh up an increase in profits in a downstream market against a decrease in profits in the upstream market where the foreclosure occurs. This is because the firm's profits in the input market falls as the number of units sold fall but the firm's profits in the downstream market may increase if it can win a proportion of the sales its competitors lose as a result of the foreclosure.
- *Effect on competition.* A key consideration is whether the competition lost from potentially foreclosed competitors is sufficient to have the effect of leading to an SLC. This may arise when foreclosure makes entry and expansion for competitors more difficult, or otherwise reduces a competitor's ability to provide a competitive constraint to the merged entity. Foreclosure does not need to force a competitor or competitors to exit the market to have such an effect.

Increased Potential for Collusion

6.14 In rare cases, vertical integration may facilitate collusion. For instance, a vertical merger may create or strengthen coordinated effects in the following way:

- A vertical merger may allow the merged entity to gain access to commercially sensitive information about the activities of non-integrated rivals. This may facilitate collusion;
- A vertical merger that results in foreclosure could reduce the number of players in an affected market, making it easier for the remaining players to co-ordinate. A vertical merger may increase the level of symmetry and/or transparency in the markets. For example, where vertical integration affords the merged entity better knowledge of selling prices in the upstream or downstream market, this may facilitate tacit collusion in either of the markets;
- A vertical merger may better align the incentives of firms in the market to maintain co-ordination (e.g. by enabling the vertically integrated firm to punish deviation more effectively if it becomes an important supplier to, or customer of, other firms in the market after the merger). A vertical merger may also increase barriers to entry, which can reduce the scope for entry to disrupt co-ordination, or it may reduce buyer power if it involves the acquisition of a customer who would otherwise disrupt co-ordination.

6.15 CCCS will assess whether a vertical merger may create or strengthen co-ordinated affects, by adopting the same general framework used in horizontal mergers, namely, whether the conditions for collusion are met following the merger, and the effect of the merger on the likelihood and effectiveness of coordination. However, as shown above, the details of the analysis of the impact of the merger may differ.

THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

- 6.16 CCCS will consider the following information when assessing the vertical effects of a merger:
- vertical relationship(s) between the merger parties before and after the merger;
 - the extent of vertical integration before the merger and how this is created or strengthened by the merger;
 - the merger parties' market shares in the upstream and downstream markets;
 - any existing supply arrangements between the merger parties; and
 - the extent to which the competitors are vertically integrated.

Barriers to Entry

- 6.17 The vertical integration resulting from vertical mergers could also create barriers to entry that raise competition concerns. Generally, three conditions are necessary (but not sufficient) for this problem to exist:
- the degree of vertical integration between the two markets must be so extensive that entrants to one market (the "primary market") would also have to enter the other market (the "secondary market") simultaneously;
 - the requirement of entry into the secondary market must make entry at the primary market significantly more difficult and less likely to occur; and
 - the structure and other characteristics of the primary market must be otherwise so conducive to anti-competitive behaviour¹² that the increased difficulty of entry is likely to affect the market's performance.
- 6.18 CCCS will assess whether the vertical integration in a merger changes the barriers to entry to the extent that it reduces a significant competitive constraint, post-merger. More details on barriers to entry can be found in paragraphs 5.46 to 5.59.

Countervailing Buyer Power

- 6.19 As with horizontal mergers, a firm's ability to exercise vertical market power may be constrained if there is buyer power. For example, the risk that customers may in the future be forced to source all their requirements for a particular product from the upstream business of the merged entity might be mitigated if the customers are sufficiently powerful so as to be able to either resist price increases or to sponsor the emergence of a new supplier.
- 6.20 CCCS will assess whether the vertical integration in a merger changes the buyer power of customers to the extent that it reduces a significant competitive constraint post-merger. More details on buyer power can be found in paragraphs 5.60 to 5.65.

Conglomerate Mergers

- 6.21 Conglomerate mergers involve firms that operate in different product markets. They may be product extension mergers (i.e. between firms that produce different but related products) or pure conglomerate mergers (i.e. between firms operating in entirely different markets). Conglomerate mergers are neither horizontal nor vertical i.e. there is no vertical relationship and no overlap in the products or services supplied by the merging parties. An example of a conglomerate merger would be between an athletic shoe company and a soft drink company. The firms are not competitors producing similar products (which would make it a horizontal merger) nor do they have an input-output relation (which would make it a vertical merger).
- 6.22 Conglomerate mergers rarely lead to an SLC solely because of their conglomerate effects except in exceptional circumstances, such as where the products acquired are complementary to the acquirer's own products, thus giving rise to so-called "portfolio power".
- 6.23 When the market power deriving from a portfolio of brands exceeds the sum of its parts, a firm may be said to have "portfolio power". Suppose, for example, that a merger creates a firm with many brands under its control. Where the brands relate to products that share sufficient characteristics to be considered a discrete group, customers may have an incentive to purchase the portfolio from one supplier to reduce their transaction costs. This circumstance may lead to an SLC if non-portfolio competitors, or those competitors that control only one or a few brands, do not impose an effective competitive constraint on the firm(s) with "portfolio power". The circumstances in which such a lessening of competition might arise are discussed below.

¹² E.g. if the structure of the primary market is conducive to monopolization or collusion.

Potential Anti-competitive Strategies

- 6.24 Large conglomerates may seek to require or encourage customers to purchase a range of their products, whether through tying or bundling of products or through significant discounts targeted at non-portfolio rivals' customers. A merger may give rise to a significant prospect that tying or bundling may occur, if the merged entity controls complementary goods. However, such conduct is likely to result in adverse effects on competition only if it is difficult for rivals or new entrants to provide competing bundles which could constrain the behaviour of the merged entity.
- 6.25 In rare cases, a conglomerate merger may also make predatory behaviour more feasible. A firm may be able to provide an aggressive response to entry or induce exit by using profits earned in one market to subsidise short-run losses in another market. This may substantially lessen competition if the likely long-run outcome is a more concentrated market. Such behaviour is likely only when the merger parties already have market power in some markets and where barriers to entry are already relatively high, so that the short-run losses can be recouped by higher prices in the long run.

Increased Potential for Coordination

- 6.26 Conglomerate mergers may facilitate coordination. This is especially so if the merged entity's rivals in one market are also rivals in at least one of its other markets, and if other factors facilitating collusion are also present in these markets.
- 6.27 CCCS will assess whether conglomerate mergers will facilitate collusion in the same manner in which it assesses co-ordinated effects in horizontal mergers.

Barriers to Entry

- 6.28 As for the possibility of entry constraining the conglomerate supplier, CCCS will primarily consider whether another firm could replicate the portfolio of products offered by the merged entity. CCCS will also consider whether the creation of the portfolio of products itself represents a strategic barrier to entry and could limit the ability of competitors to either extend their portfolios or to enter new product markets.¹³

Countervailing Buyer Power

- 6.29 In assessing whether a conglomerate merger could have anti-competitive effects, CCCS will consider the ability of customers to exercise countervailing buyer power,¹⁴ and in particular the incentives of customers to buy the portfolio from a single supplier. In a situation where customers can and do source the portfolio products from multiple suppliers and are likely to continue to do so post-merger, it is unlikely that the merger would substantially lessen competition.

7

ADDRESSING A SUBSTANTIAL LESSENING OF COMPETITION

- 7.1 In the event that CCCS finds that a merger has or is likely to result in an SLC in a market in Singapore, CCCS can consider the presence of any economic efficiencies in markets in Singapore that could outweigh the SLC arising from the merger. Any net economic efficiencies resulting from the merger would be considered under the exclusion for mergers. Mergers that generate sufficient net economic efficiencies may be excluded under the Fourth Schedule to the Act, which states that "*[t]he section 54 prohibition shall not apply to any merger if the economic efficiencies arising or that may arise from the merger outweigh the adverse effects due to the substantial lessening of competition in the relevant market in Singapore*".

¹³ Barriers to entry are discussed in greater detail in paragraphs 5.46-5.59

¹⁴ Countervailing buyer power is discussed in greater detail in paragraphs 5.60-5.65.

- 7.2 If net economic efficiencies are not sufficient to offset the adverse effects of an SLC arising from the merger, CCCS may consider possible merger remedies that could remedy, mitigate or prevent the SLC or any adverse effects resulting from the SLC.

Assessment of Net Economic Efficiencies

7.3 In the assessment of net economic efficiencies, merger parties must show that these efficiencies will be sufficient to outweigh the adverse effects resulting from SLC caused by the merger. Such efficiencies could include lower costs, greater innovation and greater choice or higher quality. While these types of efficiencies can be considered in assessing whether there are efficiencies that can increase rivalry, efficiencies considered as part of the net economic efficiencies are assessed when a merger is likely to lead to an SLC. For example, a merger may, despite leading to an SLC, give clear scope for large cost savings through a reduction in the costs of production (where these costs are not simply due to lower output alone). Mergers (leading to SLC) that only create profits for the companies concerned are unlikely to benefit from the net economic efficiencies exclusion which requires efficiencies arising from the merger to outweigh its potential anti-competitive effects.¹⁵ In some cases, a merger may facilitate innovation through R&D that could only be achieved through a certain critical mass, especially where larger fixed (and) sunk costs are involved. However, in such cases these efficiencies will not increase rivalry in the relevant market.

7.4 The types of efficiencies that CCCS may consider can be categorised as follows:

- supply-side efficiencies;
- demand-side efficiencies; and
- dynamic efficiencies.

Supply-side efficiencies

7.5 Supply-side efficiencies occur if the merged entity can supply its products or services at lower cost as a result of the merger, than compared to the merging parties operating separately prior to the merger. These could include:

- Cost reductions. A merged entity might be able to reduce costs by benefitting from economies of scale or economies of scope, or from more efficient production processes or working methods across a portfolio of products. Cost savings that reduce marginal or variable costs tend to stimulate competition and are more likely to be passed on to customers in the form of lower prices. Cost savings simply arising from lower production or output are unlikely to be accepted as efficiencies.
- Removal of double mark-ups in vertical mergers. Vertical mergers may allow the merged entity to remove (“internalise”) any pre-existing double mark-ups. These arise when, pre-merger, firms supplying the input and producing the final product set their prices independently and both charge a mark-up, resulting in prices for the final product being higher than would suit the joint interests of both firms. A vertical merger may enable, and provide incentives for, the merged firm to internalise this double mark-up resulting in a decrease in the price of the final product.
- Increases in investment. A vertical merger may lead to efficiencies from aligning the incentives within the merged firm to invest in, for example, new products, new processes or marketing. For instance, a distributor of the manufactured products of a firm further up the supply chain may be reluctant to invest in promoting those products because its investment may also benefit competing distributors/retailers. A vertical merger can alleviate this “investment hold-up” problem.
- Increases in the variety of products and services, through product repositioning. Some mergers involving differentiated products may result in the merged firm and its rivals repositioning (or “rebranding”) their products after the merger. The merging firms may seek to reduce the cannibalisation between the merging firms’ products by increasing the differentiation between them. Their rivals may also reposition their products to distinguish from those of the merging firms. If so, post-merger product repositioning increases the variety of products available to the customers.

¹⁵ Minister of State Mr. Lee Yi Shyan, Second Reading of Competition (Amendment) Bill, 21 May 2007.

Demand-side efficiencies

- 7.6 Demand-side efficiencies occur if the merged entities' products become more attractive as a result of the merger. These could arise from:
- Network effects. Where a merger results in a greater number of users of a product or service thereby increasing the value of the network, i.e. direct or indirect network effects, it may benefit the individual user.
 - Price effects of complementary products or services. A fall in the price of product A may increase the quantity demanded not only of product A but also of any complementary products or services. It may be profitable for a merged firm to offer product A and complementary products or services at a lower combined price than the set of prices previously charged by different suppliers.
 - Benefits of "one-stop shopping". Demand-side efficiencies may arise when the merging firms' products are not substitutes and customers may have a stronger incentive to buy a range of products from a single supplier. This could be because purchasing from one supplier reduces transaction costs, ensures product compatibility and/or increases quality assurance.

Dynamic efficiencies

- 7.7 Dynamic efficiencies involve innovation to change the products or services supplied by the merged entity relative to the pre-merger situation. Such efficiencies may arise, for example from technology transfer or an increase in the merged firm's R&D capacity.
- 7.8 Dynamic efficiencies generally have a non-price impact rather than reducing prices to consumers. Further, dynamic efficiencies may be less certain to occur and take more time to occur than other efficiencies which makes them more difficult to assess.

Evaluation of Efficiencies

- 7.9 In assessing claimed efficiencies, the merger parties must demonstrate that the efficiencies are:
- demonstrable;
 - merger specific, that is, they are likely to arise from the merger;
 - timely, in that the benefits will materialize within a reasonable period of time; and
 - sufficient in extent.

These are explained in further detail below.

Demonstrable

- 7.10 Efficiencies are difficult to verify and quantify as most of the information resides with the merging parties. Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified. Therefore, merger parties should produce detailed and verifiable evidence, which could include:
- confidential information prepared by or for the parties concerning the rationale for the merger;
 - confidential reports/papers for Board Members and/or Senior Management prepared by or for the merging parties; and/or
 - past behaviour by, and future intentions of, the merging parties and/or relevant third parties.
- 7.11 Efficiency claims based on past experience of operating the businesses in question, are more likely to be considered than projections of efficiencies that are generated outside of the usual business planning process. As part of its assessment of efficiencies, CCCS will also test the efficiency claims with industry participants.

Merger Specific

- 7.12 Valid efficiency claims must be merger specific, that are those that would occur only as a result of the merger and could not be attained by feasible alternative scenarios that raise less serious competition concerns. The key issue is that the efficiencies are assessed relative to what would have happened without the merger.

THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

- 7.13 The merged entity must demonstrate how the merger situation would allow the merged firm to achieve the efficiencies, the steps they anticipate taking to achieve the gains, the risks involved and the time and costs required to achieve them.
- 7.14 The claimed efficiencies should arise in markets in Singapore, although they need not necessarily arise in the market(s) where the SLC concerns arise. It is conceivable that sufficient efficiencies might accrue in one market as a result of the merger, which would outweigh a finding of SLC in another market(s). Any claim that efficiencies in one market outweigh an expected SLC in another will require clear and compelling evidence.

Timely

- 7.15 CCCS requires any claimed efficiencies to occur in a reasonable period of time. CCCS also recognises that efficiencies may arise over different periods of time, as some may occur upfront while others may not take place for a number of years. Where possible, CCCS requires any efficiencies, particularly, cost savings to be broken down according to whether they are one-off savings or recurring savings. CCCS will place less weight on the efficiencies that are likely to occur further into the future or that are more distantly related to the products and services being purchased and consumed. This is because the more distant the efficiency gain, the less direct the causal link is likely to be.

Extent of efficiencies

- 7.16 Where CCCS has clear evidence of economic efficiencies being demonstrable, merger specific and timely, it will assess the magnitude of those efficiencies. Where possible efficiency claims should be quantified, particularly for cost savings. In such cases, parties must provide a detailed and robust explanation of how the quantification was calculated. In the absence of quantitative analysis, which may exist for dynamic efficiencies, qualitative evidence should be produced to show that efficiency will occur and is merger specific and the extent of the efficiency gain.

Comparing Efficiencies with Adverse Effects of SLC

- 7.17 Once CCCS has assessed any economic efficiencies arising from the merger, CCCS will compare them with the adverse effects of an SLC. In particular, CCCS will compare the magnitude of the efficiencies against the magnitude of the anti-competitive effects from the merger that are likely to occur. If CCCS is satisfied that the efficiencies outweigh the potential anti-competitive effects, then CCCS is likely to consider clearing the merger. On the other hand, if the efficiencies are not sufficient to outweigh the competition concerns, CCCS may consider merger remedies, or in the absence of suitable remedies, prohibiting the merger under section 54 of the Act.
- 7.18 To assist CCCS in comparing the benefits of the merger with the adverse effects of the SLC, merger parties can provide their own quantified estimates of the potential loss of competition in the relevant markets, arising from the SLC in addition to quantified estimates of the claimed efficiencies that are likely to arise from the proposed merger, such as an estimate of the net changes to price and/or output, taking into account the SLC and efficiency factors. As mentioned above, where quantified estimates are provided, parties must provide a detailed and robust explanation of how the quantification was calculated.

8 REMEDIES

- 8.1 Once CCCS has decided that a merger has infringed, or that an anticipated merger, if carried into effect, will infringe the section 54 prohibition, it has to decide on the action to remedy, mitigate or prevent the SLC or any adverse effects resulting from the SLC. However, it should be highlighted that CCCS may consider any remedies that are offered by the merger parties at any time during the merger review process.¹⁶ CCCS notes that merger parties may submit remedy proposals that could seek to mitigate the SLC or ensure that adequate efficiencies materialise post-merger.

¹⁶ Section 60A provides that CCCS may accept commitments at any time before making a decision on a merger. *CCCS Guidelines on Merger Procedures 2012*, paragraph 6.8.

- 8.2 This section describes various factors which CCCS may take into account in deciding on the appropriateness of taking remedial action and the action(s) which may be taken. In practice, these can rarely be considered in isolation from one another. Key to CCCS's choice of remedy will be its ability to remedy the SLC and any resulting adverse effects.

Directions and Commitments

- 8.3 Remedies may be implemented by directions issued by CCCS or by CCCS's acceptance of commitments which address any competition concerns arising from the merger.

Directions

- 8.4 Section 69 of the Act states that where CCCS makes a decision that a merger has infringed or that an anticipated merger, if carried into effect, will infringe the section 54 prohibition, it may give to such person as it thinks appropriate directions to effect the appropriate remedy. The direction may include provisions prohibiting an anticipated merger from being carried into effect¹⁷ or requiring a merger to be dissolved or modified in such manner as CCCS may direct. The direction may also include provisions requiring any merger party to:
- enter such legally-enforceable agreements as may be specified by CCCS and designed to prevent or lessen the anti-competitive effects which have arisen;
 - dispose of such operations, assets or shares of such undertaking in such manner as may be specified by CCCS; and
 - provide a performance bond, guarantee or other form of security on such terms and conditions as CCCS may determine.

In the case of a merger, CCCS may, if the infringement was committed intentionally or negligently, require any party involved in the merger to pay to CCCS such financial penalty as CCCS may determine.

- 8.5 Where any agreement or conduct is directly related and necessary to the implementation of an anti-competitive merger, CCCS's direction may also require any parties to the agreement or concerned with the conduct to modify or stop the agreement or conduct, notwithstanding that the agreement or conduct would otherwise fall under the exclusion for ancillary restrictions under paragraph 10 of the Third Schedule (The exclusion for ancillary restrictions is covered at paragraphs 9.4 to 9.12 below).

Commitments

- 8.6 CCCS may accept commitments that address any competition concerns, which may be raised by the merger or anticipated merger. Any commitment must be aimed at preventing or remedying the adverse effects to competition which have been identified. CCCS will only accept commitments that are sufficient to address clearly the identified adverse effects to competition and are proportionate to them.
- 8.7 Commitments are, therefore, appropriate only where the competition concerns raised by the merger and the commitments proposed to address them are clear-cut, and those commitments are capable of ready implementation. It is for this reason that commitments have typically been used in merger cases in other jurisdictions where an SLC arises from an overlap that is relatively small in the context of the merger. Further, the commitments must not give rise to new competition concerns or require substantial monitoring by CCCS.
- 8.8 An acquiring company can always take the initiative to propose suitable commitments if it thinks that they may be appropriate to meet any competition concerns that it foresees. Alternatively, CCCS may invite merger parties to consider whether they want to offer commitments where it believes that it is, or may be, the case that a merger may raise competition issues potentially warranting investigation or which may be expected to result in an SLC and which seems amenable to remedy by commitments.

Structural vs. Behavioural Remedies

- 8.9 There are broadly two types of remedies which CCCS may consider: structural remedies and behavioural remedies.

¹⁷ In the case of an anticipated merger, should there be no suitable commitments that can address the potential competition concerns, the most effective remedy may be to prohibit the anticipated merger from proceeding.

Structural Remedies

- 8.10 Since a merger involves a structural change to a market, a structural solution is often the most appropriate remedy if the merger has resulted, or may be expected to result, in an SLC. Structural remedies are preferable to behavioural ones because they clearly address the market structure issues that give rise to the competition problems. Given that a structural remedy is likely to remove the scope for an SLC to occur, once implemented they require little on-going monitoring by CCCS.
- 8.11 Typically, structural remedies require the sale of one of the overlapping businesses that have led to the competition concern. Ideally, this should be a self-standing business, which is capable of being fully separated from the merger parties, and in most cases, will be part of the acquired enterprise. The sale should be completed within a specified period. A purchaser may be deemed to be a reasonable alternative purchaser if it is willing to pay a commercially reasonable price, even if the price is lower than the price that the acquiring party is prepared to pay. An independent trustee may be appointed, at the owner's expense, to monitor the operation of the business pending disposal and/or to handle the sale if the owner has not completed the divestiture within the specified period.
- 8.12 Before the sale of any business, CCCS must approve the buyer. This is to ensure that the proposed buyer has the necessary expertise, resources and incentives to operate the divested business as an effective competitor in the marketplace. If that is not the case, it is unlikely that the proposed divestiture will be considered as an effective remedy for the anti-competitive effects which have been identified.
- 8.13 In appropriate cases, CCCS will consider other structural or quasi-structural remedies. For example, divestment of the buyer's existing business (or part of it) might be appropriate, although in such cases, CCCS will also need to consider the competition implications of the asset swap. Alternatively, an amendment to intellectual property licences might, in some circumstances, be an appropriate remedy.

Behavioural Remedies

- 8.14 Behavioural remedies can also constrain the scope for a merged company to behave anti-competitively. CCCS will consider behavioural remedies in situations where it considers that divestment will be impractical, or disproportionate, to the nature of the concerns identified.
- 8.15 Behavioural remedies may sometimes be necessary to support structural divestment. For example, where CCCS imposes a partial divestment remedy, a commitment by the merged business to not approach the former customers of the divested business for a limited period of time may increase CCCS's confidence that the acquirer of the divested business will prove a viable and effective competitor.

Consideration of the Appropriate Remedy

- 8.16 In addressing the question of which remedies would be appropriate, and would provide as comprehensive a solution as is reasonable and practicable to address the SLC and any adverse effects resulting from it, CCCS will take into account how adequately the action would prevent, remedy or mitigate the competition concerns caused by the merger.
- 8.17 CCCS's starting point will be to choose the remedial action that will restore the competition that has been, or is expected to be, substantially lessened as a result of the merger. Given that the effect of the merger is to change the structure of the market, remedies that aim to restore all or part of the pre-merger market structure are likely to be a more direct way of addressing the adverse effects. However, in view of other considerations such as the effectiveness of the remedy and the costs associated with the remedy, other types of remedies may need to be considered. CCCS may, therefore, decide to impose more than one type of remedy.
- 8.18 CCCS considers that structural remedies are preferable to behavioural ones, as they tend to address the competition concerns created by the merger more directly and also require less monitoring.

The Cost of Remedies and Proportionality

- 8.19 The remedial action to be taken by CCCS will depend on the facts and circumstances of the case. When deciding on the appropriate remedy, CCCS will consider the effectiveness of different remedies and their associated costs, and will have regard to the principle of proportionality.

- 8.20 It is for the parties concerned to assess whether there is a risk that a merger may infringe the section 54 prohibition. In deciding upon the remedy, CCCS will normally not consider the costs of divestment which the parties would have to incur, as it would have been open to the parties to notify the merger to CCCS for a decision prior to carrying it into effect.

9 EXCLUSIONS AND EXEMPTIONS

Exclusions in the Fourth Schedule

- 9.1 The merger provisions do not apply to the matters specified in the Fourth Schedule. These are:
- mergers
 - approved by any Minister or regulatory authority¹⁸ pursuant to any requirement imposed by written law;
 - approved by the Monetary Authority of Singapore pursuant to any requirement imposed under any written law; or
 - under the jurisdiction of another regulatory authority under any written law or code of practice relating to competition
 - mergers involving any undertaking relating to any specified activity as defined in paragraph 6(2) of the Third Schedule; and
 - mergers with net economic efficiencies.
- 9.2 More details on the other Fourth Schedule exclusions can be found in the *CCCS Guidelines on Merger Procedures 2012*.¹⁹

Exemption under Public Interest Considerations

- 9.3 A decision by CCCS that a merger has infringed or that an anticipated merger will, if carried into effect, infringe the section 54 prohibition may be made by CCCS either upon an application by merger parties for a decision, or upon the conclusion of investigations commenced by CCCS. Where CCCS proposes to make such a decision, the Applicants who notified the merger to CCCS for decision or, in the case of an investigation, the merger parties, may apply to the Minister for Trade and Industry (“the Minister”) for the merger to be exempted from the merger provisions on the ground of any public interest consideration. More details can be found under the *CCCS Guidelines on Merger Procedures 2012*.

Exclusion of Ancillary Restrictions and Mergers from the Section 34 Prohibition and Section 47 Prohibition

Exclusion of Ancillary Restrictions

- 9.4 Agreements, arrangements or provisions which are not integral to a merger may have to be concluded in conjunction with the merger. A seller of a business, for example, sometimes accepts a non-compete obligation which prevents the seller from competing with that business after it has been sold. Agreements, arrangements or provisions which are “directly related and necessary to the implementation” of a merger are called “ancillary restrictions”.
- 9.5 Ancillary restrictions are excluded from the section 34 prohibition and section 47 prohibition under the Third Schedule.

Requirements for Ancillary Restriction

- 9.6 The Third Schedule provides that a restriction must be directly related and necessary to the implementation of the merger if it is to benefit from the exclusion.
- 9.7 In order to be directly related, the restriction must be connected with the merger, but ancillary or subordinate to its main object. For example, the main object of a merger agreement may be for one undertaking to buy a particular manufacturing operation from another. The added obligation of supplying raw materials to enable the manufacturing operation to continue is directly related to the merger agreement, but subordinate to it.

¹⁸ Other than CCCS.

¹⁹ Part 7.

THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

- 9.8 Any contractual arrangements which go to the heart of the merger, such as the setting up of a holding company to facilitate joint control by two independent companies of a new joint venture company, are not characterised as subordinate. Such arrangements are part of the merger agreement itself and will form part of the assessment of the merger under the Act.
- 9.9 A restriction is not automatically deemed directly related to the merger simply because it is agreed at the same time as the merger or is expressed to be so related. If there is little or no connection with the merger, such a restriction will not be ancillary.
- 9.10 It must also be established whether the restriction is necessary to the implementation of the merger. This is likely to be the case where, for example, in the absence of the restriction, the merger would not go ahead or could only go ahead at substantially higher costs, over an appreciably longer period, or with considerably greater difficulty. In determining the necessity of the restriction, considerations such as whether its duration, subject matter and geographical field of application are proportionate to the overall requirements of the merger will also be taken into account. CCCS will consider all these factors in the context of each case.
- 9.11 If equally effective alternatives are available for attaining the same objective, the merger parties must demonstrate that they have chosen the alternative that is the least restrictive of competition.

Examples of Ancillary Restrictions

- 9.12 The following examples set out some general principles on how some common ancillary restrictions (for example non-compete clauses, licences of intellectual property and know-how, and purchase and supply agreements) will be assessed.
- **Non-compete clauses:**
Such clauses, if properly limited, are generally accepted as essential if the purchaser is to receive the full benefit of any goodwill and/or know-how acquired with any tangible assets. CCCS will consider the duration of the clause, its geographical field of application, its subject matter and the persons subject to it. Any restriction must relate only to the goods and services of the acquired business and apply only to the area in which the relevant goods and services were established under the previous/current owner. As an indication, CCCS has in previous merger cases accepted non-compete clauses for periods ranging from two (2) to five (5) years.
 - **Licences of intellectual property and know-how:**
Where an undertaking acquires the whole or part of another undertaking, the transaction may include the transfer of rights to intellectual property or know-how. However, the seller may need to retain ownership of such rights to exploit them in the remaining parts of its business. In such cases, the purchaser will normally be guaranteed access to the rights under licensing arrangements. In this context, restrictions in exclusive or simple licences of patents, trade-marks, know-how and similar rights may be accepted as necessary to the implementation of the merger and, therefore, covered by the definition of ancillary restrictions in the Act. The licences may be limited in terms of their field-of-use to the activities of the business acquired, and may be granted for the entire duration of the patents, trade- marks of similar rights, or the normal economic life of any know-how recorded earlier. If the licences contain restrictions not within any of the above categories, they are likely to fall outside the definition of an ancillary restriction.
 - **Purchase and supply agreements:**
Purchase and supply agreements may be acceptable where an acquired business was formerly part of an integrated group of companies and relied on another company in the group for raw materials, or where it represented a guaranteed outlet for the company's products. In such circumstances, purchase and supply agreements between the new and former owners may be considered ancillary for a transitional period so that the businesses concerned can adapt to their new circumstances. Exclusivity will not, however, be acceptable, save in exceptional circumstances.

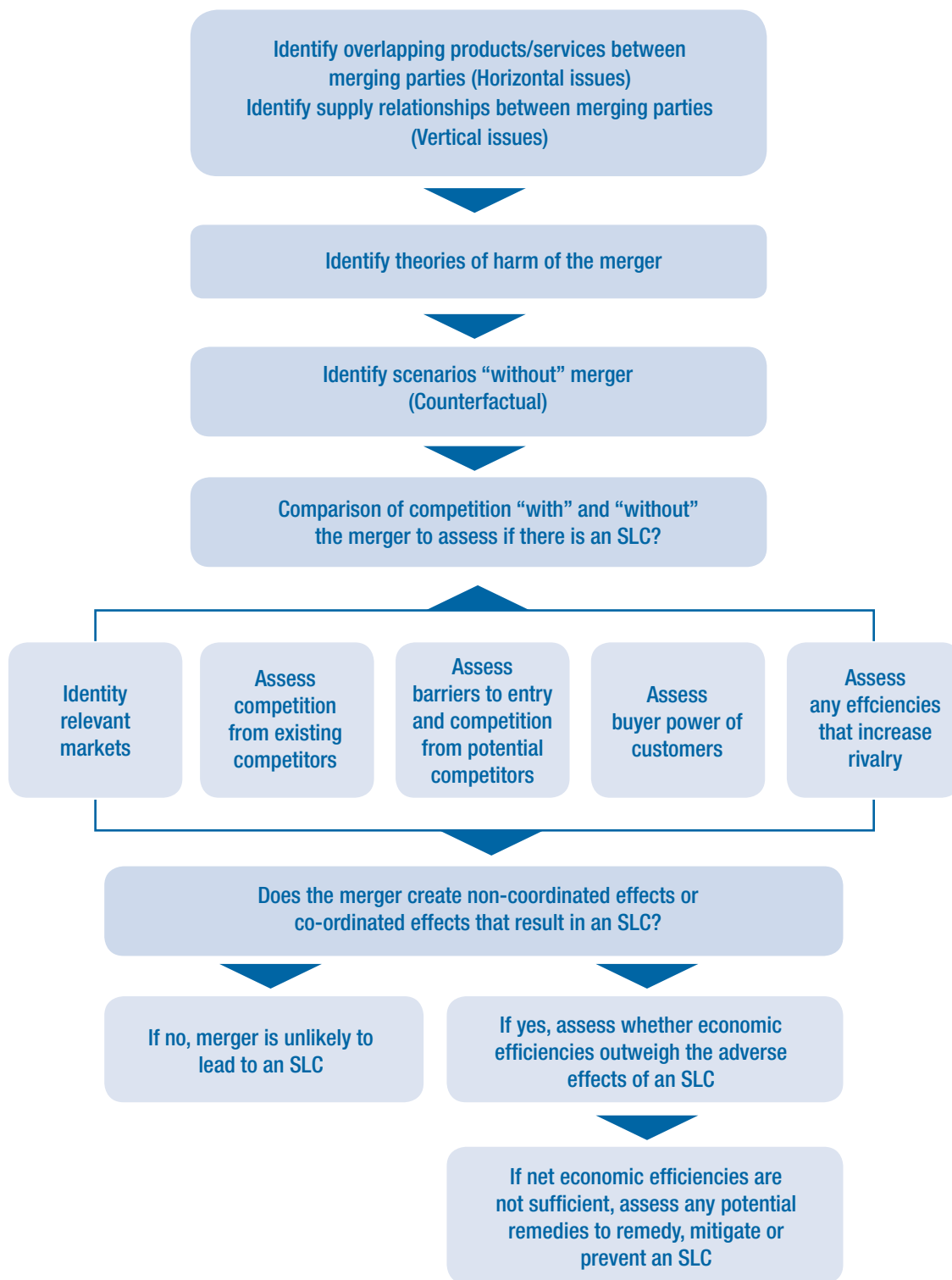
Agreements and Conduct Giving Rise to a Merger

- 9.13 Agreements and conduct giving rise to a merger will be dealt with under Part 3, Division 4 of the Act. Where a merger situation is anti-competitive, action will be taken under this division.

10 GLOSSARY

Act	Competition Act (Chapter 50B)
Ancillary restriction	Agreement, arrangement or provision which is “directly related and necessary to the implementation” of the merger. Ancillary restrictions are excluded from the section 34 prohibition and section 47 prohibition under the Third Schedule to the Act.
Anticipated merger	Arrangement that is in progress or in contemplation that, if carried into effect, will result in the occurrence of a merger referred to in section 54(2) of the Act.
Applicant(s)	The merger party or parties who have filed an Application.
Application	Application for a decision in relation to a merger situation, by way of notification under sections 57 or 58 of the Act.
CCCS	Competition and Consumer Commission of Singapore
CR3	Concentration ratio (i.e. the aggregate market share) of the three largest firms in the market.
Merger	A merger as defined in section 54 of the Act.
Merger parties	The parties to an anticipated merger, or the parties involved in a merger, as the case may be, including the merged entity.
Merger situation	Refers to both mergers and anticipated mergers.
SLC	Substantial lessening of competition in the relevant market in Singapore.
Theory of Harm	Theory on potential harm arising from the loss of rivalry between the merging firms. Theory can include type of harm, extent of harm and who would be harmed, post-merger.

11 FLOWCHART: GENERAL FRAMEWORK FOR SUBSTANTIVE ASSESSMENT OF MERGERS



12 EXAMPLES OF SITUATIONS THAT GIVE RISE TO JOINT CONTROL

- 12.1 This Part discusses various situations which CCCS may regard as giving rise to joint control, including equality in voting rights or in representation on decision-making bodies, veto rights and joint exercise of voting rights. Some of the other considerations relevant to the determination of whether joint control exists will also be covered. The illustrations provided in this Part are not exhaustive and situations not covered by or not referred to in this Part should not be assumed to be beyond the scope of the merger provisions.
- 12.2 The illustrations provided in this Part are also relevant to CCCS's determination of whether *de facto* control, referred to in paragraphs 3.11 and 3.12 above, exists.

Equality in Voting Rights or Appointment to Decision-Making Bodies

- 12.3 The clearest form of joint control exists where there are only two parent companies which share equally the voting rights in a joint venture. Equality may also be achieved when the parent companies have the right to appoint an equal number of members to the joint venture's decision-making bodies. It is not necessary for a formal agreement to exist between the parent companies. However, where there is a formal agreement, it must be consistent with the principle of equality between the parent companies, by laying down, for example, that each parent is entitled to the same number of representatives on the management bodies and that none of the members have a casting vote.

Veto Rights

- 12.4 Joint control may exist in a joint venture even where there is no equality between the two parent companies in votes or in representation in decision-making bodies, or where there are more than two parent companies. This is the case where minority shareholders have additional rights which allow them to veto decisions that are essential to the strategic commercial behaviour of the joint venture. These veto rights may be set out in the agreement establishing the joint venture or conferred by agreement between its parent companies. The veto rights themselves may operate by means of a specific quorum required for decisions taken at the shareholders' meeting or by the board of directors, to the extent that the parent companies are represented on this board. It is also possible that strategic decisions are subject to approval by a body such as a supervisory board, where the minority shareholders are represented and form part of the quorum needed for such decisions.
- 12.5 These veto rights must be related to strategic decisions on the business activities of the joint venture. They must go beyond the veto rights which are normally accorded to minority shareholders to protect their financial interests as investors in the joint venture. The protection normally accorded to minority shareholders is related to decisions regarding the essence of the joint venture, such as changes in the joint venture agreement, changes in the capital or liquidation. Thus, a veto right which allows minority shareholders to prevent the sale or winding-up of the joint venture does not confer joint control on the minority shareholder concerned.

THE SUBSTANTIVE ASSESSMENT OF MERGERS 2016

- 12.6 In contrast, veto rights conferring joint control typically pertain to decisions and issues such as the budget, the business plan, major investments or the appointment of senior management. The acquisition of joint control, however, does not require that the acquirer has the power to exercise decisive influence on the day-to-day running of an undertaking. The crucial element is that the veto rights are sufficient to enable the parent companies to exercise such influence in relation to the strategic business behaviour of the joint venture. Moreover, it is not necessary to establish that an acquirer of joint control over the joint venture will actually make use of its decisive influence. The possibility of exercising such influence and, hence, the mere existence of the veto rights, is sufficient.
- 12.7 In order to acquire joint control, it is not necessary for a minority shareholder to have all the veto rights mentioned above. It may be sufficient that only some, or even one such right, exists. Whether or not this is the case depends upon the precise content of the veto right itself and also the importance of this right in the context of the specific business of the joint venture.
- 12.8 The following lists certain types of veto rights which may confer joint control.
- Appointment of management and determination of budget:
Normally the most important veto rights are those concerning decisions on the appointment of the management and the budget. The power to co-determine the structure of the management confers upon the holder the power to exercise decisive influence on the commercial activities of an undertaking. The same is true with respect to decisions on the budget since the budget determines the precise framework of the activities of the joint venture and, in particular, the investments it may make.
 - Veto rights over business plan:
The business plan normally provides details of the aims of an undertaking, together with the measures to be taken in order to achieve those aims. A veto right over this type of business plan may be sufficient to confer joint control, even in the absence of any other veto right. In contrast, where the business plan contains merely general declarations concerning the business aims of the joint venture, the existence of a veto right will be only one element in the general assessment of joint control but will not, on its own, be sufficient to confer joint control.
 - Veto rights over investments:
In the case of a veto right on investments, the importance of this right depends, first, on the level of investments which are subject to the approval of the parent companies and, second, on the extent to which investments constitute an essential feature of the market in which the joint venture is active. In relation to the first criterion, where the level of investments necessitating approval of the parent companies is extremely high, this veto right may be closer to the normal protection of the interests of a minority shareholder than to a right conferring a power of co-determination over the commercial activities of the joint venture. With regard to the second criterion, the investment activity of an undertaking is normally an important element in assessing whether or not there is joint control. However, there may be some markets where investment does not play a significant role in the market behaviour of an undertaking.
 - Market-specific rights:
Apart from the typical veto rights mentioned above, there exist a number of other veto rights related to specific decisions which are important in the context of the particular market of the joint venture. One example is the decision on the technology to be used by the joint venture, where technology is a key feature of the joint venture's activities. Another example relates to markets characterised by product differentiation and a significant degree of innovation. In such markets, a veto right over decisions relating to new product lines to be developed by the joint venture may also be an important element in establishing the existence of joint control.

- 12.9 In assessing the relative importance of veto rights, where there are a number of them, these rights should not be evaluated in isolation. On the contrary, the determination of whether or not joint control exists is based upon an assessment of these rights as a whole. However, a veto right which does not relate either to commercial activities and strategy or to the budget or business plan cannot be regarded as giving joint control to its owner.

Joint Exercise of Voting Rights

- 12.10 Even in the absence of specific veto rights, two or more undertakings acquiring minority shareholdings in another undertaking may obtain joint control. This may be the case where the minority shareholdings together provide the means for controlling the target undertaking. This means that the minority shareholders will together have a majority of the voting rights, and they will act together in exercising these voting rights. This can result from a legally binding agreement to this effect, or it may be established on a *de facto* basis.
- 12.11 The legal means to ensure the joint exercise of voting rights can be in the form of a holding company to which the minority shareholders transfer their rights, or an agreement by which they undertake to act in the same way (pooling agreement).
- 12.12 Under exceptional circumstances, collective action can occur on a *de facto* basis where strong common interests exist between the minority shareholders, to the effect that they would not act against each other in exercising their rights in relation to the joint venture. In the case of acquisitions of minority shareholdings, the prior existence of links between the minority shareholders or the acquisition of the shareholdings by means of concerted action will be factors indicating such a common interest.
- 12.13 In the case where a new joint venture is established, as opposed to the acquisition of minority shareholdings in a pre-existing undertaking, there is a higher probability that the parent companies are carrying out a deliberate common activity. This is true, in particular, where each parent company provides a contribution to the joint venture which is vital for its operation (e.g. specific technologies, local know-how or supply agreements). In these circumstances, the parent companies may be able to operate the joint venture with full cooperation only with each other's agreement on the most important strategic decisions, even if there is no express provision for any veto rights. The greater the number of parent companies involved in such a joint venture however, the more remote the likelihood of this situation occurring.
- 12.14 In the absence of strong common interests such as those outlined above, the possibility of changing coalitions between minority shareholders will normally exclude the assumption of joint control. Where there is no stable majority in the decision-making procedure and the majority can, on each occasion, be any of the various combinations possible amongst the minority shareholders, it cannot be assumed that the minority shareholders will jointly control the undertaking. In this context, it is not sufficient that there are agreements between two or more parties having an equal shareholding in the capital of an undertaking which establish identical rights and powers between the parties. For example, in the case of an undertaking where three shareholders each own one-third of the share capital, and each elect one-third of the members of the Board of Directors, the shareholders do not have joint control since decisions are required to be taken on the basis of a simple majority. The same considerations also apply in more complex structures, for example, where the capital of an undertaking is equally divided between three shareholders and where the Board of Directors is composed of twelve members, each of these three holders A, B and C electing two, another two being elected by A, B and C jointly, whilst the remaining four are chosen by the other eight members jointly. In this case, there is also no joint control, and hence no control at all within the meaning of the merger provisions.

Other Considerations in Joint Control

- 12.15 Joint control is not incompatible with one of the parent companies enjoying specific knowledge of, and experience in, the business of the joint venture. In such a case, the other parent company can play a modest or even non-existent role in the daily management of the joint venture where its presence is motivated by considerations of a financial, long-term strategy, brand image or general policy nature. Nevertheless, it must always retain the possibility of contesting the decisions taken by the other parent company, without which there would be sole control.
- 12.16 For joint control to exist, there should not be a casting vote for one parent company only. However, there can be joint control when this casting vote can be exercised only after a series of stages of arbitration and attempts at reconciliation or in a very limited field.