



INTERNATIONAL COMPETITION NETWORK

**Proposed Recommended Practices for Merger
Analysis**

Prepared by

The Merger Working Group

**Presented at the 9th Annual Conference of the ICN
Istanbul, April 2010**

VII. Market Definition

- A. **Agencies generally should assess the competitive effects of a merger within economically meaningful markets. A relevant market consists of a product or group of products and a geographic area in which it is produced or sold that could be subject to an exercise of market power.**

*WORKING GROUP COMMENTS
Original Comments (April 2010)*

Comment 1: The purpose of market definition in merger analysis is to identify an appropriate frame of reference for assessing whether a merger may create or enhance market power. Market definition is not an end in itself, but is rather an exercise designed to inform the analysis of competitive effects of a merger by identifying which goods or services (collectively referred to herein as “products”) in which geographic locations significantly constrain the competitive behavior of the merging firms. Where available, rigorous empirical proof of effects on competition may not only directly inform the analysis of competitive effects, but may also be useful in determining the relevant market.

Comment 2: The term “market” in merger analysis has a distinct, precise meaning that may differ from the use of the term “markets” in other contexts. An economically meaningful market is one that could be subject to an exercise of market power that likely would result in significant harm to competition, rather than anticompetitive effects that are insignificant or transient in nature. While reference to “markets” in business documents and other contexts may provide important insights that may be highly relevant to market definition, businesses and customers often do not use the term “market” in the same sense used in merger analysis. Therefore, agencies should be careful to distinguish between the technical term “market” used in merger analysis and how the term “market” may be used in other contexts.

Comment 3: Mergers may have potential effects in more than one relevant product market or geographic market¹ and require an independent competitive assessment for each market of potential competitive concern. Agencies should examine the relevant markets potentially impacted by a merger to determine whether significant harm to competition in their jurisdiction is likely to occur in any of them.

Comment 4: Agencies should assess market definition within the context of the particular facts and circumstances of the merger at issue. Competitive conditions change over time and may vary in different geographic areas. While relevant markets identified in past investigations in the same industry, or in investigations by agencies in other jurisdictions, may be informative, they may not be applicable to an agency’s assessment

¹ Some agencies refer to a relevant “product market” and a relevant “geographic market,” while others consider a relevant market to consist of a product and geographic “dimension.” The same analysis applies under either framework.

of the merger in question when, for example, market conditions differ (or have evolved) over time or across geographic areas.

Comment 5: Market definition provides the basis for market share calculations and concentration levels, and more generally a framework for the analysis of competitive effects.² Market shares and concentration levels are meaningful in merger analysis only when they are based on properly defined markets. Therefore, agencies should exercise particular care in defining markets where the choice among possible market definitions may have a significant impact on market shares. In such cases, agencies may seek to develop more direct evidence regarding likely competitive effects. In other cases, it may be clear that a merger will not create or enhance market power under any plausible market definition, or that competitive harm would be predicted under all plausible market definitions. In such circumstances, agencies may not need to reach a firm conclusion on the scope of the relevant market.

B. The “hypothetical monopolist” or “SSNIP” test is an appropriate test to determine the relevant market(s) in which to analyze the competitive effects of a merger.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: An exercise of market power is feasible only when customers would not sufficiently reduce their demand for the relevant product(s), or divert sufficient demand to other products or to other locations, so as to make a price increase (or other lessening of competition) unprofitable. Market definition depends primarily upon demand-side substitution, which focuses on the extent to which customers likely would switch from one product to another, or from a supplier in one geographic area to a supplier in another area, in response to changes in prices, quality, availability, or other features. In addition, supply considerations also are relevant to understanding the competitive constraints on the merging firms. The identification of the relevant product market and relevant geographic market are interrelated. Thus, for example, the extent to which buyers would shift to other products must be evaluated in the context of the relevant geographic market.

Comment 2: The hypothetical monopolist or “SSNIP” test generally identifies an area in product and geographic space within which a hypothetical monopolist would profitably exercise market power. Under this test, agencies generally identify the relevant market as a product or group of products and a geographic area in which it is produced or sold for which a hypothetical, profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of the product(s) in that area, would impose at least a “small but significant and nontransitory increase in price” (commonly referred to

² Recommended Practices on the use of market shares are contained in section II of the ICN Recommended Practices for Merger Analysis. Recommended Practices on the analysis of competitive effects are contained in sections IV, V, and VI of the ICN Recommended Practices for Merger Analysis.

as a “SSNIP”), assuming the terms of sale for all other products remain constant.³ In practice, there often may not be sufficient data available to apply the SSNIP test quantitatively. Nevertheless, the conceptual framework of the test in most cases provides a useful methodological tool for gathering and analyzing available evidence relevant to market definition.

Comment 3: In most cases, agencies use the prevailing prices of the products of the merging firms and possible substitutes as a starting point for application of the SSNIP test. However, agencies may use likely future prices, absent the merger, when changes in the prevailing prices can be predicted with reasonable reliability. Furthermore, where pre-merger circumstances strongly suggest coordinated interaction or other evidence strongly indicates that current prices are above competitive levels, agencies may consider using a price more reflective of the competitive price. What constitutes a “small but significant and nontransitory increase in price” will depend on the nature of the industry, but a common benchmark is a price increase of between 5 and 10 percent lasting for the foreseeable future (*e.g.*, one year). In some cases, the SSNIP test is applied to the value added by suppliers in the market rather than the final price.

Comment 4: Agencies generally apply the “smallest market principle” to identify a relevant product and geographic market that is no bigger than necessary to satisfy the SSNIP test. At times, however, it may be appropriate to define broader markets. In some cases, applying the smallest market principle may fail to detect a horizontal overlap of concern between the merging parties. In other cases, where the competitive effects analysis is the same for a broader market, it may be unnecessary to define the smallest market. Similarly, it may be appropriate as a matter of convenience to aggregate markets where the competitive effects analysis is the same across a group of products or geographic areas, each of which could be defined as a separate relevant market.

Comment 5: Evidence regarding the likely demand responses of customers to a SSNIP may be derived from several sources, such as customers, the merging firms, competitors, industry or trade associations, and intermediate sellers. In some cases, adequate reliable price, cost, and quantity data may exist that allow empirical analysis, such as estimation of the relevant elasticities of demand or estimates of sales that would be lost in response to a SSNIP. In addition, evidence directly related to a merger’s actual or likely competitive effects, such as evidence derived from prior market events such as entry and exit or a prior merger (sometimes called “natural experiments”), is also relevant to market definition. Such evidence may identify potential relevant markets and reinforce or undermine other evidence relating to market definition.

³ Agencies may characterize the test in different terms as to whether a hypothetical, profit-maximizing monopolist “would,” “likely would,” or “could” profitably impose a SSNIP. The analysis is very similar under any of these formulations, and each generally will lead to the same results in the substantive assessment.

- C. In applying the SSNIP test to identify a relevant product market, agencies generally should identify a product or group of products for which a hypothetical, profit-maximizing monopolist would impose profitably at least a SSNIP, assuming the terms of sale of all other products were held constant.**

*WORKING GROUP COMMENTS
Original Comments (April 2010)*

Comment 1: In determining the appropriate product market(s) in which to assess the competitive effects of a merger, agencies should assess the extent to which products are substitutable from the point of view of customers. Agencies should consider not only whether products are functional substitutes, but also whether they are good economic substitutes for sufficient numbers of customers so as to make a SSNIP unprofitable. Own price or cross price elasticities of demand, and diversion ratios, where they can be reliably calculated, are highly relevant in assessing whether products are close substitutes for one another and part of the same relevant market. In practice, the data necessary to calculate reliable demand elasticities often are not available.

Comment 2: A single firm may participate in a number of product markets. Agencies generally should begin the process of product market definition by applying the SSNIP test to a candidate market of each product produced or sold by each of the merging firms, assessing what would happen if a hypothetical monopolist of that product imposed at least a SSNIP on that product, while the terms of sale of all other products remained constant. If the hypothetical monopolist would not profitably impose such a price increase because of substitution by customers to other products, the candidate market is not a relevant product market by itself. Agencies then should add to the product group the product that is the next-best substitute for the merging firm's product, and apply the SSNIP test to a candidate market of the expanded product group. This process continues until a group of products is identified such that a hypothetical monopolist supplying the product(s) would be able to exercise market power, and profitably impose a SSNIP in the candidate market. The relevant product market generally will be the smallest group of products that satisfies this test. In practice, sufficient data are usually not available to implement this sequential process as described. Nevertheless, the conceptual framework of the test in most cases provides a useful methodological tool for gathering and analyzing available evidence relevant to market definition.

Comment 3: The boundaries of relevant product markets may not be precise, particularly in differentiated products where substitutes may exist along a continuum. In such cases, some products may be in the same market yet may be much closer substitutes for each other than they are for other products that are also in the market. The degree of product differentiation and customer substitutability may vary over time and across geographic areas. Agencies should recognize that the simple dichotomy of classifying products as either "in the market," and therefore a close substitute for other products within the product market, or "out of the market," and therefore offering little or no competitive constraint on products in the market, does not adequately capture the competitive

interaction either of particularly close substitutes or of relatively distant substitutes. In some cases, it may be appropriate to draw a market boundary around a subset of possible substitutes that is narrower than the full range of functional substitutes from which customers choose, to the extent that a hypothetical monopolist over such a segment of the possible substitutes profitably would raise prices significantly.

Comment 4: In considering the likely reaction of customers to a price increase, agencies should consider the available evidence relevant to the likelihood of product substitution by customers in response to a SSNIP. Relevant evidence often includes, but is not limited to:

- the characteristics, prices, functions, and customer usage of the product(s) in question;
- evidence that customers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables. In some instances, agencies may be able to derive such evidence from empirical analysis of quantitative data, such as through calculation of own price or cross price elasticities of demand;
- the margins between price and marginal or incremental cost, as higher margins as a fraction of price may imply that consumers are less price sensitive;
- evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables;
- evidence regarding the strength and nature of customer preferences among products (*e.g.*, brand loyalty, preferences for certain product performance or compatibility standards, etc.);
- relative price levels and price movements of the products compared to costs and to potential substitutes;
- legal or regulatory requirements (*e.g.*, product certification standards, regulatory compliance standards, etc.) that may impact the substitutability of products from the standpoint of customers; and
- the time and costs required to switch products, as high switching costs relative to the value of a product tend to make substitution less likely.

D. In applying the SSNIP test to identify a relevant geographic market, agencies generally should identify an area in which a hypothetical profit-maximizing monopolist would impose profitably at least a SSNIP, assuming the terms of sale of all products at all other locations were held constant.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: In determining for each product market the appropriate geographic market, absent price discrimination, agencies should consider the extent to which customers, in response to a SSNIP by a hypothetical monopolist within a geographic area, would shift

to products produced or sold outside the geographic area. Agencies should consider not only whether customers could shift to suppliers in other geographic areas, but also whether sufficient numbers of customers would shift so as to make a SSNIP unprofitable.

Comment 2: A single firm may operate in a number of geographic markets. Agencies should typically begin the process of geographic market definition by applying the SSNIP test to a candidate market of each location in which each merging firm produces or sells the relevant product, assessing what would happen if a hypothetical monopolist in that location imposed at least a SSNIP on sales of the product in that location, while the terms of sale at all other locations remained constant. If the hypothetical monopolist would not profitably impose such a price increase because of substitution by customers to products from other geographic areas, the candidate market is not a relevant geographic market by itself. Agencies then should add the location that is the next-best substitute for the merging firm's location, and apply the SSNIP test to a candidate market of the expanded area. This process will continue until an area is identified such that a hypothetical monopolist would achieve market power, and profitably impose at least a SSNIP in the candidate market. The relevant geographic market generally will be the smallest area that satisfies this test.

Comment 3: A relevant geographic market may be local, regional, national, multinational, or global in nature, and may not correspond to political or jurisdictional boundaries. In considering whether a market may be multinational or global in nature, agencies should assess the extent to which imports, or the potential for imports, would constrain the ability of a hypothetical domestic monopolist to impose a SSNIP by constituting a competitive threat that would make such a price increase unprofitable. As part of this assessment, agencies should consider evidence regarding the extent to which customers currently view imported products as acceptable substitutes, the potential and likelihood for substitution to imports to increase in response to a SSNIP imposed by a hypothetical domestic monopolist, and whether imports would occur on a sufficient scale, and sufficiently quickly, to constrain an exercise of market power by a hypothetical domestic monopolist.

Comment 4: In considering the likely reaction of customers to a price increase, agencies should consider the available evidence relevant to the likelihood of substitution by customers to suppliers outside the geographic area in response to a SSNIP. Relevant evidence often includes, but is not limited to:

- the cost and difficulty of transporting the product in relation to the value of the product (the higher the value of a product relative to its transportation costs, the more likely customers are to seek suppliers in more distant locations and the more likely suppliers located in other areas are willing to supply customers in that area);
- product characteristics (*e.g.*, product perishability or fragility, the nature and requirements of offered services, etc.), geographic features, or other circumstances impacting the ability of customers to obtain products from sellers outside the geographic area;

- evidence that customers have shifted or have considered shifting purchases between different geographic locations in response to relative changes in price or other competitive variables. In some instances, agencies may be able to derive such evidence from empirical analysis of quantitative data;
- evidence that sellers base business decisions on the prospect of buyer substitution between geographic locations in response to relative changes in price or other competitive variables;
- relative price levels and price movements of products in different geographic areas;
- the willingness of customers to obtain the relevant product or service from suppliers in other geographic locations, including customer preferences for obtaining the product from a supplier with a local presence or with the ability to communicate in the local language;
- constraints on the ability of outside sellers to expand their sales into the geographic area (*e.g.*, production capacity, committed capacity, the need to establish brand recognition and acceptance; distribution and after-sales service capabilities, etc.);
- legal or regulatory requirements (*e.g.*, import duties, tariffs, quotas, licensing requirements, required regulatory authorizations or approvals, etc.) that may raise the costs of suppliers from outside the geographic area or impact the ability of customers to obtain the product or service from suppliers located outside the geographic area; and
- the timing and costs of switching suppliers from one region to another, as high switching costs relative to the value of the product will make substitution less likely.

E. Where a hypothetical monopolist would profitably discriminate in prices charged to particular groups of customers or in particular geographic areas, agencies should consider whether a narrower relevant market, consisting of a product or group of products sold to certain groups of customers or in particular geographic areas, is appropriate.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: Existing customers may differ in their ability and willingness to switch to other products, or to suppliers in other areas, in response to a SSNIP. If a hypothetical monopolist would price differently to different groups of customers or to customers in different locations, agencies should evaluate the likely demand responses of each such buyer group. If a hypothetical monopolist would exercise market power only, or especially, in sales to a targeted group of customers or customers in particular locations, agencies may delineate a relevant product market consisting of a particular use or uses by groups of customers of the product, or a relevant geographic market consisting of particular locations of customers, for which a hypothetical monopolist would profitably and separately impose at least a SSNIP.

Comment 2: In assessing whether a hypothetical monopolist would price discriminate to impose a SSNIP profitably on particular groups of customers or customers in particular locations, relevant factors include, but are not limited to:

- whether price discrimination is feasible in the market at issue;
- whether a hypothetical monopolist could successfully identify transactions subject to successful price discrimination;
- whether customers or third parties could undermine price discrimination through some form of arbitrage in which a product sold at lower prices to some customer groups is resold to customer groups intended by the firms to pay higher prices; and
- whether price discrimination would permit or enhance the successful exercise of market power against particular buyer groups or customers in particular locations.

F. Agencies should consider the potential for supply-side substitution, and whether to include as participants in the relevant market not only all firms that currently produce or sell in the relevant market, but also firms that likely would, in response to a SSNIP in the relevant market, produce or sell in the relevant market within a short time frame and without incurring significant sunk costs.

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: Supply-side substitutability focuses on the extent to which, in response to a SSNIP, suppliers that do not currently produce or sell the relevant product likely would profitably switch their existing production facilities, in whole or in part, to produce or sell the relevant product in the relevant geographic market within a short time frame (*e.g.*, within one year), and without incurring significant sunk costs of entry or exit. Firms that meet these conditions are capable of making such quick supply responses that they likely influenced the market pre-merger, would influence it post-merger, and accordingly are appropriately considered as market participants at both times. Some agencies consider supply-side substitution as part of market definition, while other agencies consider it in identifying market participants. The same analytical results should apply regardless of the particular method used.

Comment 2: If a firm has existing assets that could be shifted or extended quickly into production or sale of the relevant product in the relevant geographic market, it does not necessarily mean that (a) the firm would have the incentive to produce or sell the relevant product, (b) the firm would entirely switch or extend its production or sales of the relevant product, and (c) all firms producing the other product would do so. The relevant question for analysis is not whether a firm has the capability to produce or sell the relevant product, but whether it would likely make such sales profitably in response to a SSNIP.

Comment 3: In determining the extent to which supply-side substitution is likely, relevant factors include, but are not limited to:

- the extent to which obtaining new tangible or intangible assets, or switching or extending existing assets, to enter into production or sale in the relevant market is technically feasible;
- the extent to which customers would be willing to switch to products offered by the firm in the relevant market;
- the time it would take to enter into production or sale, including the time necessary to comply with any applicable legal or regulatory requirements;
- the costs of shifting or entering into production or sale relative to the profitability of sales at the elevated price; and
- whether the firm's capacity is elsewhere committed or elsewhere so profitably employed that such capacity likely would not be made available to respond to an increase in price in the relevant market.

Comment 4: Agencies should assess the competitive significance of probable supply responses that will not meet the requirements for quick supply-side substitution in their analysis of entry.⁴

⁴ Recommended Practices on the analysis of entry and expansion are contained in section III of the ICN Recommended Practices for Merger Analysis.

VIII. Failing Firm/Exiting Assets

- A. A merger is not likely to create or enhance market power if one of the merging parties is likely to fail and its assets are likely to exit the market in the imminent future. In cases where the merging parties assert that a merger is unlikely to harm competition because one of the merging firms is failing, agencies should carefully assess the appropriate counterfactual in which to analyse the competitive effects of the merger.**

*WORKING GROUP COMMENTS
Original Comments (April 2010)*

Comment 1: Agencies should carefully review claims by the merging parties that a merger will not harm competition because the acquired firm and its assets would have exited the market absent the merger in any event. In such cases, the basis for concluding that the merger will not harm competition is that the competition provided by a failing firm would be lost even without the merger and, consequently, the competitive situation post-merger may be no worse than the counterfactual, i.e., the competitive situation absent the merger. In cases where one of the merging parties is an allegedly failing firm, agencies should carefully assess whether there is a causal link between the merger and any worsening of competitive conditions, or whether the competitive structure of the market would deteriorate at least to the same extent even without the merger.

Comment 2: Agencies should carefully consider the implications of an allegedly failing firm in the context of the counterfactual analysis. In this regard, agencies should be mindful that there might be more than one relevant counterfactual scenario (e.g., the failing firm's assets exit the market or are bought by a less competitively significant incumbent or a potential new entrant). Consequently, the choice of the appropriate counterfactual could be a complex exercise. In addition, much of the evidence of exit of the allegedly failing firm is in the hands of the merging parties who may advance failing firm claims even when the productive assets would not leave the relevant market, in which case the failure and exit of the firm is not the appropriate counterfactual.

Comment 3: In many cases, a merger involving a failing firm will not in fact raise competition concerns because there are sufficient competitive constraints remaining in the market to prevent significant harm to competition regardless of whether the firm will fail and its assets exit the market in the imminent future. When there are no competition concerns, agencies need not consider whether the conditions of a failing firm have been established.

- B. In assessing claims that a merger will not harm competition because one of the merging parties is failing, agencies should determine whether: (a) the firm is unable to meet its financial obligations in the imminent future; (b) there would be no serious prospect of reorganizing the business; (c) there would be no credible less anticompetitive alternative outcome than the merger in question; and, (d) the firm and its assets would exit the market in the imminent future absent the merger.**

*WORKING GROUP COMMENTS
Original Comments (April 2010)*

Comment 1: In some jurisdictions, consideration of whether a firm is failing is included as part of the competitive effects analysis (for example as part of the counterfactual), while in other jurisdictions the imminent failure of the firm is a formal defence to an otherwise anticompetitive merger. Furthermore, some agencies may require a more exacting standard of proof and some may place the burden on the merging parties to establish the conditions for a failing firm, but a similar substantive analysis applies regardless of the particular method used.

Comment 2: Where a failing firm claim is raised, agencies should carefully review whether the firm in question is truly failing. Many firms, despite temporary difficulties, are able to survive and continue competing. The fact that a firm has not been profitable does not necessarily mean that it is a “failing firm” since accounting losses do not necessarily reflect the true economic losses from ongoing operations, i.e., its fundamental ability to compete effectively in the future. For instance, a firm with a substantial debt may be able to emerge from its financial trouble as an effective competitor through a new business strategy or new management because it possesses valuable assets.

Comment 3: To assess whether the firm is unable to meet its financial obligations, agencies should require merging parties to provide current and historic financial information about the business that is claimed to be failing. This information may include profit and loss and cash flow information, recent balance sheets and analysis of the most recent statutory accounts, the timing and nature of the firm’s financial obligations, the relationship between the company’s costs and its revenues, the likely ability of the firm to obtain new revenues or new customers, and the current and future availability of key inputs. Agencies should consider whether ordinary course of business documents indicate an imminent financial failure, or whether the claims of failure appear overstated to justify the merger. Prospective financial information should also be requested including forecast information for the current year, ideally forecasts produced either in advance of the proposed transaction or for another purpose and not produced solely for the agency. In most cases, agencies should seek the (in-house or outsourced) assistance of financial and accounting expertise.

Comment 4: To assess whether the failing firm is unable to re-organize itself successfully, agencies should require the merging firms to demonstrate that they have no

reasonable corporate restructuring or re-financing options, since even firms in administration⁵ often survive and recover. Such evidence might come from board papers or other strategy documents produced by the firm when considering various ways to improve its situation. If the firm is in administration, agencies should consider investigating with the administrator whether there was any serious prospect that the firm could emerge from administration, potentially in a re-organised form.

Comment 5: In assessing whether there is no credible less anticompetitive alternative to the merger, agencies should assess whether the failing firm has unsuccessfully sought in good faith any credible alternative offers of acquisition of the firm or its assets that would both retain the assets in the relevant market and pose less harm to competition than the merger in question. In this regard, agencies should require evidence that there is sufficient awareness regarding the sale of the firm or its assets to attract the attention of likely prospective purchasers. Agencies should consider any offer to purchase the assets of the failing firm above the liquidation value of those assets (net of the costs associated with the liquidation process). The fact that an alternative purchaser's offer is not commercially preferable to that of the merging parties should not lead agencies to disregard the alternative purchaser's offer so long as it is above the asset liquidation value. In addition, some jurisdictions consider whether the failure of the firm and the liquidation of its assets could be a less anticompetitive alternative to the merger since the remaining firms in the market would compete for the failing firm's market share and assets that otherwise would have been transferred wholesale to a single purchaser.

Comment 6: In considering a failing firm claim, agencies also should assess whether the failing firm's assets would exit the market in the imminent future but for the merger in question. If the firm owns important assets whose value is greatest in their current use, these assets are unlikely to exit the market, even if the firm cannot meet its financial obligations in the imminent future. On the other hand, assets that are not economically viable would not be expected to remain in the market unless the acquirer expects the acquisition to generate significant efficiencies that will make the assets economically viable. In such cases, the acquiring firm would acquire the failing firm to benefit from the resulting efficiencies, arising from the merger, rather than from a reduction in competition since the failing firm would leave the market in any event. Such a merger is likely to result in consumer benefits since the competitive outcome with the merger may be better than without the merger.

Comment 7: It may be that there will be more merger cases involving financially troubled firms and, as a result, more failing firm claims in difficult economic times. However, agencies should assess whether the conditions for a failing firm are met in the

⁵ The term "administration" is used here as shorthand for the various bankruptcy procedures in place in ICN jurisdictions whereby a company in financial distress is judged insolvent and its property sold or liquidated, or is restructured. These procedures typically involve the appointment of a person to oversee the company's estate on behalf of creditors during the liquidation or the restructuring process, indicated here by the term "administrator." While it is not necessary for a firm to go into administration to qualify as a failing firm, the fact that a firm is in administration is relevant to whether the firm is unable to meet its financial obligations in the imminent future. Laws governing administration vary across jurisdictions and may consequently restrict the options available to potential acquirers of all or part of a failing firm.

same way during difficult economic times as during a less challenging economic environment.

Comment 8: Merging parties may advance claims that a merger will not harm competition on the grounds that one of the merging parties is “flailing”, i.e., is in financial distress but does not meet the conditions of a failing firm. If the criteria to establish a failing firm are not met, agencies should appropriately consider these claims in the analysis of competitive effects since the financial weakness of the firm may still be a relevant factor in determining whether the merger is anticompetitive. In such cases, a firm’s weakened financial condition may indicate that it is likely to compete less effectively in the future, such that the merger will not substantially lessen competition.

- C. In assessing claims that a merger will not harm competition because a division of a firm is failing, agencies may assess whether the following conditions are met: (a) the division has a negative cash flow on an operating basis; (b) the division and its assets would exit the market in the imminent future absent the merger; and, (c) there is no reasonable less anticompetitive alternative outcome than the merger in question.**

WORKING GROUP COMMENTS
Original Comments (April 2010)

Comment 1: In some instances, a merger may involve the acquisition of a failing division (or group of related assets) of an otherwise financially viable company. In such cases, in some jurisdictions the merging parties may claim that the merger will not harm competition significantly because the failing division and its assets will exit the market absent the merger. Such claims may be considered as part of the competitive effects analysis, or as a formal defence to an otherwise anticompetitive merger.

Comment 2: In jurisdictions that consider failing division claims, agencies should apply similar conditions to determining whether a division is failing as would be applied to failing firm claims. However, given factual differences between a failing division and a failing firm, agencies should also be aware that the conditions may need to be applied differently. In assessing failing division claims agencies should be aware of the possibility that, in some cases, the accounting practices of the parent company may create the appearance of a failing division when the division is not in fact failing. The fact that a business division is not currently profitable does not necessarily mean that the division is failing or necessarily that it will exit the market in the imminent future. A division may operate with temporary losses but be able to recover, and even an unprofitable division may be unlikely to exit if it serves an important purpose in the company, such as supporting or developing an important brand or other business line. In addition, it may be difficult to assess the amount of money that the parent company could be expected to invest in the division absent the merger. Therefore, agencies should seek from the merging parties clear evidence demonstrating that, absent the merger, the division is likely to fail and its assets are likely to exit the market in the imminent future.

Comment 3: In assessing whether the failing division has a negative cash flow on an operating basis, agencies should ensure that the correct revenues and costs are considered. Given the ability of the larger firm to allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, agencies should require supporting evidence not based solely on documents that have been prepared by the merging parties for the purpose of demonstrating negative cash flow or the prospect of exit.