ASSESSING THE “UNILATERAL” EFFECTS ON HORIZONTAL NON-COORDINATED MERGER

INTERNSHIP PROJECT REPORT
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UNDER GUIDANCE OF
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This dissertation has been prepared by the author as an intern under the Internship programme of Competition Commission of India for academic purposes only. The views expressed are personal and do not reflect the view of the Commission in any manner. This report is the intellectual property of the Competition Commission and the same or any part thereof may not be used in any manner whatsoever without express permission of the Commission in writing.
This dissertation is an effort made by me with the astute guidance of my mentor, Mr. P.K Purvar Advisor (Combination Division) of the Competition Commission of India. His valuable inputs and constant encouragement has inspired me to carry out this research fruitfully. He gave me his valuable time to discuss the facets of this topic and guided me towards an enlightening and holistic research.

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I am indebted towards Competition Commission of India, for providing me an opportunity to have a learning experience.
# ACRONYMS

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<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>CCI</td>
<td>Competition Commission of India</td>
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<td>AAEC</td>
<td>Appreciable Adverse Effect on Competition</td>
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<td>DOJ</td>
<td>Department of Justice</td>
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<td>EUMR</td>
<td>European Merger Regulation</td>
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<td>FTC</td>
<td>Federal Trade Commission (USA)</td>
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<td>HHI</td>
<td>Herfindahl-Hirschman index</td>
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<td>M &amp; A</td>
<td>Merger and Acquisition</td>
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<td>MRTP</td>
<td>Monopolies restrictive trade practices</td>
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<tr>
<td>SSNIP</td>
<td>Small but significant and non-transitory increase in price</td>
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<tr>
<td>SLC</td>
<td>Significantly Lessening Competition</td>
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<tr>
<td>SIEC</td>
<td>Significantly Impede Effective Competition</td>
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<td>OJ</td>
<td>Official Journal</td>
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1. INTRODUCTION: WHY COMPETITION LAW?

The belief that competition amongst undertakings produces the best outcomes for society is a thesis based on economic theory that employs models of perfect competition and monopoly, and concepts of welfare and efficiency. It is possible for systems of competition law to pursue objectives other than the economic ones of welfare and efficiency. Whether they should and, if so, what other objectives should be pursued is extremely controversial. The 3 central concepts used in competition law are market power, market definition and barriers to entry.

Over the past one and a half decade, with globalization the overall approach to economic management in India has been revised towards greater market orientation. Wide-ranging economic reform measures have been undertaken. The government assuming the role of a facilitator rather than a controller and intervenes by exception. Economic reforms have been undertaken in policies relating to industrial licensing, foreign trade, foreign investment, technology imports, financial sector, etc.

These efforts towards ensuring a competitive economy have got a further impetus with the Government of India making ‘competition’ a law of immense importance with its increasing importance.

In the present research, I would do a comprehensive study on the unilateral effects on horizontal merger of the Competition policies in India and foreign jurisdiction including UK, EU and USA with reference to Merger Regulation (Section 5 & 6), EU Merger Regulation, US Merger and UK Merger Regulation. A comparative overview of unilateral effects or ‘Single Firm Dominance’ of Merger in EU, USA and India will be considered and various economic factor that need to be considered and incorporated in Indian Merger Regulation. This report discusses the likely impact of the inclusion of unilateral effects analysis in Merger Control.

First it gives a general introduction to unilateral effects analysis in India and EC Merger Control regime, US Merger and illustrates the tentative differences in approach when compared with traditional dominance test. Secondly, the report examines merger examines cases in which
the Commission has already undertaken effect type analysis. Building on the above considerations, the report shall analyze the possible impact of the introduction of unilateral effects analysis on the conduct and outcome of Merger Control proceedings. The report concludes that the Commission will make substantial use of the new “appreciable adverse effect on competition” test.

Thus, in the end it can be said the Competition law upholds the workings of the free market economy by policing the conduct of firms as they compete in the market. Since the inception of the Commission, it has relentlessly been adopting and working on the decisions involving complex and difficult analysis within the stringent time period prescribed by the Competition Act.
2. PURPOSE OF MERGER CONTROL

2.1 Introduction

The purpose of merger control is to enable competition authorities to regulate changes in market structure by deciding whether two or more commercial companies may merge, combine or consolidate their business into one. It has been that the authorities are hostile to anti-competitive agreements concluded between independent undertakings.

Mergers may raise severe competition concerns. In particular, they may result in the undertakings acquiring or strengthening a position of market power and, consequently, in an increase in the market price of the products or services on the relevant market. However mergers also give the owner of a business the opportunity to sell it. Without this possibility, entrepreneurs might be reluctant to start a business. Also mergers provide many efficiency opportunities.

The reasons\(^1\) for not making mergers unlawful per se or for not even coming anywhere near such a rule are plain. Widespread prohibition of merger would impose serious, if not intolerable, burdens upon owners of businesses who wished to liquidate their holdings for irreproachable personal reasons. Moreover, economic welfare is significantly served by maintaining a good market for capital assets. Most importantly, a policy of free transferability of capital assets tends to put them in the hands of those who will use them to their utmost economic advantage, thus tending to maximize society’s total output of goods and services.

Growth by merger ...will often yield substantial economies of scale – in production, research, distribution, cost of capital and management. Entry by merger... may stimulate improved economic performance in an industry characterized by oligopolistic lethargy and inefficiency. Finally, acquisition of diversified lines of business, by stabilizing profits, may minimize the risk of business failure and bankruptcy\(^2\).

\(^{1}\) D. Turner, ‘Conglomerate Mergers and Section 7 of the Clayton Act’(1965) 78 Harvard LR 1313,1317
\(^{2}\) D. Turner, ‘Conglomerate Mergers and Section 7 of the Clayton Act’(1965) 78 Harvard LR 1313,1317
2.2 Purpose underlying the Principles for Merger

A. The Motives for, and Advantages of, a Merger

(i) Efficiency
In many cases the parties will state that the main motivation for their merger is that the merged entity will be more efficient. The entity may be able to exploit economies of scale in production. Such economies will be of particular importance in a market in which the cost of production of a product is high in comparison to the size, or the anticipated size, of the market or where there is a minimum efficient scale of production. The merger may also give rise to other operating efficiencies such as economies of scope, marketing efficiencies, efficiencies arising from broader product lines, streamlining of the sale force efficiencies arising from integration of complementary activities or the ability to pool research and development skills.

(ii) Barriers to Exit
It has already been noted that few people would go to the trouble to set up a business if they could not sell it when they had enough or when they wished to realize capital profits from it. In particular, many smaller business owners may wish to sell their business if no successor is available.

(iii) Failing Undertakings, Unemployment and/or Industry Stability
A merger may provide an escape route for a company facing an otherwise inevitable liquidation. In these circumstances the possibility of selling the business to another may mean that assets are kept in production that creditors, owners and employees are protected from adverse consequences of the undertaking failure and that stability is preserved in a critical industry sector.

B. The Adverse Consequence of Merger
More important perhaps than focusing on the benefits of a merger is the answer to the question: why should mergers be prohibited? When, and on what grounds, should a competition authority take steps to interfere with the market for corporate control? Failure to agree on these key issues was one of the factors which seriously delayed the introduction of any comprehensive systems of merger control at the Community level.
(1) Damaging effect on the Competitive Structure of the Market

There is an inherent danger that the undertakings may wish to merge in order to achieve or to strengthen their market power. Both horizontal and vertical merger may lead to dominance or the acquisition of market power.

(2) A Fear of Big Business

Mergers may cause other concerns apart from competition ones. It is believed that it would create large businesses which will have adverse impact for the freedom of society more generally. It is feared that too great an economic concentration is anti-democratic and restricts individual freedom and enterprise.

(3) Special Sectors and Fear of Overseas Control

It may be believed that tighter control should be exercised over mergers which occur in particularly sensitive sectors. In these sectors it might be thought that a broader range of factors should be taken into account whether or not a merger operates in the public interest.

2.3 Kinds of Merger: A Comparative Study of Merger Regulation in US EU and India

There are 3 kinds of merger between two firms

1. Horizontal Mergers

2. Vertical Mergers/Conglomerate Mergers

1. Under the Horizontal Merger there 2 practices wherein the firms abuse their market position through tacit collusion/coordinated effects on a Horizontal Merger or unilateral Single firm Dominance through non-coordinated merger

2. Vertical Merger/Non-Horizontal Merger the authorities are concerned that one of the parties to such a merger has market power in at least one market; vertical and conglomerate mergers may harm competition through:

- Foreclosure of a distinct upstream, downstream or related market; or
Changing the structure of competition on a market in such a way that the firms operating on it are likely to coordinate their behavior.

The practice of anti-competitive merger conduct can be analyzed in line of the above 3 forms of merger. For simplification it can be seen that in case of horizontal mergers there are 2 practices either the firm abuse their market position through tacit collusion or coordinated effects on a horizontal merger or unilateral single firm dominance/non-coordinated merger.

**EUMR Law**

With the adoption of a new substantive test in the revised Merger Regulation, and the publication of the European Commission Guidelines on the assessment of horizontal merger (“EC Horizontal Merger Guidelines”). The substantive test under the ECMR is whether the merger would “significantly impede effective competition” in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position. The test came into force on May 1, 2004. The Commission has provided guidance on its approach to substantive issues under the ECMR by publishing guidelines on the assessment of horizontal mergers (“Notice on Horizontal Mergers and Notice on Non-Horizontal Mergers”).

The unilateral effects analysis is poised to become an integral part of merger review in the European Union. Notwithstanding the Commission’s insistence on a European terminology (“non-coordinated rather than “unilateral effects”), the EC thus embraces a concept that has gained substantial traction in the US since its explicit recognition in the 1992 Horizontal Merger Guidelines as one of a “substantial lessening of competition”(SLC) under S7 of the Clayton Act. This was a very interesting development as the Commission was hesitant to recommend any departure from the traditional dominance test in order to bring the EC Merger regime closer to the US SLC test.

**US Law**

Merger policy has shown several interesting new developments over the past years. The Horizontal Merger Guidelines describe the principal analytical techniques and the main
types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition. The relevant statutory provisions include Section 7 of the Clayton Act, 15 U.S.C. § 18, Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2, and Section 5 of the Federal Trade Commission Act. Most particularly, Section 7 of the Clayton Act prohibits mergers if “in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.”

A primary goal of the 2010 guidelines is to help the agencies identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that either be competitively beneficial or likely will have no competitive impact on the marketplace. To accomplish this, the guidelines detail the techniques and main types of evidence the in the U.S., the policy principles have been modified to incorporate recent theoretical developments in Industrial Organization, such as the analysis of oligopoly behavior and the role of efficiencies. This evolution is illustrated by the various revisions of the Merger Guidelines. At the same time, U.S. policy practice has shown significant changes. In particular, there has been an increasing reliance on empirical methods and simulation analysis. The evaluation of mergers under Section 7 of the Clayton Act is undergoing a significant shift. Both the courts and the federal antitrust agencies increasingly are requiring a fully articulated economic basis for concluding that a merger likely will result in anticompetitive effects, and they are reducing the strength of the presumption of illegality based solely on market concentration, established in United States v. Philadelphia National Bank. Accordingly, an increasing emphasis is now placed on "competitive effects analysis," i.e., the evaluation of market conditions beyond market concentration that affect the likelihood that a proposed merger will result in adverse competitive effects.

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4 US Horizontal Merger Guidelines 2010
The latest revision of the federal antitrust agencies' Merger Guidelines is the most prominent indication of this shifting emphasis\(^6\). These potential adverse effects may be caused by coordination among competitors or unilateral conduct by the merged firm. A significant economic literature describes unilateral anticompetitive conduct and the closely related subject of dominant firm behavior\(^7\).

In Europe, policy principles have evolved more slowly, in part because of the shorter experience with European merger cases. But once the market is defined, the actual merger investigation is still largely based on the traditional criterion of dominance, including the assessment of the market shares and qualitative criteria such as the easy of entry and buyer power.

### 2.4 International Practice of Merger Regulation - Convergence and Divergence

**i) General Overview – EU Law**

In order to assess whether or not the merger is compatible with the common market the Commission must determine whether or not it would be SIEC (significantly impede effective competition) that is whether the merger is the cause of SIEC. The creation or the strengthening of a dominant position is a primary form of such competitive harm and provides ‘an important indication as to the standard of competitive harm that is applicable when determining whether a concentration is likely to impede effective competition to a significant degree.’\(^8\) EU case laws and decisional practice clarify when mergers will lead to an SIEC. The Commission’s Horizontal Merger Guidelines are, therefore intended to provide a sound economic framework for the assessment of horizontal concentration with a view to determining whether or not they likely to be declared compatible with the common market.

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\(^7\) Id. § 2.2. Note that the Guidelines describe the analysis of coordinated activity in terms of "coordinated interaction" and "coordination," i.e., as what traditionally is referred to as "conduct" or "behavior." Id. § 2.1. By contrast, the Guidelines' analysis of unilateral anticompetitive conduct is denominated as an analysis of unilateral "effects." Id. § 2.2. Nevertheless, the internal discussion is properly characterized as an analysis of conduct. Id. ("merging firms may find it profitable to alter their behavior unilaterally").

\(^8\) Available on DG Comp’s website
Non-horizontal Merger guidelines are also published. These guidelines describe an analytical approach to be followed and do not provide a mechanical checklist requiring application of all the mentioned factors in each and every case. The Commission enjoys a degree of discretion in determining whether or not to take into account certain factors in a given case.

In *Airtours plc v Commission*\(^9\), the judgment established that in the absence of single firm dominance, the Commission was entitled to prohibit a merger only if it could establish that the criteria for coordinated effects. This decision was perceived to create certain ‘gap’ in the powers of the Commission which needed to be filled. The reason was that merger in oligopolistic markets that did not create or strengthen a position for a single firm dominance and did not satisfy the onerous criteria necessary, might nevertheless harm the consumers. For this purpose the Commission introduced the clarification to the meaning of the term ‘dominance’ to include non-coordinated effects.

**ii) Market Definition - Central Role of market definition under EU Law**

A proper definition of the relevant market is a necessary precondition for any assessment of the effect of concentration on competition.\(^10\) An economic appraisal of the impact of merger on the competitive process whether or not it will SIEC requires as a starting point, that the relevant market is defined. The definition of a market is crucial to enable the Commission to attain meaningful information regarding the market power that the merged parties will acquire, to understand how competition operates on the market and to make its competitive assessment. The purpose of market definition is to identify in a systematic way the competitive constraints facing the merged entity.\(^11\) Thus the main purpose of market definition is to identify in a systematic way the immediate competitive constraints facing the merged entity. It is not an end in itself but a tool to identify situations where there might be competition concerns’.

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\(^11\) Horizontal Merger Guidelines [2004] OJ C315/5 para.10
**US Law: Market Definition under Horizontal Merger Guidelines**

When the Agencies identify a potential competitive concern with a horizontal merger, market definition plays two roles. First, market definition helps specify the line of commerce and section of the country in which the competitive concern arises. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration. The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger’s likely competitive effects. Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to raise significantly can itself establish that those products form a relevant market.

**Relevant Market:** Under the US Merger Guideline, there are tests that are involved to understand the relevant market

a). The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets. The test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products (“hypothetical monopolist”) likely would impose at least a small but significant and non-transitory increase in price (“SSNIP”) on at least one product in the market, including at least one product sold by one of the merging firms.

When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product.

b). Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger. If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as
the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test.

This methodology is used because normally it is possible to quantify “small but significant” adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects. The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a “small but significant” increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms’ positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent.

c). Implementing the Hypothetical Monopolist Test

In considering customers’ likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, demand of customers, information from buyers, including surveys, conduct of industry participants. These are few factors considered essential in assessment.

d) Product Market Definition with Targeted Customers

If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers.

Product Market Test

Market definition focuses solely on demand substitution factors, i.e., on customers’ ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these
Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test is designed to ensure that candidate markets are not overly narrow in this respect.

Under the US Guidelines on Horizontal Merger, elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition. Such unilateral effects are most apparent in a merger to monopoly in a relevant market, but are by no means limited to that case. Whether cognizable efficiencies resulting from the merger are likely to reduce or reverse adverse unilateral effects is addressed in the Guidelines.

Geographic Market Definition

The arena of competition affected by the merger may be geographically bounded if geography limits some customers’ willingness or ability to substitute to some products, or some suppliers’ willingness or ability to serve some customers. Both supplier and customer locations can affect this.

In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers. In other cases, notably if price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, the Agencies may define geographic markets based on the locations of customers.

In considering likely reactions of customers to price increases for the relevant product(s) imposed in a candidate geographic market, the Agencies consider any reasonably available and
reliable evidence, including: Shifts of customers purchases between different geographic locations in response to relative changes in price or other terms and conditions; the cost and difficulty of transporting the product, in relation to its price; evidence on whether sellers base business decisions on the prospect of customers switching between geographic locations in response to relative changes in price or other competitive variables; the costs and delays of switching from suppliers in the candidate geographic market to suppliers outside the candidate geographic market; and the influence of downstream competition faced by customers in their output markets.

The US Merger Guidelines highlight the abovementioned tests in evaluating the relevant market and then based on effects it looks into the thresholds to assess the anti-trust practice.
3. ECONOMIC CONCEPTS IN DETERMIING UNILATERAL EFFECTS OF MERGER

3.1 General Principle: Unilateral Market Power

An individual firm has "unilateral" market power if it can raise price above the competitive level without inducing customers to reduce their purchases to a degree that makes the price increase unprofitable\(^\text{12}\). There are two broad categories of potential distinctions between firms that support the ability of a firm to exercise unilateral market power:

1. Cost differences and
2. Differentiated products.

A traditional economic model\(^\text{13}\) of unilateral anticompetitive behavior includes a dominant firm and a "fringe" of competitors producing a homogeneous product. In the assumptions of the model the sole distinction between the dominant firm and the fringe firms is that each fringe firm has a substantial cost disadvantage relative to the dominant firm. The dominant firm's profit-maximizing price is significantly above its marginal cost because fringe firms' cost disadvantage limits their ability to expand their sales at the price determined by the dominant firm. In Economists 'jargon, the "elasticity of fringe supply" is too low to constrain the dominant firm to price competitively.

Unilateral anticompetitive behavior also can occur in markets with differentiated products. Here, differences among competitors' products rather than differences in their costs enable a firm to exercise unilateral market power. Strong customer preferences for a firm's product sometimes may imply that the reduction in sales of that product resulting from raising price above the competitive level is insufficient to prevent that price elevation from being profitable.

\(^{12}\) 1992 Guidelines, supra note 4, § 0.1. ("Circumstances may also permit a single firm, not a monopolist, to exercise market power through unilateral or non-coordinated conduct the success of which does not rely on the concurrence of other firms in the industry or on coordinated responses by those firms");

3.2 Economic Analysis of the Impact of Merger in Oligopolistic Market

This part focuses on the economic analysis of the impact of mergers on market power in oligopolistic industries.

Competition in Oligopolistic Market -

In this section, we consider what could be expected to result from competition between firms when each firm is reacting to market conditions but is not expecting to influence the future behavior of other firms. If firms are producing the same good with the same technology then, if many firms are effectively active\textsuperscript{14} in the market, and absent tight capacity constraints, one would expect to see competitive prices and outputs (specifically with output priced at or close to marginal cost). Conversely, when there are a limited number of firms, noncompetitive outcomes may arise, particularly if the goods (or services) produced by different firms are not in fact identical, but are imperfect substitutes for each other, even while belonging to the same market.

Study of Mergers in differentiated products –

Another important consideration is where products are differentiated on a market; some will be closer substitutes for each other than others. A merger between firms which produce products that are closer substitutes, is more likely to produce anti-competitive consequences.

Potential variations in the closeness of competition between competing firms that arises from product or geographical differentiation raises a number of additional complications in applying the traditional approach to assessing whether a merger gives to unilateral effects. It is argued that defining the relevant market is much more problematic in industries characterized by a high degree of differentiation. Also interpreting market shares in highly differentiated industries is rendered more difficult since the very essence of competition between differentiated products implies that the consumers do not consider all products to be equally substitutable. Where this is

\textsuperscript{14} This is unlikely in the presence of significant economies of scale or scope; such economies give rise to a “natural monopoly” or oligopoly type of industry, in which only a small number of firms can be effectively
the case, market shares provide a poor proxy for discriminating “close” competitors and “not so close” competitors.

A merger between firms selling differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost due to the price rise will merely be diverted to the product of the merger partner and, depending on relative margins; capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable prior to the merger.

3.3 Illustration of unilateral effects

The concept of ‘closeness’ of competition is illustrated in the following example. Suppose there are four firms A, B, C and D each with sales of 100. Suppose that if A raises its price by 5 percent, it will lose 20 percent, of its sales, which makes the price unprofitable. These sales would be diverted to the other three firms as shown below in Table. This table shows that 15 consumers divert from A to B, three divert to C and two divert to D. In this sense, B is a closer competitor to A than either C or D; the extent to which consumers would divert from A to B is understated by B’s market share. If A and B were to merge, then an increase in the post–merger price of products supplied by A would lead to the combined firm, AB losing only to 5 units of sales. In consequence, increasing the price of A by 5% is more likely to be profitable than a merger between A and D, where the same increase in the price of products supplied by A would lead to the loss of 18 units of sale.

<table>
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<th>Firm</th>
<th>Sales at current price(units)</th>
<th>Sales if A raises price 5 percent</th>
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<tbody>
<tr>
<td>A</td>
<td>100</td>
<td>80</td>
</tr>
<tr>
<td>B</td>
<td>100</td>
<td>115</td>
</tr>
<tr>
<td>C</td>
<td>100</td>
<td>103</td>
</tr>
<tr>
<td>D</td>
<td>100</td>
<td>102</td>
</tr>
</tbody>
</table>
This example illustrates that the degree to which a merger in a differentiated product market might result in a unilateral price increase depends on the relative “closeness” of the merging firms to one another. Based on market shares alone, B, C and D all appear to be providing an equally strong competitive constraint on A. However, examination of the diversion of sales from A to these firms shows that in this hypothetical example, B provides a much stronger pre-merger competitive constraint on A than either C or D since most of A’s lost sales went to B, indicating that A and B in some sense particularly ‘close’ competitors.

It is important to understand that the concept of closeness of competition cannot be divorced entirely from an assessment of market shares. In this example B, is said to represent a particularly close competitor because of the proportionate of sales lost to B exceeds that predicted by market share alone, on the basis of market shares, we would predict that six to seven units would be diverted to B whereas in reality the number of units diverted would be 15.

Assessing whether two firms represent particularly close competitors is an empirical question and cannot be determined solely with reference to physical or geographical attributes of the firms\(^\text{15}\).

### 3.4 Economic Consideration in Oligopolistic Market

There are various other factors which need to be considered besides market power and market definition, these are the ones which are not in the control of merged entities.

1. Countervailing Buyer Power

The Horizontal guidelines stresses that a competitive constraint can be exercised over possible non-coordinated or coordinated anti-competitive effects identified not only by competitors but by customers with countervailing buyer power. Such a buyer may have incentive to credibly threaten to find an alternative source of supplier perhaps by changing supplier, vertically

\(^{15}\) The Economics of EC Competition Law Concepts, *Application and Measurement* (3\(^{rd}\) edn., Sweet Maxwell, 2010); S. Bishop and M. Walker
integrating or persuading /sponsoring new entry, were the supplier to increase price. In such cases, the countervailing buyer power may neutralize the market power of the parties.

2. Entry, exit and potential competition
The second aspect that must be accounted for is the impact of the merger on the market structure.
Potential competition
First, a merger may induce a new firm to enter the market. Since the merger reduces the competitiveness of the industry, there is an increased scope for entry: the post-merger profitability of entry is higher than the pre-merger profitability of entry. Such entry could reduce and even eliminate any negative impact of the merger.
Clearly the likelihood of entry is higher when barriers to entry are low. Thus, an assessment of barriers to entry is required. It seems preferable to conduct this assessment in a separate part. Typically it will be based on different information than that used for the benchmark evaluation, and include qualitative judgments on such things as the know-how required or human capital.
We should point out here the link with the discussion of efficiency gains. A reason for adopting a lenient attitude when barriers to entry are low is not only that there are less competitive concerns but also that there is a stronger presumption in favor of efficiency gains.

In RyanAir /Aer Lingus, the Commission concluded that significant barriers to entry meant that new entry was most unlikely. In particular, other airlines did not have a large base in Dublin and they faced significant entry costs and capacity constraints in terms of obtaining slots at Dublin and destination airports. The Commission also noted that Ryan Air acted aggressively to new entrants. This reinforces the desirability of a lenient attitude: the absence of barriers to entry should be a factor that strongly favors the approval of a merger.

Exits
One should be concerned with the possible exit of currently active firms. In fact there is limited scope for that. A merger typically reduces competition. Indeed, it has been seen that, albeit any change in the cost structure, all market participants benefit from a merger. By increasing their profitability, the merger in fact reduces firms’ incentives to exit the market.

16 Case IV/M833, the Coca cola Company /Carlsberg A/S [1998] OJ L145/41
17 RyanAir /Aer Lingus T-342/07
This is not to say that exit cannot occur, but when this happens it is due to some other effect of the merger. In particular, an inefficient firm may exit the market if the merger creates an entity that is far more efficient than the pre-merger entity, thus if there are efficiency gains. But this occurs precisely when efficiency gains are so strong that the post-merger prices would be lower than their pre-merger levels in the absence of exit. Thus this occurs in situations where the merger is quite desirable. From a welfare perspective, there should be less concern about that, since efficiency gains will compensate for the exit of an inefficient producer. Indeed, the process by which inefficient firms are replaced by more efficient and innovative firms is one of the main engines of progress in an industry, described at length since the work of Schumpeter\textsuperscript{18}.

3. Efficiency Gains

Efficiency gains are not the object of this report, and are a matter for study in themselves.\textsuperscript{19} However there are clear links between the evaluation procedure for the likely impact of a merger and the treatment of efficiency gains. We discuss here some of these links. Efficiency gains can take many forms. First they may be achieved in the short-run or in the long-run, which may call for a different treatment. There may be generated by a better exploitation of the tangible assets of the firms\textsuperscript{20}:
- rationalization through the reallocation of the production
- exploitation of economies of scale (e.g., eliminating redundancies), or economies or scope investment. There may also be generated by the exploitation of intangible assets such as:
  - sharing of know-how
  - Management
  - R&D and innovation
  - Product line redefinition
  - Purchasing power

\textsuperscript{18} Schumpeter (1943), \textit{Capitalism, Socialism and Democracy}, see also Aghion and Howitt (1998), \textit{Endogenous Growth Theory}.
\textsuperscript{19} Efficiency gains are discussed at length on the issue N°5, 2001, of European Economy. We build on this issue for the discussion.
\textsuperscript{20} See for instance Perry and Porter (1985), Farrell and Shapiro (1990)
Some of these efficiency gains will be passed on to consumers, either through lower prices, or through the introduction of new products, or an improvement of the quality of the products. Other efficiencies, for instance the reduction of fixed costs, will translate only into larger profits.

4. Failure and Exiting Assets

A merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. This is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining: the projected market share and significance of the exiting firm is zero. If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.

The Agencies under the Horizontal Merger Guidelines of US do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.
4. PRINCIPLES OF COMPETITION HARM ON NON-COORDINATED HORIZONTAL MERGER

4.1 Introduction

Non-coordinated effects arise when, as a result of a merger, the merged group is able profitably to increase price or reduce quality, choice or innovation through its own acts without the need for a cooperative response from competitors.\(^{21}\)

If the merged group adopts such strategies, rivals may follow at least to an extent, with the consequence that any anti-competitive effects of merger are felt across the whole market (and not just by the merged group’s customers).\(^{22}\)

The Notice on Horizontal Mergers indentifies three principal theories of competitive harm which may arise in non-coordinated effects cases when the parties have overlapping activities. These factors as identified are whether considered separately or together, may lead the Commission to conclude that the merger is likely materially to harm consumers. Also this report considers whether a merger which creates efficiencies may form part of a theory of competitive harm, although this issue is not raised directly in the Notice of EU Merger Guideline.

The three points that require analysis are:

A. Merging Firms Have Large Market Shares
B. Differentiated Products
C. Competitors are unlikely to increase supply if price increase
D. Other factors which may give rise to non-coordinated effects

\(^{21}\) See the discussion of the scope of “non-coordinate effects” in the UK Office of Fair Trading Substantive Merger Guidelines, May 2003

\(^{22}\) It is to capture this point that the Commission uses the term “non-coordinate effects” to describe such theories such theories of competitive harm rather than “unilateral effects”
A. Merging Firms Have Large Market Shares

The larger the merged group’s market share, the more likely it is to enjoy market power, and the larger the increment in market share arising from the merger, the more likely the merged themselves, decisive proof that the merged group will hold market power, they comprise important evidence.

Under the horizontal guideline, “Although market shares and additions of market shares only provide first indications of market power and increases in market power, they are normally important factors in the assessment.”23

B. Differentiated Products

In markets involving differentiated products (i.e. products which consumers perceive to have different attributes from rival products) the intensity of competition between brands or physical locations may vary across the market. This means that an orthodox market share analysis, which ascribes equal value to every unit of sales of products which fall within the market definition, may be misleading.25 If the merging parties’ products are not regarded by customers as close substitutes, then relatively high market shares may not be indicative of market power. “The Notice on Horizontal Mergers states that a merger may significantly impede effective competition constraints on one or more firms, which consequently would have increased market power, without resorting to coordinated behavior”.26

The merged group’s incentive to raise the price of product A depends, in particular, on three factors:

(i). The closeness of substitution between products A and B27, in particular of their product attributes geographic location or perceived quality or reliability. Under the Notice of Horizontal

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23 Para 27 Notice on Horizontal Mergers
24 Notice on Horizontal Mergers, n32.Porter
26 Horizontal Guidelines Para 22(a)
27 Notice on Horizontal Merger, Para 28; Starek and Stockum, “What Makes Merger Anti-competitive?”
Mergers, states: “The higher the degree of substitutability between the merging firms’ products, the more likely it is that the merging firms will raise prices significantly”\(^28\).

(ii) The gross margin earned on B. The higher the gross margin, the greater the profit earned on each sale of B which is gained as a result of customers switching from A.

(iii). Efficiency Gains. The merged group’s most profitable strategy may be to increase its sales of A to take advantage of efficiency gains arising from the merger\(^29\).

Cases where the merged group would not have the ability profitably to raise the price of A in particular in the following circumstances:

(i) Rival suppliers’ products may be sufficiently close substitutes for the products supplied by the merging parties to defeat an attempt by the merged group profitably to raise the price of A\(^30\).

(ii) Actual and potential rival suppliers may have the incentive and the ability to enter the market as suppliers of close substitutes, or to reposition\(^31\) their products as closer substitutes for A in a way which is timely, and likely and sufficient to defeat any attempt profitably to raise the price of A.

C. Competitors are unlikely to increase supply if price increases

If the rival suppliers are unlikely to expand production in the short to medium term, then the merged group may have an incentive to increase its output with the aim to raising prices. A horizontal merger increases the merged group’s incentive to adopt such a strategy, because the merged group will have a larger base of sales on which to benefit from the higher margins arising from the increase in price.\(^32\) Rival suppliers may be unlikely to expand production because they face capacity constraints or if existing spare capacity is not cost effective.

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\(^28\) Para 28
\(^29\) “Mergers with Differential Products”[1996] Antitrust 23 Shapiro
\(^30\) Notice on Horizontal Mergers, Para. 28 and n37
\(^31\) US Horizontal Merger Guidelines, 1992
\(^32\) Notice on Horizontal Mergers, n45 stating that, when analyzing the scope for competitors to add new capacity, the Commission applies by analogy the principles relevant to new entry
D. Other factors which may give rise to non-coordinated effects

The notice on horizontal merger identifies three other factors which taken separately or together, may lead to a finding that a merger is likely to lead to a significant impediment to effective competition.

1. The Ability of Customers to Switch

Customers unable to switch for example, by the limited availability of alternative suppliers or by significant switching costs, are particularly vulnerable to price rises.\(^{33}\)

2. The likelihood that Competitors will increase Supply\(^{34}\)

If competitors cannot increase capacity then it may be easier for the merging firms to restrict output themselves and to benefit from price rises\(^{35}\). The ability of competitors to increase capacity in response to such a decision might be limited by capacity constraints the cost of increasing capacity or ‘barriers to entry’

In *MCI WorldCom/Sprint*\(^{36}\) for example the Commission prohibited a proposed merger of two global communications. The Commission considered that the combination of merged firms may create a super-tier provider of global internet connectivity. It will have an inherent strong position due to its absolute and relative size compared to its competitors. The combined entity will be able to sustain such behavior due to its capacity to discipline the market notably through the threat of selective degradation of its competitor’s internet connectivity offering and also through its essential ability to determine and agree any new technical development to enable advance internet services.

3. The Competitive Force Eliminated by the Merger –

Under the Merger guidelines merger is more likely to cause concern where it is with a firm that is likely to change the competitive dynamic of a market more than its market share suggests, e.g.

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\(^{33}\) Horizontal Merger Guidelines para.14
\(^{34}\) Ibid., para. 31
\(^{35}\) Case COMP/M. 3637, Total/Sasol/JV
\(^{36}\) Case COMP /M 1741
if the merger involves a new entrant or an important innovator in the market. In *Boeing/McDonnell* 37 the Commission considered the issue

4. Possible Coordinated Anti-Competitive Effects – Collective or Joint Dominance

Besides unilateral effects, the other form of anti-competitive effects is collective dominance. As explained earlier, the Horizontal Merger deals separately with the problem of coordinated effects or collective dominance. The Commission thus examines mergers to determine whether or not they will make coordination more likely to emerge in markets through the creation or strengthening of a collectively held dominant position. The guidelines state that coordination is more likely to emerge in market where it is relatively simple for the firms to reach a common understanding on terms of coordination and where there is some form of credible deterrent mechanism to ensure discipline; and the reaction of outsiders, customers or competitors will not jeopardize the results expected from the coordination 38.

Several cases have held collective dominance position in the EUMR like *France v Commission* 39, *Gencor v Commission* 40, *Airtours plc v Commission* 41 and in the *Sony /BMG* appeals the Commission clarified that a collective dominant position could be held by members of a tight oligopoly.

4.2 Techniques To Measure Degree of Substitutability

To simplify and adopt a better understanding the Commission in the horizontal merger guideline lists 8 techniques or evidence to measure the degree of substitutability which helps to measure the intensity of the competition between suppliers of differentiated goods. These are enumerated as under:

1. The bidding study

A bidding study 42 may be used in cases involving tender markets. This may show, for example, that the merging parties tended not to bid against one another; if they do there was always a third bidder present; when they did, they did not submit the lowest and lowest prices; and/or prices

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37 Case IV/M 877,[1997] OJ L 336/16
38 Horizontal Merger Guidelines, para. 41
40 T 102/96 [1999] All (EC) 289

31
were lower whenever a third bidder was present.\textsuperscript{43} In the cases \textit{Boeing/Mc Donnell Douglas}\textsuperscript{44}, shows that when Mc Donnell Douglas did not bid, where on average 7.6 per cent higher. In GE/Instrumentarium\textsuperscript{45} the Commission carried out to assess the closeness of competition on the markets for medical equipment. Finding in one market that Instrumentarium appeared to bid lower when GE was present and Philips tended to bid lower when both Instrumentarium and GE present.

2. Diversion Ratio

In this practice rough indicator of possible anti-competitive non-coordinated effects may be obtained by multiplying the diversion ratio by the gross margin. It identifies the proportion of sales of a product, A which would be lost to another product, B if the prices of A increased or if A was not available (i.e. it identifies customers second preferred choice)\textsuperscript{46}. This can be calculated econometrically if good data are available, survey evidence can be used.

3. Survey Evidence

It may be used to assess customers’ preferences for particular characteristics in products, provided that valid sampling procedures are used and the questions are framed neutrally\textsuperscript{47}. In \textit{Johnson & Johnson/Guidant}\textsuperscript{48} the Commission asked customers of the merging parties to identify the first and second next best alternatives to the products they currently purchased and used the responses to conclude that the parties were one another’s closest competitors. In \textit{Continental/Phoenix} the Commission asked customers and competitors to rank manufactures in six categories and found that the merging parties tended to rank first and second, indicating that the merger would result in the loss of Continental’s strongest competitor from the market.

4. Switching Data

It may be used to assess the closeness of competition. In \textit{T Mobile/ Orange Netherlands}\textsuperscript{49}, the commission considered evidence of switching flows and concluded that the parties were not close competitors as neither won a high proportion of the customers switching away from the other.

\begin{itemize}
\item \textsuperscript{43} 2002 draft Commission Notice on Horizontal Merger ,para 14
\item \textsuperscript{44} Case IV/M. 877 [1997] OJ L336/16
\item \textsuperscript{45} Case COMP/M 3083 [2004] OJ L109/1
\item \textsuperscript{46} Baker & Coscelli, “The Role of Market Shares in Differentiated Product Markets”[1999] E.C.L.R 273,p277
\item \textsuperscript{47} Shapiro, “Mergers with Differntiated Products”[1996] Antitrust 23,at p.25
\item \textsuperscript{48} Case Comp / M 3093
\item \textsuperscript{49} Case Comp/M 4748 para 41 and 42
\end{itemize}
5. Merger Simulation
It may be used to predict directly the likely effect of merger on price. In Volvo/Scania\textsuperscript{50} the Commission instructed economists to seek to measure directly the likely effects of the merger on the prices charged by heavy truck producers in various national markets. The study pointed to serious competition problems, but the Commission did not rely on it in reaching its decision to prohibit the transaction because of the novelty of the approach and disputes about the validity of the study.

6. Other econometric techniques
It may also be used. For example, in GE/Instrumentarium \textsuperscript{51}the Commission ran multiple regressions to seek to identify the likely effect of the merger on price in the light of the bidding data it collated. The parties supplied different types of medical equipment and tenders were invited for a wide variety of different specifications, so the Commission measured the price impact by examining the discounts proposed by the suppliers. In Rynair/ Aer Lingus\textsuperscript{52}, the Commission carried out of a price regression analysis to test whether the presence of one of the parties on a route was associated with a reduction in the fares of the other.

7. Shock Analysis
It can be used to assess the effects of previous launches of new products or similar significant changes in the operation of the market\textsuperscript{53}. In Piaggio/Aprilia \textsuperscript{54} the Commission assessed issues of closeness of competition in the supply of scooters below 50cc. Aprilia sales dropped significantly when it developed financial difficulties and reduced its production. The Commission identified the models which benefited most from this reduction in supply, finding that a Piaggio product benefited from the largest increase in market share.

8. Internal documents
Such a business plans, competitor analysis and marketing studies, may reveal the parties own perceptions about the relative market positions of the different products or the extent to which different rivals prices are taken into account in determining price.

\textsuperscript{50} Case Comp M/1672
\textsuperscript{51} COMP/M.3083
\textsuperscript{52} Case Comp/M 4439
\textsuperscript{54} International Competition Network, “ICN Investigation Techniques Handbook for Merger Review” June 2005
4.3 Distinction between Co-ordinated practice and Non- Coordinated practice

It is crucial to distinguish tacit collusion and non-coordinated practice in the market in order to study the post-merger effects. To begin with we see that tacit collusion supposes significant entry barriers (otherwise the collusion would be pointless since it would rapidly be undermined by new entry to the industry). But it could occur even in the absence of significant individual market power - for instance, when the firms present in the industry produce exactly the same good with the same technology.

A necessary condition of tacit collusion is that firms should be acting with the intention of influencing the future actions of their competitors. If firms are acting in a way that takes their competitors’ future actions entirely as given, and not as open to influence by the firm’s own actions in the present, then the situation is not one of tacit collusion, even if (as a result of the high concentration in the market) prices are significantly above marginal cost, or if other symptoms of non-competitive behavior are present. Note that even if firms are not expecting to influence their competitors, this does not imply that they are unresponsive to market conditions.

On the contrary, each firm will be taking its decisions regarding prices, output or other choice variables in a way that responds to market conditions (which themselves are the results of the decisions of other firms). To see this most clearly, suppose that in each relevant time period, firms’ decisions only involve the setting of prices or outputs for that period. We can abstract for the moment from other dimensions, such as investments, innovation, and so on, that may have a lasting impact on the industry. Nevertheless, if the distinction between these two kinds of situation is clear in principle, can they be distinguished in practice? Consider a situation in which one firm changes its behavior, say by making an investment in capacity. Shortly afterwards, one or more of its competitors adds to capacity as well. What could possibly lead us to decide whether the firms were reacting passively to market conditions or acting strategically to influence each other? Here it might be helpful to bear in mind the distinction between actions that are strategic complements and those that are strategic substitutes – these are, respectively, actions that normally induce a similar response from rivals and actions that normally induce an opposite
response, holding constant other features of the market environment such as the level of
competition.
Let us consider an example, wherein tacit collusion be seen and factors that influence tacit
collusion be considered.

*A Case Study for Tacit Collusion vs Non-coordinate Practice*

A case when the actions of one firm send information that changes the expectations of another.
Thus, even though a rise in capacity by firm A means that, for a given anticipated level of
demand, firm B should cut its capacity, the rise in capacity may convey information about a
likely increase in future demand that makes it optimal for B to increase capacity as well. This
may even trigger a “rush to be next” where all remaining firms react at once by expanding their
own capacity. More generally, things tend to be more complicated when accounting for market
dynamics. For example, if firms invest at the same time because they try to pre-empt each other,
what may look like positive correlation with strategic substitutes may in fact result from healthy
competition.

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**Box 1: Capacity choices: the case of airlines**

Airline A announces a doubling of its number of weekly flights on a key intra-European route
along with price cuts on that route. Airline B, two weeks later, announces price cuts and an
increase of 50% in the number of its weekly flights on that route (without making changes on
any other routes). How can the competition authorities tell whether this is individual rivalry or
tacit collusion? This depends on whether B was taking A’s capacity increase as given or was
hoping to influence A into reversing it. Some indicators:

☐ B’s price cut does not constitute evidence either way. Cutting prices in response to A’s
capacity increase would be a profit-maximising response in either case.

☐ B’s capacity increase *does constitute prima facie* evidence in favour of tacit collusion, since
the profit-maximising response to capacity increase by a competitor that is expected to persist is
to *cut* capacity. However, this depends on B’s not having increased its expectations about likely
future demand since the time of A’s announcement.

☐ In principle 2 weeks seems a short time lag so it is likely that B has not changed its
expectations (unless significant news events have intervened). However, it could be that A’s
announcement itself convinced B of the existence of significant additional price-sensitive
demand which could be satisfied even if A’s capacity increase persists. If internal documents to that effect exist, could be used to counter the *prima facie* evidence of tacit collusion.

In the context of merger control, the primary task is not to distinguish between individual rivalry and tacit collusion when they occur but, rather, to assess the competitive impact of a proposed merger, and therefore the likelihood that they will occur in the future. Since both types of situation may create competitive concerns, we should therefore assess the impact of a merger on both the exercise of individual market power and on the risk of tacit collusion. To assess the first type of effect, it is necessary to evaluate the impact of the merger on the behavior of the new entity, and also to account for the extent to which other firms could be expected to react to the modification of the new entity’s expected actions.

Thus it can be said for the purposes of merger control, it makes sense to distinguish two tasks.

- The first is the task of assessing how a given concentration affects prices, outputs and other important features of a market if firms responded in an individually rivalrous way to market conditions, without any increased likelihood of engaging in tacit collusion.
- The second is to assess what the impact of the concentration may be on the incentives for tacit collusion. In the first instance the role of unilateral effects come into play. Various economic approaches and theories of competition harm play a vital role.

### 4.4 International Practice in Merger – A Case Study EU, USA, UK

To start with, the initial case wherein the judgment of Commission was criticized is in the *Continental Can case*. The Commission held that Continental Can abused its already dominant position by seeking to acquire one of its few potential competitors in Community markets by way of merger the effect of which would be to reduce further competition. The Commission, in its decision, did not offer evidence that Continental Can had actually “abused” its position in the

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55 The distinction between these two effects corresponds to the distinction in the US merger guidelines between “unilateral effects” and “coordinated effects”. Note however that “unilateral effects” clearly include here not only the impact of the merger on the behavior of the merging firms, but also the “equilibrium effect” resulting from the other firms’ adjustment to the merging firms’ new decisions.

56 6/72 [1973] CMLR 199
marketplace. There was, in fact, no clear evidence that consumer welfare had been damaged by Continental Can’s monopolistic behavior. *Continental Can case* thus marks an important step towards the evolution of merger control law in the EU.

*Air Tours/First Choice*\(^{57}\) the Commission held that the concentration would lead to the creation or strengthening of a collective dominant position on the UK-short haul foreign package holiday market. The dominant position would be held by Air/Tours (32 percent) and Thomson 27 percent and Thomas Cook (20 percent). The concept of non-coordinated effects were identified. The Commission held at Para 54 of its decision that it is not essential to show that parties would adopt a common policy on the market. The ability to engage in tacit collusion is not essential. It was sufficient that each individual undertaking operating on the oligopolistic market had sufficient market power on the market to act independently.

The General Court thus requires proof of 3 criteria in collective dominance cases important to establish:

a. Market transparency; the market has to be sufficiently transparent for the firms to be able to monitor each other’s behavior and thus tacitly create a common policy.

b. Sustainability and the existence of a retaliatory mechanism; the common policy must be sustainable over time. This is achieved through ensuring the punishment of deviating firms.

c. The absence of competitive constraint; externals, such as current and future competitors and consumers, should not be able to jeopardize the existence of the common policy.

These 3 requirements were re-iterated by the General Court in *Independent Music Publishers and Labels Association (IMPALA) v Commission*\(^{58}\)

*T-Mobile/Tele Ring Case*\(^{59}\) a merger in oligopolistic markets involving the elimination of important competitive constraints that the merging parties previously exerted on each other together with a reduction of competitive pressure on the remaining competitors may, even where there is little likelihood of coordination between the members of the oligopoly, also may result in a significant impediment to competition.

\(^{57}\) Airtours/First Choice Case (2000 O.J. L93/1)  
\(^{58}\) Case T-464/04, [2006] ECR II-2289  
\(^{59}\) Supra
Certain landmark cases in the history of US Merger Regulation have been analyzed in this section and its likely impact on competition among the rival competitors have been discussed below which defined the impact of unilateral behavior on horizontal mergers.

*FTC v Staples Inc* Merger of Staples/Office Depot was prohibited as it created a dominant position in sub-market of office supply superstores. Where Staples did not compete with other office supply superstores, it charged 15% higher than in areas where it did compete with other superstores.

In *Boeing/McDonnell Douglas* the merger involves new entrant or an important innovator in the market. The Commission was concerned that the merger would strengthen the Boeing’s already dominant position in the markets for commercial aircraft. The merger is more likely to cause concern to changes to competitive dynamics of a market more than its market share suggests.

*United States v. Philadelphia National Bank* 61

Facts
Philadelphia National Bank, the second largest commercial Bank with headquarters in Philadelphia, sought to acquire Girard Trust Corn Exchange Bank, the third largest. The resulting Bank would be the third largest commercial Bank in four county areas. The proposed question to be asked here is not where parties to merger do business or even where they compete, but where, within the area of competitive overlap, the effect of merger on competition will be direct and immediate.

Findings
The court stated that a merger which produces a firm controlling an undue percentage share of relevant market, is so inherently likely to substantially lessen competition. The court believed that 30 percent concentration of business resembled threat. The court also expressed that there is no reason to think that concentration is less inimical to the free play of competition in banking than in any other service industries.

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60 *Supra*

61 374 U.S. 321 (1963)
United States .V. General Dynamics Corporation

Facts
In this case General Dynamics Corporation and its predecessor `material service’, acquired the stock of two major Illinois coal producers. In Illinois, Freeman was no 2 Coal Mining firm with 15 percent of sales and United Electric Companies was no 5 with more than 8 percent market share; combined the Firms had 23.2 percent market share and became the no 1 firm. Premerger the top two firms had 36.6 percent of Illinois market; post merger the top two firms had 44.3 percent.

Findings
United Electric Company was found to be facing the future with relatively depleted resources at its disposal and with the vast majority of those resources already committed under contracts allowing no further adjustment in price. And thus was not in a position to increase its reserves to replace those already depleted or committed. United Electric’s weakness as a competitor was fully analyzed by the District Court and fully substantiated that Court’s conclusion that its acquisition by ‘Material service’ would not “substantially lessen competition”.
From the above cases it can be that several issues are involved while assessing the anti-trust merger. The tests laid down help in analyzing various factors in detail and examine the given merger that comes under review.

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5.1 Introduction

India enacted a new competition law to replace the earlier Monopolies and Restrictive Trade Practices Act of 1969. The Act provides for constitution of Competition Commission which is the focal regulatory body to check anti-competitive practices. A new Competition Act was legislated in 2002 and was partly enforced since 2003. The provision regarding merger control and merger regulations were enforced after detailed deliberations in June 2011.

The analytical approach in assessment of Merger in India is covered under the Act in Section 20 wherein inquiry into Combination by Commission is regulated. To begin with we define the relevant market and this is done by defining the relevant product market and geographic market as defined under Section 2(r) and 2(s) of the Act.

The next step to be considered is the threshold limit and whether the merging firms confirm to the threshold limits laid down. The Indian Competition law while dealing with mergers adopts both assets and turnover while considering jurisdictional thresholds under the Act:

<table>
<thead>
<tr>
<th>Only in India</th>
<th>Assets(Total) In India</th>
<th>Turnover Total (In India)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Group</td>
<td>Rs 1500 crore</td>
<td>Rs 4500 crore</td>
</tr>
<tr>
<td>Group</td>
<td>Rs 6000 crore</td>
<td>Rs. 18000 crore</td>
</tr>
</tbody>
</table>

| In and outside India | No Group | US $ 750 m (Rs. 750 cr) | US $ 2250 m(Rs 2250 cr) |

Relevant Product Market is defined in terms of demand substitutability of the product. In the Indian Merger Regulation Guideline 2011, also it has been incorporated as a market comprising all those products or services which are regarded as interchangeable by the consumer by reason of characteristic s of the product or services, their prices.

Relevant Geographic Market The Indian Merger Regulation aptly defines it as the area in which the conditions of competition for supply of goods or provision of services are distinctly homogeneous and can be distinguished from the conditions prevailing in the neighboring areas.
Therefore in India, for the merger regulation to be attracted, the transaction must qualify the thresholds as stated under section 5 of the Act. Section 6 of the Act seeks to regulate combinations covered by Section 5. Under sub-sections (1) to (3), any person or enterprise which proposes to enter into a combination has to approach the Commission, by giving notice in the prescribed form with fee, for seeking its approval.

Since June 2011, the Commission has scrutinized and approved combinations. Competition law in India, can thus be successfully classified as a “*means to achieve the end, rather than just an end in itself*”. Every merger transaction would most likely have certain pro competitive as well as certain anticompetitive effects. It is the duty of the competition authorities to balance out these effects, through substantive tests and procedures and determine whether the proposed transaction meets the requirements to be blocked. Thus abuse of dominance plays a very decisive role in determining anti-competitive practice.

The Indian Competition which has largely followed the European and US law prohibits any merger which is likely to cause ‘*appreciable adverse effects on competition*’. The law does not mention rigid *modus operandi* for inspection of merger transactions. Nonetheless, it does mention various factors to be considered by the competition authorities while analyzing a merger.

### 5.2 Case Study: Evolution of Competition Policy in India

The history of the high merger activities in India may be documented in five major periods or waves. The first wave occurred in the early part of the 20th century, when the companies undertook M&A activities with the explicit objective of dominating their industries and creating monopolies. The second wave coincided with the rising market of 1920s, when the firms again embarked on M&A activities as a way of extending their reach into new markets and expanding

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64 Manthan India, Cross Border Mergers and Takeovers: Recent Trends, Available at: http://manthanindia.blogspot.in/2007/08/cross-border-mergers-and-takeovers.html,
their market share. The third wave occurred in 1960s and 1970s, when the firms focused on acquiring firms in other lines of business, with the intent of diversifying and forming conglomerates. The fourth wave occurred in the mid 1980s, when the firms were acquired primarily for restructuring assets. This wave ended as deals became pricier and it became more difficult to find willing lenders. The next era began post 1990 after economic liberalization saw the emergence of large scale corporate ambition and the last fifth wave occurred towards the end of 1990s when the firms focused on the acquired firms with the aim of restructuring.

During 1991, Cross Border Merger for the first time opened its economy at the global level and put its steps towards liberalization, privatization and globalization. The trade practice in India after the globalization went through radical changes from being extremely restrictive to being more competitive, global and comprehensive. Before 1991, the question of competition never arose because there was monopoly of government in certain key areas such as telecommunication and banking etc. But post globalization, a need for competition law was felt because the Indian companies at that time were aggressively looking at North American and European markets to spread their wings and become global players in the true sense. At this stage of development one of the major responsibilities of the government was to promote and maintain a favorable atmosphere for international trade. In the last decade many cross border deals took place involving the Indian companies acquiring the foreign companies. Some of the deals are as follows:

**TOP 10 CROSS BORDERS MERGERS BY INDIAN COMPANY**

<table>
<thead>
<tr>
<th>Acquirer</th>
<th>Target company</th>
<th>Country</th>
<th>Deal value ($ Million)</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tata Steel</td>
<td>Corus Group Plc</td>
<td>U.K</td>
<td>12000</td>
<td>Steel</td>
</tr>
<tr>
<td>Hindalco</td>
<td>Novelis</td>
<td>Canada</td>
<td>5,982</td>
<td>Steel</td>
</tr>
</tbody>
</table>

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65 Available at: http://trak.in/tags/business/2007/08/16/indian-mergers-acquisitions-changing-indian-business/, Last
These are the most important mergers in the history of Indian industry. As discussed at length mergers are sought to be effected for a variety of reasons such as, it is an easier way of entering into a new activity or a new market; it gives the opportunity to use the spare capacity in the acquiring company with the assets of the other company and the where the companies are under the control of the same group, a merger may be seen as a means of effective economies.

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

It has been argued time and again that the Agencies should only intervene to prohibit or remedy a merger when it is necessary to prevent anticompetitive effects that may be caused by that merger. The appropriate goal of agency intervention to prohibit or remedy a merger is to restore or maintain competition affected by the merger and not to enhance premerger competition.

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5.3 Jurisprudence Development: Agreement causing Appreciable Adverse Effect on Competition

In the western economies, M&A’s are commonplace, being a normal feature of a vibrant economy. Firms may grow organically or they may choose the M&A route. M&A’s are undertaken by firms to achieve economies of scale and accompanying efficiencies, gain entry to new markets, or access to new technologies. But unfortunately, sometimes the motivation may be less driven by economics and more by personal ambition, as achieving a big presence over a market can be very ego-massaging.

Section 3 of the Act provides that no enterprise or association of enterprises or person or association of persons shall enter into any agreement which causes “appreciable adverse effect” on competition in India and any such agreement would be declared void. On similar lines, Section 6 of the act dealing with regulation of Combinations stated that no person or enterprise shall enter into a combination which causes or is likely to cause an “appreciable adverse effect on competition within relevant market in India”. The above expression can be broken into three components, viz.

1. adverse affect of competition should be within India;
2. affect should be appreciable, and
3. it should actually effect or is expected to affect competition.

The affect on the competition should be the result of the agreement, as defined. The consequential effect may even be unintentional. The starting point of the inquiry into appreciable adverse effect on competition calls for determination of the market where the competition complained of as having been adversely effected. The relevant market again has to

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be divided into relevant product market and relevant geographic market relating to the product or the service supplied.

The term “appreciable adverse effect” has not been defined in the act. The word ‘appreciable’ has been defined in Law Lexicon as capable of being estimated, weighted, judged of or recognized by the mind which is “perceptible but not a synonym of substantial” . According to author T. Ramappa in order to be “appreciable”, the effect has to be substantial. The determination of “appreciable effect” depends on facts and circumstances of each case and is therefore a subjective test.

For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission shall have due regard to all or any of the following factors, as mentioned in Sec 20(4) of the Act.

5.4 Case Study of Combination: An Analysis

In this section of the report the various important cases that came under Indian Merger Review are discussed. The findings of the Commission are explained, all the below mentioned cases cleared the threshold test and the substantive test.

1. The Walt Disney Company (Southeast Asia) Pte. Limited (Acquirer) and UTV Software Communication Limited (Acquired Enterprise)⁶⁹

Facts

In this case, the Commission considers the proposed combination relating to the media and entertainment industry. In the context of the proposed combination relating to acquisition of sole control of Acquired Enterprise by the acquirer, it is observed that both the Disney Group and the UTV Group are engaged in the businesses of motion pictures, TV broadcasting and related activities and interactive media in India. Also the Disney Group also operates in the business of character merchandising and publishing in India.

⁶⁹ Notice for Acquisition filed by Walt Disney Company C-2011/08/02
Findings

It is observed that in the business of motion pictures in India, there are large number of market players, with low entry barriers to entry. It is not in the commercial interest of producers and distributors of the films to restrict the supply in the market in most cases as films tend to have a short commercial life and restricted supply would adversely impact their returns. Furthermore it is observed that Disney Group’s products are into Character merchandising, a commercial activity which refers to adaptation of a character (real or fictional) in relation to goods or services, to create demand for acquiring those goods and services due to customer’s affinity with that particular character. The above factors were considered and the notice of the proposed combination filed by the Acquirer under section 6 of the Act concluded that business involved which are commonly characterized by the presence of following factors:

- large number of players and prevalence of intense competition among them
- availability of ample choice and variety of products to the consumers
- demand driven nature of the business
- relative easy and exit in these businesses
- less likelihood of any co-ordinated or exclusionary behavior

Thus on the basis of the following grounds, the Commission hereby approves the proposed combination under section 31(1) of the Act.

2. G&K Baby Care Pvt. Ltd and Danone Asia Pacific Holdings Pte. Ltd. (Acquirers) and Wockhardt Group

Facts

The terms were considered under the Regulation 14 of the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulation, 2011. The notice was filed by the Acquirer pursuant to execution of Framework Agreement, Business Transfer Agreement and Agreement to Assign Intellectual Property Rights referred as Binding Agreements. It is a case of acquisition wherein the acquirer will acquire the nutrition business of Wockhardt Ltd. as a going concern on a slump sale basis.
G&K is a special purpose vehicle incorporated under the provisions of the Companies Act, for the purpose of proposed combination. It is a wholly owned subsidiary of Danone Asia Pacific, an incorporation of Singapore based company. Wockhardt is a public limited company incorporated under the provisions of the Companies Act and its shares are listed on the Bombay Stock Exchange and National Stock Exchange. As per Binding Agreement, it is engaged in the business of manufacturing and selling pharmaceutical, nutraceutical and biotech products.

The proposed combination would transfer the nutrition business relating to protein based supplement products, in-licensed pre-biotic and pro-biotic products and infant and child nutritional products of Wockhardt Group to G&K and Danone Asia Pacific.

Findings

Relevant Market: It is concerned with the nutraceutical sector, products extracted from natural resources or manufactured synthetically that supplement the diet to provide nutrition over and above regular food and helps to prevent nutrition related disorders. The market in India is at infancy and less than 1% of the global nutraceutical sector. The Acquirer has stated that the proposed combination pertains to the baby food and medical nutrition business regulated by the Food Safety and Standard Authority of India Act, 2006 and Regulations made there under.

Market share: As per the baby food business, the Acquirer have stated that Wockhardt share in India is less than seven percent and with respect to the medical nutrition business the share is less than 10% in India. The substantive issues that were analysed in this case with respect to Danone Group in India, relating to bottled water and fresh dairy products, it has no presence in India in any activity that either competes or vertically related to any of the business proposed to be acquired. Further, given the significant presence of other players in the baby food and medical nutrition businesses in India, as it shall not have significant competition concern in India.

3. SML Isuzu Limited, Isuzu Motors Ltd. and Sumitomo Corp.

Facts

70 Notice for Merger filed by Nippon Steel Corporation and Sumitomo Metal Industries Ltd. C-2011/10/07
It is a case wherein a business of manufacturing and sales of commercial vehicles and engine components in Japan and overseas. As per details provided in the notice, in India, Isuzu (Japan) provides technical information, assistances and licenses to SML Izusu to enable it to manufacture, assemble, sell, repair and maintain vehicles in India under the technical assistance agreement. SML Izusu is a company incorporated under the Companies Act and it is listed in the Stock Exchange. It is engaged in the business of manufacturing and sale of commercial passenger and goods carrying vehicles for domestic market in India.

Sumitomo is a company incorporated in Japan having its operation across the world, as per the notice Sumitomo exports and sells auto components i.e. power trains and chasis components to SML Izusu. Further it is stated that in the notice that Sumitomo through its subsidiary sells brake casting components and through another subsidiary distributes electrical components in India. Presently Sumitomo has 54.96% and 4% of the equity share capital of SML Izusu respectively. Under the proposed combination Izusu (Japan) is acquiring additional 11% equity shares of SML Izusu from Sumitomo and thus increasing the aggregate of 15% in SML Izusu.

Findings
The proposed combination concerns the automotive industry comprising of the automobile and auto component sectors.

Relevant market: SML Izusu is engaged in the business of manufacture and sale of commercial passenger and goods carrying vehicles in India. Izusu (Japan) is engaged in manufacture and sale of commercial vehicle in Japan and not in India, nor does it have any direct or indirect interest or shareholding in any of the enterprise engaged in the manufacturing or supply of commercial passenger and goods carrying vehicle in India.

As per the report published by Automotive Component Manufacturers Association of India, it is observed that the market share of Izusu (Japan) and Sumitomo in auto component sector in India is negligible. Under the Act, section 20(4) provides that proposed combination is not likely to give rise to any adverse competition concern in India.

4. Notice for Merger filed by Nippon Steel Corporation and Sumitomo Metal Industries Ltd.
The proposed combination relates to merger of NSC and SMI, whereby SMI will merge into NSC, with NSC being the surviving company, which after the proposed combination be called as “Nippon Steel and Sumitomo Metal Corporation” falls within the purview of section 5 of the Act. NSC is mainly engaged in steel making and steel fabrication. As per the details provided by the combination, in India, NSC is engaged in sale of steel products and does not have production operations. Though it has presence through 3 unit’s set-up in India.

Nippon Steel India Pvt. Ltd, Nippon Steel Pipe India Pvt Ltd, Nippon Steel engineering India Plant and Machinery Pvt.Ltd

SMI is basically engaged in the business of manufacturing and sale of variety of iron and steel products and other businesses such as engineering, manufacturing of electronic products etc.

Findings

Through the proposed combination the parties to the combination, both integrated blast furnace steel manufacturers in Japan. They have entered into an integration agreement in order to integrate all of their businesses including core business of steel making and fabrication.

Relevant Market: In India, steel producers are engaged in production of all varieties of iron and steel. Top producers are SAIL, Rashtriya Ispat Nigam Ltd, Essar Steel, JSW Steel Ltd. India is the fourth largest steel industry in India with the presence of steel producers with large and modernized steel plants having capacity in millions. The industry now works with open economy with no major trade barriers, global steel producers are also engaged in sale of variety of iron and steel products in India. Imports have accounted for 14% in India. It is seen that within each of the above eight finished steel products, there could be further variations based on their dimensions and grades.

As per the sales volume in India in respect of each of the eight finished steel products, it is noted that the percentage of the combined sales volume of the parties to the combination in India is negligible. The turnover of the parties is from export of steel products to India. It is observed that the % of combined sales volume of the parties to the combination in India in respect of each of the above eight products.
It is observed that either one or the other party has to the combination has a more prominent presence in India than the other in respect of each of the said eight finished steel products. Therefore it is unlikely to cause AAEC. Also in India there is large number of domestic and global steel producers engaged in the manufacture/sale of various types of steel products, absence of any major trade barrier for import of steel products Further capacity expansion by most of the domestic steel producers as well plans of some global steel producers to set -up Greenfield steel manufacturing projects in India

Thus the Commission was of the view that the present case does not appreciable adverse effect on competition in India, therefore the present combination is approved.
6. CONCLUSION

In the end it can be said the Competition law upholds the workings of the free market economy by analyzing the structure or the market and the conduct of firms as they compete in the market which has direct effect in the performance of the market. The merger control law in India has all the elements of a progressive law and has imbibed several practices from the EU regime. Despite its nascent existence, it has achieved tremendous success. However, there are a number of lessons that it still has to learn from the veteran anti-trust regimes of the world. As on date, the Commission has also not taken any merger case to Phase-II stage by way of issuing a show-cause notice to the parties regarding the prima-facie opinion of appreciable adverse effect on competition (AAEC) in the relevant market.

Another important aspect that has been considered by Indian authorities is the effect doctrine. It was felt necessary to protect the competition by controlling the activities taking place in India as well as those activities which takes place outside India but their effect was in India. Therefore, following the Effect Doctrine as practices in EU and US section 32 in the Competition Act, 2002 was incorporated to control the activities which take place outside India but have adverse effect in India. Section 32 provides both the powers of inquiry as well as the power to pass order. It has been vested with a greater scope and jurisdiction.

Future Finding

I would comment on the future findings of the Merger Regulation, it is essential to have a comprehensive guideline on horizontal and vertical merger for substantial analysis and better understanding of Merger Regulation. In a nutshell, we have seen mergers are advocated on the basis of possible cost synergies which could compensate the price increases due to the internalization of substitution effects among products by the merging firms. As we have noted that Sec 20(4) of the Competition Act lays down factors that analyze the combinations that come for review. An elaborate analysis keeping in mind the abovementioned economic effects on non-
coordinated as well as coordinated effects on horizontal merger will help us to better scrutinize a case which comes for merger review.

The techniques or evidence to measure the degree of substitutability which helps to measure the intensity of the competition between suppliers of differentiated goods as mentioned and incorporated by EU Merger Regime be also considered. Other factors that are likely to cause unilateral effects on a merger as discussed extensively in part 4 of the report on theories of competition harm and factors causing unilateral effects in oligopolistic market be studied and put in force.

A comprehensive analysis will help us in developing a better understanding of Indian Merger Regulation, identifying when coordinated or non-coordinated effects are likely to affect competition in the market. Subsequently on the basis of these guidelines it will help to develop remedies to resolve competition concerns.
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