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# Regional Competition Center for Latin America presents Guideline on Coordinated Effects Study in Merger Cases

Prepared by the CRCLA

With an introduction by
Competition Policy International

*This month, the Regional Competition Center for Latin America (or CRCAL by its acronym in Spanish) continues its presentation of the different studies and guidelines it has only recently commissioned to enhance Latin America's competition agencies' technical capacities. In this case, the CRCAL presents a summary of Professors Motta and Fabra's guidelines on the analysis of coordinated effects for merger review. We hope you find this interesting.*

In a growing context of globalization and competitive pressure, enterprises are constantly searching for strategies to enhance their position and expand their market reach. A common instrument observed to achieve this goal is to merge with other firms, or to acquire other firms' assets. These kinds of operations can influence the competition environment of the market and industry in several directions; while they can sometimes have pro-competitive effects due to efficiency gains, they can also be detrimental to competition when a merger or acquisition results in the creation of a market power.

As a result, the competitive effects' assessment of a proposed merger or acquisition is one of the main preventive interventions that competition authorities utilize today. There are two main types of concerns regarding the merger effect on competition: the unilateral effects and the coordinated effects.

In this context, the members of the Regional Competition Center for Latin America (or CRCAL, by its acronym in Spanish) were very interested in developing a guideline that could help them assess the coordinated effects that may arise from a merger case. The draft guideline on "Coordinated Effects in Merger Cases" was presented last September during the Center´s first workshop held in Santo Domingo, Dominican Republic. The report was developed by Massimo Motta and Natalia Fabra, two leading researchers on this topic.[1]

[1] Massimo Motta is ICREA Research Professor at Universitat Pompeu Fabra and Research Professor of the Barcelona Graduate School of Economics. He founded the GSE's Competition and Market Regulation Program and still teaches in this Master. Prof. Motta's main areas of research are industrial organization and in particular competition policy, but he has also worked on international trade and multinational firms.

Natalia Fabra is Associate Professor at Universidad Carlos III de Madrid and Research Affiliate at the Centre for Economic Policy Research. Her main research areas are oligopoly and other forms of market imperfections, competition policy, regulation of electric utilities, among others.

Its introductory chapter posits that the impact of mergers on the likelihood of collusion has been a major concern for antitrust authorities since merger control first began. As stated by Judge Richard Posner, the "ultimate issue" in reviewing a merger under antitrust law is "whether the challenged acquisition is likely to hurt consumers, by making it easier for the firms in a market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level".[2]

The authors begin their report by analyzing unilateral versus coordinated effects in horizontal mergers, hinting that it is not always initially clear which effects may dominate. For this reason antitrust authorities may find it necessary to conduct an assessment of both unilateral and coordinated effects.

The next part of the guideline deals with the economic analysis of collusion for the assessment of coordinated effects. According to the authors, the assessment of whether a merger would create coordinated effects can be done by raising three fundamental questions:

1. *The enforcement problem*: Would collusion post-merger be possible and sustainable?

2. *The coordination problem*: Would firms be able to reach a collusive agreement and adapt it to the potentially changing market conditions*?*

3. *The coordinated effect*: Would the merger enhance the likelihood of collusion?

The first question suggests that firms must find it in their interest to respect the collusive agreement. The second question relates to the issues of communication among firms that arise while solving problems relating to, for example, the coordination of pricing or output. Answering the first two questions allows a complete assessment as to whether the merger would give rise to coordinated effects.

Two fundamental issues that need to be solved when evaluating the coordinated effects of horizontal mergers is to clearly define the term collusion (which can be

[2] For further information see Hospital Corporation of America versus Federal Trade Commission.

tacit or explicit) and to examine the mechanisms by which firms can make it sustainable over time.[3]

Experience and theory suggest that in order to sustain collusion, firms must be able to detect deviations from the tacit agreement. This means that firms must be able to monitor each other; certain factors like transparency, exchange of information, simplicity and homogeneity of the products or services offered, facilitate price or output comparisons. A second critical condition for the sustainability of collusion is a firm´s ability to credibly retaliate when they detect a deviation of the "optimal collusive behavior." This retaliatory conduct, also known as "punishment," may take the form of a temporary price war, for example.

Lastly, the authors examine factors that facilitate collusion, such as enforcement relaxation (meaning that firms have no incentive to deviate from the collusive agreements) or issues with coordination (conditions that facilitate coordination on a collusive equilibrium), under four broad categories: 1) supply factors; 2) demand factors; 3) transparency, communication and information exchange and 4) corporate governance structures.

Concerning the supply side, some factors such as high market concentration; symmetry among market shares, capacities or technological capabilities; barriers to entry; or multimarket contacts, make coordination--or the sustainability of the collusive agreement--easier.

On the demand side, a stable demand will make the market more transparent, thus making it easier to identify a deviation. Frequent market interactions and regular orders similarly make sustainability of collusion more likely.

Transparency of information among rivals is another factor that may facilitate collusion. This means that certain pricing rules may favor collusion, such as basing point price or a simple and exclusive distribution system where distributors are closely related to suppliers.

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[3] Explicit collusion means unequivocal agreements for which there is hard evidence of communication. In most jurisdictions these agreements are considered illegal. Tacit collusion means that there is no direct evidence of communication. However, through indirect proofs and reasoning it is possible to deduce collusion. Both explicit and tacit collusion are taken into account when assessing the coordinated effects of horizontal mergers.

Finally, governance factors, cross-ownerships, cross-directorships and joint ventures also offer opportunities for competitors to talk to each other, making coordination easier.

The authors of “Coordinated Effects in Merger Cases” demonstrate that while conducting an assessment of coordinated effects in mergers, agencies have at their disposal some very simple indicators that offer hints to detect collusive behavior; those indicators can be used as the initial screening device.

The CRCAL expects this document to be an important reference for all its members while conducting market investigations. It will become available for Latin American countries and the public in the coming months, once the Webpage of the CRCAL is operational.