PHILIPPINE COMPETITION COMMISSION
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1. Introduction

1.1. These Guidelines on substantive non-horizontal merger analysis are issued by the Philippine Competition Commission (the "PCC") pursuant to Section 16 of Republic Act No. 10677, otherwise known as the Philippine Competition Act ("PCA").

1.2. These Guidelines outline the principal analytical techniques, practices, and the enforcement policy of the PCC with respect to non-horizontal mergers and acquisitions that may have a direct, substantial, and reasonably foreseeable effect on trade, industry, or commerce in the Philippines. They build on the PCC Merger Review Guidelines issued on 09 October 2018 and the experience of the PCC over the past years. These Guidelines are tailored to apply to Philippine commercial and legal practices and made consistent with the PCA and its Implementing Rules and Regulations ("PCA-IRR").

1.3. The purpose of these Guidelines is to strengthen the transparency of the analytical process undertaken by the PCC and thereby assist the business community and competition law practitioners. These Guidelines may also assist the courts in developing an appropriate framework for interpreting and applying the PCA, PCA-IRR, and other regulations relating to mergers and acquisitions.

1.4. The PCC will consider each merger with due regard to the attendant circumstances and will apply these Guidelines flexibly, or where appropriate, deviate therefrom.

1.5. The PCC may revise these Guidelines from time to time to reflect developments and may publish new or supplemental guidance.

2. Rationale for Merger Review

2.1. When exercised by sellers, market power is the ability to profitably raise prices above competitive levels for a significant period, and/or to lessen competition on parameters other than price, such as quality, service, or innovation.

2.2. When exercised by buyers, market power is the ability to profitably reduce the price paid to suppliers below competitive levels for a significant period, which may lead to an anti-competitive reduction in supplier output.

2.3. Non-horizontal mergers combine entities or assets that do not directly compete in the same relevant market. Unlike horizontal mergers, non-horizontal mergers do not eliminate a competitor. The main economic issue is not the elimination of a competitor but whether the merger is likely to lead to anti-competitive conduct.

2.4. Through merger control, the PCC predicts a merger's competitive impact to prevent competitive problems before these materialize. The PCC will only intervene to prohibit or remedy a merger when it is necessary to prevent anti-competitive effects that may be caused by that merger. The goal of the PCC's intervention is to restore or maintain competition affected by the merger.

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3. Non-Horizontal Mergers

3.1. Non-horizontal mergers involve parties that do not operate in the same market. As the parties to these mergers do not compete, these mergers do not produce an immediate change in the level of concentration in the market, unlike horizontal mergers. Non-horizontal mergers include both vertical and conglomerate mergers.

A. Types of Non-Horizontal Mergers

3.2. A **vertical merger** covers entities operating at different levels of the same production or supply chain, that is, entities that supply or buy from each other. For example, the merger of an upstream wholesaler (e.g., digital payment technology) with a downstream retailer (e.g., e-commerce website).

3.3. A **conglomerate merger** involves entities that do not operate in the same supply chain. This covers a potentially large range of mergers. For example, they could involve mergers between suppliers of complementary products on the demand side (e.g, a merger between a manufacturer of laptops and a developer of operating systems) or on the supply side where the merging parties use the same distribution channels or sell to the same customers (e.g., a merger between two entities operating video and photo sharing platforms). Additionally, there may be no apparent relationships between merging parties, either on the demand side or supply side, for example, between a wholesaler of fruits and a retailer of clothes).

3.4. Conglomerate mergers may take various forms and may cause different harm. These include, but are not limited to:

3.4.1. A merger involving *complementary products* sold to the same customers. Complementary products are closely related and include:

3.4.1.1 Commercial complements are products that form part of a range of products normally sold together.

3.4.1.2 Economic complements are products that are consumed together such as shampoo and conditioner.

3.4.1.3 Technical complements are necessary for both products to function.

3.4.2. A merger between an input supplier and a downstream entity that does not use the input but competes with the customers of the input supplier, this is commonly referred to as a *diagonal merger*. This merger is not squarely classified as either a vertical or horizontal merger. For example, a car manufacturer who produces petrol-driven cars (and does not make electric vehicles) buys a manufacturer of batteries for electric cars who compete with petrol cars.

3.4.3. Mergers between suppliers of completely *unrelated products* e.g., in different supply chains, with no product connection between them (either on the demand or

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supply side) but which is likely to be controlled, post-merger, in some way by the merged entity.

4. Market Definition

4.1. The PCC, in defining the markets in non-horizontal mergers, will use the same standards provided in the PCC Merger Review Guidelines. However, in defining the market/s affected in non-horizontal mergers certain considerations peculiar to theories of harm arising from the merger must be taken into account.

4.2. Special consideration must be made for any other market for goods or services that may be affected by the merger to be determined by the PCC ("Other Affected Market"). The approach taken will depend on the specific facts of each case. This means that the PCC will assess the impact on competition in markets beyond where the merging parties compete.

4.3. In non-horizontal mergers, market definition will not be limited to markets where the merging parties directly compete. The PCC will consider multiple markets in assessing whether the merger will result in SLC.

4.4. The same transaction can give rise to more than one non-horizontal concern, and different concerns that may affect different markets.

4.5. The PCC is not precluded from limiting itself to using the approaches provided in the PCC Merger Review Guidelines in defining the market. This is particularly necessary for assessing non-horizontal mergers in industries affected by emerging or fast-moving innovations that may render entirely independent markets as adjacent markets or complementary markets post-merger. Even if products are currently entirely independent of each other, however, if based on available evidence, it may be reasonably foreseen to compete due to innovations or other factors, then the PCC will consider them to be competitors and define a market based on available evidence.

4.6. It is possible that a vertical or conglomerate merger may also impact competition in markets wherein the merging parties compete. In this situation, the PCC will refer to the 2018 PCC Merger Review Guidelines.

5. Market Shares and Concentration

5.1. The discussion in the PCC Merger Review Guidelines on the role of market shares and concentration are equally important in assessing the competitive impact of non-horizontal mergers. To recall, market shares are an indication of the competitive significance of each merging party in the relevant market. They provide an indication of a firm's incentive to coordinate its actions with rivals and its ability to exercise market power. The significance of market shares and measures of market concentration are specific to the analytical context presented in each review. They are

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not determinative of possible competition concerns in themselves, as they may, for instance, either underestimate or overestimate the future competitive significance of a firm or the impact of a merger.[1]

5.2. The PCC evaluates market shares and concentration in conjunction with other market evidence to conclude whether a merger may substantially lessen competition. Non-horizontal mergers are likely to raise competition concerns when the merging parties have a significant degree of market power in at least one of the affected markets. The level of concentration in the affected markets is a useful, but not a conclusive indicator of the market power of the merging parties and their competitors.

5.3. Market shares and concentration measures used for merger analysis reflect parties' current and future competitive significance. Measurements may be based on units or monetary values, volume of sales, production, supply, and number of customers, as may be appropriate.2

5.4. The PCC will use the same methodologies set out in the PCC Merger Review Guidelines to measure market shares and concentration. The PCC may consider historical market shares in assessing the competitive effects of the merger. The PCC may also consider factors such as, but not limited to, the likely exit of parties in the market, the introduction of additional capacity, the speed and degree of technological innovation, and expected changes in consumer preference, which have influenced the existing market shares, especially when the computations are expected to change significantly.

5.5. High levels of market concentration in one or more of the relevant markets may provide indications about the likelihood, scope, ability, and incentive of the merged entities.

6. Counterfactual

6.1. The PCC will determine the prevailing conditions of competition in the pre-merger situation as the counterfactual against which to assess the impact of the merger. In the case of vertical mergers, the counterfactual may be the pre-merger scenario where the parties are not vertically integrated, whereas for conglomerate mergers, the counterfactual may be the pre-merger scenario where the parties operate independently of each other.

6.2. However, the PCC, based on the evidence available to it, may consider the likely scenarios other than the prevailing conditions, e.g., whether one of the merger entities would inevitably have exited from the market, where there is a realistic prospect of a new entrant in the market, the acquired party would have failed financially, or when the merger has already consummated, in its determination of the counterfactual.

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[1] 6.1. PCC Merger Review Guidelines (2018)
[2] 6.4. PCC Merger Review Guidelines (2018)

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7. Competitive Effects Analysis/Assessment

A. The Anti-Competitive Impact of Non-Horizontal Mergers

7.1. Generally, non-horizontal mergers are less likely to harm competition compared to horizontal mergers. However, non-horizontal mergers may still lead to a significant increase in the market power of the merged entity, thereby increasing the ability of the merged entity to profitably increase prices, reduce output, choice or quality of goods and services, or diminish innovation. Like horizontal mergers, two (2) main kinds of potential anti-competitive harms are identified for non-horizontal mergers:

7.1.1. **Unilateral effects** arise where the newly merged entity gains additional market power sufficient to engage in anti-competitive conduct. For vertical mergers, the unilateral effect occurs within the same supply chain, while for conglomerate mergers, the effect might cross different supply chains, where the merged entity uses increased market power in one market to achieve excess profits on another unrelated market in a different supply chain.

7.1.2. **Coordinated effects** arise where a merger makes existing collusion more likely to occur. With horizontal mergers, a decline in the number of competitors increases the likelihood of collusion within a relevant market because fewer competitors make forming and monitoring a cartel agreement easier, and therefore more likely.

7.2. For non-horizontal mergers, potential anti-competitive coordinated effects might occur in any market in which the vertical or conglomerate merged entity operates. Coordination outside relevant markets is more likely to occur where there are few competitors in a market (oligopolies).

7.3. Vertical mergers may also bring about foreclosure in the relevant markets involved. Foreclosure may lead to significant harm to competition because of the higher likelihood in increasing the cost of rivals or altogether excluding them from competing.

7.4. Similar to vertical mergers, the main concern for conglomerate mergers is that of foreclosure. The combination of products in related markets may increase the merged entity’s ability and incentive to leverage its dominance in one market to another by means of exclusionary practices.

B. Information Required by the PCC in Investigating Non-Horizontal Mergers

7.5. The PCC will identify and consider all the products relating to the merger. This allows the PCC to identify all the businesses and professional links (including family control links) between merging parties that could impact competition. This includes, but is not limited to, all products that:

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7.5.1. Compete or are complementary or related in some way at the same level in each supply chain pre-merger;

7.5.2. Considered inputs or outputs to each entity pre-merger, either in the same supply chain or in other supply chains; and

7.5.3. Are sold by the merging parties that are not related at all, either at the same or different levels of any supply chain.

7.6. The PCC will normally conduct interviews and request for internal documents and other relevant data from the merging parties. These internal documents could include strategic plans, the acquirer's assessment of the acquisition, emails in relation to the merger, etc. Normally, these documents would contain important information necessary to understanding the market and assessing the competitive effect of the merger. Similar requests will be made third parties including competitors, suppliers, customers, academics, and business analysts, as well as from regulators and other government agencies.

7.7. While the information sought will depend on the merger situation, some of the information include, but not limited to:

7.7.1. Market share of the entities involved in the merger including other entities in their group;

7.7.2. Documents relating to demand conditions such as consumer preferences, the way customers combine complementary products, etc.;

7.7.3. The history of competition in all markets that the merging parties are involved in including past anti-competitive conduct. This would include past collusion on price and output, history of joint research, joint purchasing or selling, and the like;

7.7.4. Entry and exit costs in all possibly affected markets, including the likelihood that the merger will deter potential entry;

7.7.5. The kinds and importance of confidential information to business operations;

7.7.6. The likely costs and benefits of engaging in exclusionary conduct such as bundling and tying post-merger;

7.7.7. Whether the potential loss of inputs or access to distribution channels or potential cross-subsidization will adversely affect competitors; and

7.7.8. Information may also be sought from competition agencies in other countries

7.8. While conglomerate mergers are neither horizontal nor vertical, there may be impacts on both horizontal and vertical competition. The closer the products involved in a merger are to each other, the more likely the merger will be

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classified as a vertical merger rather than as a conglomerate merger. In deciding between classifying a notified merger as vertical or conglomerate the following product relationships will be considered:

7.8.1. **Complementary products** where customers combine complementary products together to consume (e.g., bread and sandwich spread).

7.8.2. **Neighboring products (**or weak substitutes) where the products are not complements but are in 'neighboring' markets (e.g., a sedan car and an off-road vehicle).

7.8.3. **Unrelated products** where consumers do not regard them as substitutes or complements but which may be supplied by a manufacturer with similar production methods (e.g., different kinds of furniture). This is sometimes called a pure conglomerate merger.

7.9. Merging parties are required to provide information about all products in the merging entity's product portfolio. While conglomerates are usually reluctant to disclose information about costs, profits, and business plans all merging parties may be asked to identify all the likely impacts of the merger in any market in which the entities operate, and not just information about the product markets involved in the merger. This includes information about likely changes to the markets involved due to changes in costs, possible technological change, and business plans, among others.

7.10. In considering the range of possible factual scenarios and competitive effects, the PCC will turn to reasonably available and reliable evidence. However, the main sources of reasonable and reliable evidence will come from the merging parties themselves, that may be validated using information from customers, competitors, government departments, academia, and industry observers. This information can take the form of documents, testimony, or data, and can consist of descriptions of competitively relevant conditions or reflect actual business conduct or decisions.

B.1. Information in Relation to the Determination of Control

7.11. The PCC will assess whether the merged entity has a greater ability to restrict competition in any market through the acquisition of greater influence or control over the merging parties and their affiliates and subsidiaries.

7.12. Control is an important issue in mergers because it may indicate anti-competitive conduct after a merger. Even where an entity has a passive minority interest in a merging party, its overall economic profits may increase given less competition in the other markets in which the merging parties operate.

7.13. Information on the importance of minority shareholders (including passive

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shareholders) in all relevant corporate structures may be used. These include shareholder connections through family links involving the merging parties. Minority shareholdings, while involving less than full control, may nevertheless confer effective control over merging parties. The issue for competition law is how best to identify minority shareholdings that might lead to anti-competitive effects. This can only be done on a case-by-case basis.

7.14. Control may be exercised through family ties or long-time business relationships. Conglomerates often expand through acquisitions of smaller entities in complementary or unrelated product markets. This allows a merged entity to have an internal capital market that allows resources to be moved between internal products and creates opportunities to engage in anti-competitive conduct, for example, excess funds may be used to sustain pricing below cost. This harms competition by driving existing competitors out of business or stopping potential entry. It also signals to competitors not to enter markets or compete too hard. With greater control of markets, there is also the possibility that conglomerates will co-ordinate their conduct.

7.15. Acquisition of the whole or part of the assets of an entity may also result in an entity being able to replace the acquired entity in the business or in part of the relevant business or allow an acquirer to build up a market presence or develop market access within a reasonably short period of time.

7.16. Assessment of whether the acquisition will bestow control to the acquiring entity requires a case-by-case analysis of the entire relationship between the merging parties. In making this assessment, the PCC will evaluate not only the legal effect of any instrument, deed, assignment, or any other agreements between the merger parties but also other relevant circumstances such as the source of financing for the acquisition, family links, and economic relationships.

C. Substantive Legal Standard for Merger Analysis: The Substantially Prevents, Restricts, or Lessens Competition (SLC) Test

7.17. Under the PCA, anti-competitive impact is assessed by determining whether the merger "substantially prevents, restricts or lessens competition in the relevant market or in the market for goods and services as may be determined by the Commission" (Section 20 the PCA). A merger gives rise to an SLC when it has a significant effect on competition, and consequently, on the competitive pressure on firms to reduce prices, improve quality, or become more efficient or innovative. A merger that gives rise to an SLC is likely to lead to an adverse effect on consumers.

7.18. The objective of the PCA is to foster and promote competition. Thus, in reviewing non-horizontal mergers, the PCC will look at the effects on competition over time both in any relevant market (where the merging parties compete) or any other market(s) in which they operate that might be adversely

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affected by the merger.

7.19. The PCC will conduct merger analysis reasonably and flexibly, recognizing the broad range of possible factual contexts and the specific competitive effects that may arise in different transactions.

7.20. In its evaluation of the competitive effects of a merger or acquisition, the PCC may consider, on a case-by-case basis, a broad range of possible factual contexts and the specific competitive effects that may arise in different transactions, including the:

7.20.1. Structure and features of any markets that the merging parties operate in;

7.20.2. Market position of the entities concerned in all markets;

7.20.3. Actual or potential competition from entities within or outside any market;

7.20.4. Alternatives available to suppliers and consumers; and

7.20.5. Any legal or other barriers to entry to any market.

7.21. Theories of harm for both vertical and conglomerate mergers are described below. For some mergers, more than one theory of harm involving the same market may be considered. The PCC may revise the theories of harm used as its assessment is refined as more information is obtained.

7.22. In assessing whether the merger is likely to result in SLC, the PCC will use the same principles of substantive assessment for Phase I and II review (see IRR, Rule 4, Section 5).

7.23. The PCC will determine the prevailing conditions of competition in the pre-merger situation as the counterfactual against which to assess the impact of the merger. Based on the evidence available, the PCC may consider the likely scenarios other than the prevailing conditions (e.g., whether one of the merger entities would inevitably have exited from the market or where there is a realistic prospect of a new entrant in the market), in its determination of the counterfactual.

7.24. Arrangements and agreements that are entered into by the merging parties, which restrict such parties' freedom of action in the market, will be included in the PCC's merger analysis. Agreements which contain a restriction on competition but are not directly related and necessary to the implementation of the merger may be the subject of Sections 14 and 15 of the PCA.

C.1. VERTICAL MERGERS

C.1.1. Potential Harm to Competition from Vertical Mergers

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7.25. As previously mentioned, vertical mergers may potentially harm competition in markets affected by the transaction. In vertical mergers, the PCC is concerned about the possible anti-competitive impact in both upstream and downstream markets in the relevant supply chain.

7.25.1. Upstream markets refer to stages in the supply chain that are further from the end consumers. Upstream entities are usually the input suppliers, providing a specific service or good to downstream entities.

7.25.2. Downstream markets refer to stages in the supply chain that are closer to the end consumers. Downstream entities are normally the buyers within the supply chain.

7.26. Thus, the assessment necessarily involves a detailed fact-specific assessment in relation to the upstream and downstream markets and will normally entail assessing: these levels in the supply chain. In general, the PCC will assess:

7.26.1. If the merger is likely to raise the costs or otherwise damage the viability of competitors or make collusion easier in upstream or downstream markets. As part of this assessment, an evaluation of market power will be undertaken at both the upstream and downstream levels, before and after the merger. If both upstream and downstream markets are currently competitive (e.g., not concentrated) then vertical integration would seem less likely to enable or extend the exercise of market power unless it is through superior efficiency;

7.26.2. Any likely adverse consequences for customers or final consumers (e.g., higher prices, lower quality, or less product variety etc.); and

7.26.3. Claimed efficiencies that might offset possible adverse competitive effects – that are based on efficiency claims by the merging parties.

7.27. There are several ways in which vertical mergers can impact competition, such as:

7.27.1. Input foreclosure;

7.27.2. Customer foreclosure;

7.27.3. Raising a downstream rival's costs;

7.27.4. Raising an upstream rival's costs;

7.27.5. Coordinated effects; and

7.27.6. Gaining a competitive advantage from obtaining access to confidential information.

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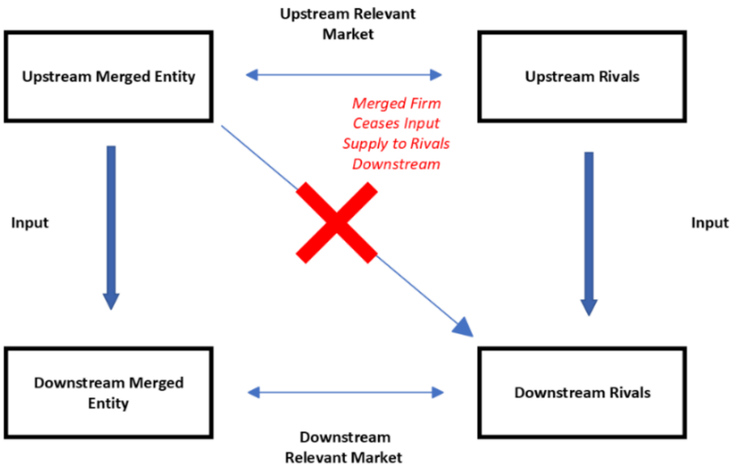
C.1.1.1. *Input Foreclosure and Customer Foreclosure*

7.28. A vertical merger may result in foreclosure when competitors' access to inputs or customers is restricted or hampered as a result of the transaction, affecting the entities' ability to compete. In a vertical merger, the merged entity may engage in input foreclosure or customer foreclosure.

7.29. **Input foreclosure** involves the upstream supplier of an input restricting the supply of an important product or service to downstream competitors of the merged entity.

FIGURE 1. Input Foreclosure



7.30. Fig. 1 illustrates input foreclosure. Pre-merger, the merging parties supplies the input of all downstream entities. Post-merger, if the merged entity has sufficient market power, it can choose not to supply to rivals. If the merged entity continues to have access to the input at a lower price, then it has a competitive advantage and can therefore limit competition in the downstream relevant market.

7.31. A vertical merger may result in **customer foreclosure.** When the upstream supplier integrates with a downstream customer, the merged entity's downstream business unit may refuse to buy from rivals of its upstream business unit. The preference of the downstream rivals then shifts to its affiliate entities thereby foreclosing a customer base of its actual or potential rivals supplying the input. This may make upstream rivals less efficient due to fewer downstream customers and therefore reduce competition upstream.

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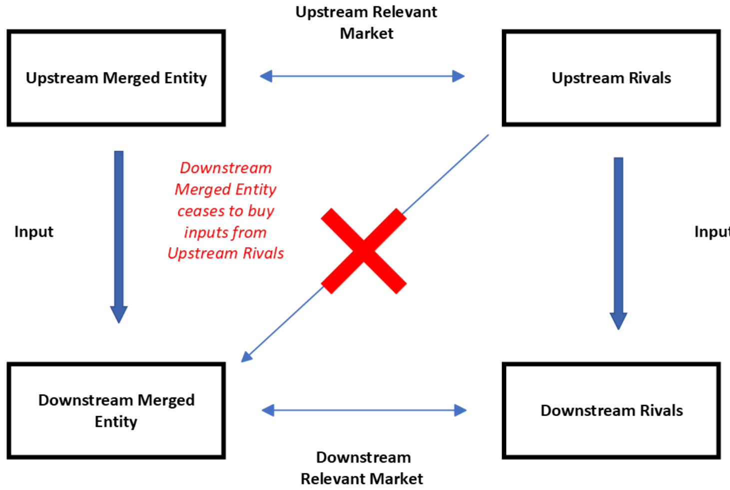
FIGURE 2. Customer Foreclosure



7.32. Customer foreclosure is illustrated in Fig. 2. It shows the merged entity only buying the input from itself or its affiliates. That is, the merged entity refuses to buy input from upstream competitors. This reduces upstream rival's sales which may make it difficult for them to cover fixed costs. If they are driven out of the market, the merged entity can raise price due to less competition in the relevant upstream market.

7.33. The foreclosures discussed above are **total foreclosures**, because the merged entity will fully withhold the supply of products or services or customers. However, the merged entity, instead of engaging in total foreclosure, may likewise continue providing access to products, services, or customers, albeit at a higher price or lower quality. This situation is commonly referred to as **partial foreclosure.**

C.1.1.2. *Raising Downstream Rival's Costs*

7.34. **Raising Downstream Rival's Cost** ("RRC Downstream") is also referred to as partial input foreclosure. RRC Downstream allows for continued supply but involves increasing the input's price, reducing the number supplied, or the input's quality, or downgrading the terms under which the input is supplied. RRC Downstream increases costs to the merged entity's downstream competitors (e.g., who compete against the merged entity in the relevant downstream market) which makes them less competitive against the merged entity.

C.1.1.3. *Raising Upstream Rival's Costs*

7.35. **Raising Upstream Rival's Cost** ("RRC Upstream") is also referred to as partial customer foreclosure. RRC Upstream occurs when the merged entity's downstream business unit only buys at a lower price from rivals of its upstream business compared to those of the merged entity's which raises the costs for

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the rival upstream entity. This would decrease competition upstream or lower the quality of the inputs.

C.1.1.4. *Coordinated Effects*

7.36. A vertical merger allows the merged entity to better understand the market dynamics at both levels (upstream and downstream) relative to their own operations. For example, they may be able to determine that competitors at both levels (and other merged entities) have similar costs and may be more amenable to cooperation. Or they may better be able to monitor any agreement due to their understanding of costs and other economic considerations at both levels. In view of this, vertical mergers may increase the likelihood of coordinated effects, such as explicit or tacit coordination.

C.1.1.5. *Gaining a competitive advantage from obtaining access to confidential information*

7.37. If an upstream supplier needs technical data or information to supply competitors of the merged entity downstream, it may be able to gain a competitive advantage downstream.

C.1.2. Assessing Harm: Ability, Incentives and Likely Impact

7.38. In identifying the likelihood of any anti-competitive effects as a result of vertical mergers, the PCC will consider the following:

7.38.1. The *ability* of the merged entity to foreclose or engage in RRC in either the upstream or downstream market(s) depends on the degree of its market power. This could be indicated by the following: market shares, entry barriers, existence of alternative suppliers, essentiality, or importance of the input, switching costs, expansion capacity of rivals, among others.

7.38.1.1 To illustrate, in input foreclosure, the PCC will assess the market power of the upstream firm over an important or critical input. Whereas, for customer foreclosure, the PCC will assess market power of the downstream firm by determining if it is a large customer or if it controls distribution.

7.38.2. The *incentive* of the merged entity to foreclose or engage in RRC in either the upstream or downstream market(s) depends on the overall profits that the merged entity stands to gain from engaging in such conduct. To illustrate, the merged entity would gain profits from a foreclosure strategy if there is likely to be a significant diversion of sales from a foreclosed downstream rival to the merged entity. This profit must be weighed against the sales that would be lost upstream arising from the foreclosure strategy. If the merged entity pursues a profitable foreclosure strategy and raises input price to downstream competitors, then this means the merged downstream unit is now more competitive and can, for example, either keep its prices low to drive out downstream competitors or increase prices

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which allows competitors to stay in business, but which disadvantages consumers. This assessment depends on fact-specific information about the entity's motives, the likely financial gains and whether the anti-competitive conduct eliminates or constrains more efficient entities in the relevant market.

7.38.2.1 Assessing whether there is a significant diversion of sales to the merged entity downstream or upstream is important. Estimating these diversions in practice is difficult and complicated and direct evidence may not be obtainable. Initially, the PCC may rely on internal merging party's documents (e.g., strategy documents) that show the propensity of customers or suppliers to switch.

7.38.2.2 In the absence of such information, the size of entity margins can also provide information about likely switching (e.g., consumer substitution). For example, high margins (price above cost) indicate inelastic demand and vice versa. If upstream margins are high (demand is inelastic) and downstream margins are low (demand is elastic) then it is easier for consumers to switch in the downstream product than in the upstream, input, market.

7.38.3. The *likely impact on competition:* There must be competitive harm in the downstream market (the impact on competitors is irrelevant). The PCC will assess the impact on price, quality etc. in the downstream market (in the case of input foreclosure) or upstream market (in the case of customer foreclosure). This depends on the number of competitors in those markets and their relative efficiency. For example, if all other entities were already vertically integrated and do not depend on inputs from the merged entity then there would be minimal impact on competition.

7.38.3.1 Information will be sought from both the merging parties and other likely affected other entities as to likely impacts on costs, product quality and whether competition will be harmed, for example, by raising entry barriers etc.

C.1.3. Economic Models Used to Assess Foreclosure Incentives

7.39. Where appropriate data is available, the PCC may conduct quantitative analysis using economic models. Some examples include Vertical Arithmetic ("VA") analysis and Vertical Gross Upward Pricing Pressure Index ("vGUPPI"). These two models determine the incentive of a merged entity to engage in input foreclosure. However, the PCC may also use other quantitative tools that it deems appropriate and permitted by available data.

7.40. The VA analysis is a cost-benefit analysis framework that is used in order to determine whether or not the merged entity has the incentive to engage in input foreclosure. To illustrate, the costs of foreclosure arise from the loss of upstream margins that would have been gained from sales to rivals, whereas the benefits arise from the additional downstream margins gained from those

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customers that divert away from the foreclosed rivals. Given this, VA determines whether or not the benefits of adopting a foreclosure strategy outweigh the costs (e.g. the gains from are greater than the losses and thus is profitable).

7.41. Similar to VA analysis, vGUPPI is a metric for gauging the incentives of the merged entity to engage in foreclosure. The basic GUPPI methodology applied to horizontal mergers also applies similarly to vGUPPI. Vertical mergers can have an impact on the incentives of upstream firms, downstream firms, and rivals. The most important vGUPPI is the vGUPPIu (upstream) which scores the incentive of the upstream merging party to raise input prices to the target downstream rival. The other vGUPPIs are vGUPPId (downstream) and vGUPPIr (rivals), which assesses the incentives of the downstream firm and rivals, respectively.

7.42. Alternatively, measuring both the pro and anti-competitive effects through a full merger simulation may be undertaken which takes account of both upward and downward pricing pressures. These models, however, are highly complex and sensitive to model assumptions. As such, the PCC will take caution in determining the most appropriate economics tools and models applicable when it undertakes its analysis of vertical mergers.

C.1.4. Some Illustrative Vertical Merger Examples

7.43. These examples are simply provided for illustrative purposes and hypothetical. Since merger review is fact-specific, these examples do not bind the PCC in relation to its assessment of future vertical mergers in similar markets.

7.43.1. **Example 1 - Input Foreclosure:** Entity$_{down}$ makes electric cars for sale to the public and decides to merge with Entity$_{up}$, the maker of electric car engines - that makes the best quality electric engines available and has 82% of the downstream electric car engine market. If the merger goes ahead there is the possibility that the merged entity could stop supplying their electric engines altogether (e.g. foreclose supply) to other electric car manufacturers. The merged entity would have the ability to do this and would have the incentive to stop supply and so gain the business of other electric car manufacturers. This would be likely as it would be profitable to do so if the other car manufacturers could not source electric engines from elsewhere (overseas) or could only do so at a much higher price which could force them out of business or allow the merged entity the ability to charge a much higher price for cars.

7.43.2. **Example 2: - Input Foreclosure:** Entity$_{down}$ buys Entity$_{up}$ who owns intellectual property rights ("IPR") over pharmaceutical products that downstream competitors of Entity$_{down}$ use to produce their products. If the merger goes ahead them competitors of Entity$_{down}$ either:

7.43.2.1 Cannot buy IPRs from the merged entity at all (e.g., the IPRs are foreclosed) and so cease production, reduced competition leading to higher

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consumer prices; or

7.43.2.2 Pay a higher price for IPRs from the merged entity (RRC Downstream) which either leads to their exit from the market because they can't compete or are forced to charge a higher price which allows the merged entity to raise its downstream price and make higher profits.

7.43.2.3 Obviously, competitive outcomes depend on whether there are other technologies available and the extent to which other downstream entities have their own IPRs.

7.43.3. **Example 3 – Customer Foreclosure:** Entity$_{up}$ supplies a well-known brand of high- definition televisions (HDTVs) to downstream retailers. There are three major retail chains in the country, A, B and C, who operate across the Philippines. Entity$_{up}$ owns shares in both A and C, but not a controlling interest. However, Entity$_{up}$ is able to appoint a Director to C and so obtains access to confidential information about C's products, costs and strategies as well as the competitiveness of both A and B. Based on information from C, Entity$_{up}$ decides to buy additional shares in A sufficient to obtain control (and so merges vertically with A). The merged entity (A+ Entity$_{up}$) stops supplying (e.g., forecloses) their brand of HDTVs to B and C. The ability to do this depends on whether B and C can source them elsewhere (e.g., from overseas).

7.43.3.1 The incentive to do this depends on whether the increased profits from the merged entity's sale of this brand of HDTVs at the retail level at a higher price are greater than the losses due to B and C's reduced sales of the brand.

7.43.4. **Example 4 – Counterfactual: Likely future plans of the merging entities without the merger:** Entity$_{up}$ a book wholesaler wants to merge with Entity$_{down}$ a book retail chain. As part of the impact on competition, the PCC not only examines likely loss of competition compared with the situation before the merger but will also consider other futures without the merger. In this case, the PCC would also ask if the merger didn't take place, Entity$_{up}$ and Entity$_{down}$ would separately enter upstream and/or downstream markets and so provide more competition at either level compared to the pre-merger situation.

7.43.5. **Example 5 - Sensitive Information Involved:** A vertically merged entity may gain access and control of sensitive business information that it did not have before the merger. This can deter competing entities at both levels from aggressively competing because the competing entities fear that their confidential information passed onto one stage of the merged entity is passed to the other level which gives a competitive advantage.

7.43.5.1 For example, for highly technical products, an upstream entity must gain technical information from the downstream entities it supplies to ensure compatibility.

7.43.5.2 Merging with a downstream entity means the merged entity gains

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technical information on the technical compatibility of products produced by downstream competitors. This may allow the merged entity to gain technical information that improves its own products sufficiently to drive downstream competitors out of business.

C.2. CONGLOMERATE MERGERS

C.2.1. Potential Harm to Competition from Conglomerate Mergers

7.44. Like vertical mergers, conglomerate mergers only have anti-competitive effects if overall economic welfare is reduced. This requires examining whether there is sufficient market power to behave anti-competitively and whether there are efficiencies that are sufficient to outweigh any possible harmful impacts on welfare. Conglomerates operate in different, often unrelated markets, and are often under the control of a single person or entity.

7.45. The central issue is whether a conglomerate merger gives increased exclusionary power to the merged entity. For example, does the merger (i) increase the firm's ability to bundle or tie other products, or (ii) increase the likelihood that cross-subsidization will be effective to drive out existing competitors or forestall entry of competitors?

7.46. Increased conglomerate size may provide considerable financial size. More money means more resources for lobbying and greater ability to engage in exclusionary conduct or the threat that such strategies will be pursued.

7.47. In family conglomerates, central control can be exercised across all the family entities (which may seem unrelated), but which could include possible predatory subsidization of entities in the conglomerate (perhaps for 'face' reasons) that may drive competitors out of business. This may create a reputation for 'toughness' to discourage potential players from entering the market or competing head-to-head with the conglomerate.

7.48. If a net positive effect on medium-term conglomerate profits is expected, the newly merged entity can use cross-subsidy to undercut competitors and potentially drive them out of business or to effectively deter new entrants.

C.2.1.1. *Unilateral Conduct*

a. *Leveraging*

7.49. Leveraging is a general term where a firm exploits its market power in one market to extend that power in an adjacent market. Leveraging is not necessarily anti-competitive unless it is pursued to establish a second monopoly.

7.50. Abusive leveraging may take in the form of other more specific conduct such

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as self-preferencing (wherein the undertaking intentionally favors its own products); bundling and tying, refusing to deal; and predatory pricing.[3]

7.51. Considering the nature of merger review being forward looking, abusive leveraging may be difficult to establish prior to consummation. In such cases, prior conduct or strategies, even if not necessarily related to the merger or market being reviewed or investigated, may be used to support the claim that the merger increases the likelihood of abusive leveraging.

i. Tying and Bundling

7.52. A conglomerate merger may allow the merged entity to tie or bundle products to the detriment of the consuming public. Tying conduct occurs when customers who wish to purchase the tying product are required to also purchase the tied product from the dominant entity. Tying can either be technical or contractual: *technical tying* refers to an instance where the dominant entity designs the tying product in such a way that it may only properly work when the tied product is used with the tying product; *contractual tying* occurs when the dominant entity, through the agreement, requires its customers, who intend to purchase the tying product, to also purchase the tied product.

7.53. The dominant entity might also engage in anti-competitive bundling practices. In general, bundling refers to how products are offered and priced. In *pure bundling*, the bundled products are only sold together and in fixed proportions. On the other hand, in *mixed bundling*, the bundled products are individually available, albeit more expensive than the bundled price.

7.54. Tying and bundling are common commercial arrangements but do not necessarily harm competition and may even promote competition if done using compelling offers. However, tying or bundling by an entity with a substantial degree of market power may lead to a substantial lessening of competition when that entity uses a tie or bundle to extend or leverage this market power into another market.

ii. Cross Subsidization

7.55. Conglomerate mergers may increase exclusionary power if there is incentive to utilize their size to drive out competitors. Cross subsidization refers to the situation where a conglomerate would use its profits in one or more markets to subsidize its operations in other markets. Cross subsidization may lead to a substantial lessening of competition when the merged entity has the ability and incentive to restrict competitors from growing within the subsidized market.

C.2.1.2. Unilateral Effects in Relation to Conglomerate Mergers

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7.56. Under certain conditions, conglomerate mergers may have anticompetitive effects, including unilateral effects through the elimination of imperfect substitution, the elimination of potential competition, and an increase in financial strength.

7.57. Unilateral or non-coordinated merger effects are those that result from a change in individual incentives and the likely reactions of all market participants to this change, while the strategic interaction between market participants remains unaffected. Some unilateral effects may also, however, increase efficiency and do not impede effective competition.

a. *Elimination of Imperfect Substitution*

7.58. The elimination of imperfect substitution can cause unilateral effects if the products of the merger parties can, to some extent, be substituted for one another, even though they belong to different product markets. The products of the respective relevant markets differ slightly from the imperfect substitutes in that they can either only be replaced by them to a limited extent or subject to certain conditions.[12]

7.59. Even though imperfect substitutes cannot sufficiently control a dominant company's scope of action, they can restrict it to some extent. Depending on the scope of substitution, the elimination of imperfect substitution can thus lead to unilateral effects.[13] In dynamic industries where products and resources are highly differentiated, imperfect substitutes can be another significant source of competitive pressure that reduces the risk of harmful effects.[14] From an economic perspective, the analysis of the unilateral effects of the elimination of imperfect substitution is essentially the same as in the case of horizontal mergers.[15]

b. *Elimination of Potential Competition*

7.60. Unilateral effects can also occur if a potential competitor is eliminated by the merger. The theory of contestable markets illustrates how potential competition can have a disciplinary effect.[16] According to this theory, firms will be forced to ensure an optimal allocation of resources provided that the market in which they operate is "contestable," or one where it is possible for firms to easily enter the market without incurring sunk costs and to leave it without loss.[17] If potential competitors can enter a market immediately and without sunk costs, a hypothetical monopolist would be forced to supply at the competitive price or the competitive quantity.[18]

7.61. Even if barriers to market entry exist, it may be rational for a dominant entity to prevent market entry by departing from short-term profit maximization. For instance, the dominant entity may reduce prices to deceive potential competitors about the actual profit opportunities in the market. The dominant entity could also increase its capacity to make it credible that potential

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competitors would not be able to generate sufficient profits to cover the costs of their potential entry. Both practices increase consumer welfare on a short-term basis.[19]

7.62. Conversely, the elimination of a firm which the established entity considered to be a potential competitor can generally lead to unilateral effects, also on a short-term basis. In the long term, the elimination of a potential competitor generally leads to anti-competitive effects if this firm had entered the market without the merger.[20]

c. *Increase in Financial Strength*

7.63. An increase in financial strength can lead to cost reductions which usually have a positive effect on consumer welfare. However, under certain conditions, consolidation of financial strength can also result in unilateral effects. For instance, an entity with limited sources of finance prior to the merger may, with greater financial strength, have an increased capacity to carry out exclusionary strategies, particularly price cutting strategies. If competitors expect price-cut strategies to be used, this can lead to deterrent effects.[21]

7.64. Squeezing competitors out of the market through price cuts is a relatively costly strategy. On the other hand, renouncing the use of price cuts can lead to future costs, as competitors could possibly gain market shares or enter the market. From the dominant entity's view, squeezing competitors out of the market through price cuts is only a rational strategy if the costs incurred during the price-cut phase are lower than those involved in renouncing price cuts. The analysis of whether an increase in financial strength leads to such unilateral effects is thus largely based on existing knowledge about predatory pricing.[22]

C.2.1.3. *Coordinated Effects in Relation to Conglomerate Mergers*

7.65. The PCC will also look into the possibility of coordinated effects in a conglomerate merger. Coordinated effects arise when firms that were not coordinating their behavior are now significantly more likely to coordinate and raise prices or otherwise harm effective competition or where a merger makes coordination easier, more stable or more effective for firms which were coordinating prior to the merger.[23]

7.66. The PCC will determine the possibility of coordination and its sustainability by taking into account all relevant information on the characteristics of the markets concerned, including both structural features and the past behavior of firms.[24]

7.67. The non-exhaustive list of factors is looked into to assess the likelihood of coordinated effects:[25]

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7.67.1. Extent of market concentration;

7.67.2. Number and symmetry of the companies;

7.67.3. Demand Characteristics;

7.67.4. Extent of market transparency; and

7.67.5. Existence of barriers to market entry.

7.68. Symmetrical merging companies, or those which have similar capacities or product ranges, have a higher likelihood of colluding and there is a higher possibility of coordination in the markets both are engaged in, as opposed to asymmetrical entities. As the corporate structures become more similar across the markets, cooperation becomes more likely.[26]

7.69. Low barriers to entry would also decrease the risk of coordination. If a conglomerate merger makes market entry less attractive, e.g., due to financing aspects, economies of scope, or bundling strategies, the likelihood of coordinated effects will increase.[27]

C.2.1.4. *Other Frameworks*

7.70. Other than the above-discussed economic tools, the PCC may utilize the following other frameworks in analyzing the conglomerate effects of mergers:

7.70.1. *Reduced Innovation Incentives*. Under this framework, impacts on incentives to innovate given the market conditions resulting from a merger are analyzed. The merged entity increases innovation efforts due to the internalization of benefits in complementary markets, but there is a lower probability of rival success because rivals need to successfully innovate several products to offer competitive bundles. This framework implies the assessment of: (a) innovation complementarities; (b) demand externalities across products; (c) market power in different products; and (d) the nature of innovation (e.g., incremental versus disruptive).[28]

7.70.2. *Bargaining Theories.* Bargaining determines how the gains of trade are split among counterparties. Under bargaining theories of harm, mergers can increase the "cost of no deal" for the customer and decrease the same for the conglomerate. These theories require the assessment of: (a) conglomerate market power in different products; (b) buyer's demand complementarities; (c) buyer's market power; and (d) preferences of final consumers.[29]

7.70.3. *Exclusive Dealing and Full-Line Forcing*. Conglomerate mergers could facilitate bundling and tying or closely analogous practices such as exclusive dealing or full line forcing.

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7.70.3.1 **Exclusive dealing** occurs when one person trading with another imposes some restrictions on the other's freedom to choose with whom, in what, or where they deal. A subtype of exclusive dealing, third line forcing, occurs when a business will only supply goods or services, or give a particular price or discount on the condition that the purchaser buys goods or services from a particular third party. If the buyer refuses to comply with this condition, the business will refuse to supply them with goods or services.

7.70.3.2 **Full-line forcing** involves a supplier refusing to supply goods or a service unless the intending purchaser agrees not to: (a) buy goods of a particular kind or description from a competitor; (b) resupply goods of particular kind or description acquired from a competitor; and (c) resupply goods of a particular kind acquired from the company to a particular place or classes of places. The acquisition of a comprehensive portfolio of brands is likely to lead to full line forcing.

C.2.1.5. Assessing Harm: Ability, Incentives, and Likely Impact

7.71. The PCC will consider all kinds of anti-competitive conduct in assessing the likelihood of reduced competition. In doing so, the PCC will use the same basic approach described above in assessing vertical mergers. That is, the PCC will examine the ability, incentive, and likely effect of post-merger conduct. This requires considerable information on entity plans that is not usually available or disclosed. For example, a merged entity with substantial market power could tie unrelated products from a related entity to help a struggling family member. This might be carried out to ensure family conglomerate stability in the long run. Important to this possibility is the issue of *control* which provides the reason for the PCC examining ALL possible relationships in the conglomerate companies and the merging companies.

7.72. The PCC will not limit the markets investigated. They could include not only *relevant markets* (where the merging parties compete) and markets where the merging parties are in supply and buy relationships (vertical) but also consider Other Affected Markets.

7.73. As with vertical mergers, the PCC will use a three-stage approach to conglomerate mergers (ability, incentive, and impact) to determine whether the merger will likely result in *exclusionary conduct* that will lead to anti-competitive price increases, output reductions and less innovation.

7.73.1. *The ability of the merging parties to exclude competitors from competing*. This depends on the nature of the products and markets involved and the extent of market power. For example, to be successful, tying requires market power in the tying market to force consumers to take the tied product. The PCC will investigate all the markets that the merging parties are involved in, both pre- and post-merger, to identify markets where market power is currently important. As part of its

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assessment the PCC will seek the reasons for merging from the entities, and opinions from those who may be affected or oppose the merger. The PCC will consider each case based on its specific facts. For conglomerates, the issue of "control" is important as it is defined in the PCA Sec. 4 (f) as "Control refers to *the ability to substantially influence or direct the actions or decisions of an entity, whether by contract, agency or otherwise."*

7.73.1.1 Factors to be assessed include market structure and market shares; barriers to entry; degree of vertical integration; existence and power of competitors; competitor access to inputs and distribution channels; ability of customers and suppliers to switch to other goods or services; technology used and whether changing; its recent conduct etc.

7.73.2. *The* *<u>incentives</u>* *of the merging parties to exclude.* The PCC will determine the nature of all products involved to assess whether the products are complements (and to what extent), whether there are common consumers, whether technical tying is feasible, the nature of the relationship between merging parties and their customers, any past anti-competitive conduct in the markets concerned etc. Given time constraints and the likely large amount of evidence needed, the PCC will concentrate on those markets most likely to yield large anti- competitive effects. For most cases, the incentive to merge will depend on the likely profitability post-merger. The PCC will carefully investigate this, considering long-term conglomerate profitability and the relevance of the merger to long-term conglomerate goals, not just the profits of the immediate merging parties.

7.73.3. *The* *<u>likely impact</u>* *of the strategy on competition.* This assessment will be done in conjunction with both (a) and (b) above. Usually, the information for this assessment will come from competitors to all markets that a merging party is engaged in. Of course, conglomerate mergers may allow the entities involved to achieve efficiencies, better integration, increased customer convenience and overall reduced transaction costs.

7.74. For diagonal mergers there is a weak vertical link between the merging parties and so Elimination of Double Marginalization ("EDM") effects are marginal. Also, before a merger, there may be contractual links between the merging parties used to overcome the EDM problem and so the EDM changes from the merger may be small. For mergers involving non- related products, there is no EDM.

C.2.1.6. Economic Models

7.75. The PCC shall use relevant economic models to evaluate conglomerate mergers on a case-to-case basis, considering factors such as, but not limited to the relevant markets; other affected markets; and factual and economic circumstances surrounding the merger.

C.2.1.7. Some Illustrative Conglomerate Merger Examples

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7.76. Economic theory underpinning the anti-competitive effects of conglomerate mergers is not well-developed. The PCC will use available economic tools to evaluate all evidence from documents, data, and witnesses to build a coherent understanding of likely effects to form the basis for sound decisions.

7.76.1. **Example 1 - Bundling/Tying:** Entityup1 and Entityup2 make complementary products used by filmmakers downstream (which is here the *relevant market)*. Entityup1 supplies software for drawing cartoons for use in filmmaking, including to its own subsidiary Entitydown1. Entityup2 owns cartoon characters that are also used by downstream filmmakers (the cartoon drawing software and cartoon are *related*). Entityup1 decides to buy Entityup2. There are two possible anti-competitive effects to examine:

7.76.1.1 Will the merged entity refuse to sell cartoons to its downstream competitors (foreclose) or alternatively bundle or tie the drawing cartoon software with cartoons at a higher price to competitors of its subsidiary Entitydown1 which gives it a comparative advantage in filmmaking (RRC)?

7.76.1.2 Deter new entry by refusing to supply cartoons to new filmmakers and so making it difficult for them to produce cartoons or forcing them to set-up their own cartoon producing entity upstream?

7.76.1.3 The PCC here would take special care to examine, not only whether a vertical merger will foreclose or raise rival's costs either downstream or upstream but will also consider whether the merging parties would be likely competitors at both levels in the future without the merger.

7.76.2. **Example 2 – Cross Subsidization:** Entity A who is the biggest entity in the Philippines selling washing machines, merges with Entity B who operates in the market for shoes in Metro Manila. Once the merger is completed, the merged entity takes profits from the market for washing machines and subsidizes their shoe operations. Several shoe entities cannot compete and are driven from the market. The remaining entities understand that they could be next and agree, with the merged entity, to raise the price of shoes gradually.

8. Efficiencies

8.1. The PCA and PCA-IRR provide that an anti-competitive merger may be exempted from prohibition by the PCC if the parties can establish that the merger will bring about or is likely to bring about gain in efficiencies that are greater than the effects of any limitation.

8.2. The PCC in evaluating efficiencies in non-horizontal mergers will be guided by the principles provided in the Merger Review Guidelines.

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A. Potential Benefits from Vertical Mergers

8.3. Market contracts are necessarily incomplete due to the costs of specifying every possible outcome and so there are opportunities for opportunistic conduct. It is often difficult to ensure there are contractual safeguards particularly when there are high exit costs involved with a contract. A merger might provide a guaranteed input supply or access to supply chains and so ensure better supply chain management, reduced inventory size, etc.

8.4. When disputes arise between different levels in an integrated company, they can be resolved by a manager rather than costly negotiation or litigation.

8.5. A merger might also ensure adequate investment. If separate entities anticipate future disputes, they have reduced incentive to invest in the vertical relationship. A merger can also eliminate 'hold-up' (e.g., where an investment useful to both entities does not occur). In both cases, final consumers are likely to be better off.

B. Potential Benefits from Conglomerate Mergers

8.6. A conglomerate merger, concerned with maximizing overall conglomerate profits, may also see benefits such as:

8.6.1. Economies of scale and scope e.g., cost savings from the transfer of management and technical skills etc.

8.6.2. Reduced costs via better spreading of risks across the entity (e.g., where there are differences in business cycles between entity products). Reduced financial risks may allow for more innovation.

8.6.3. Reduced costs where products made by the merged entities are interdependent – so better integration can lead to cost savings (including from less reliance on other entities) and consumer benefits.

8.6.4. Demand side efficiencies mean bundling may mean lower consumer search costs and convenience.

8.7. Conglomerates can also operate an internal capital market which allows for cross-subsidization and the use of unused money to take advantage of new opportunities.

8.8. Evaluating whether conglomerate mergers are anti-competitive is difficult due to difficulties obtaining information about operations and future plans in entities that are involved in many different markets. This is particularly true where:

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8.8.1. The controlling entity handles management, which provides a number of benefits such as guaranteed loyalty and trust, flexibility of operations, quick decision-making and relatively low costs.

8.8.2. From a regulator's perspective, family control allows for minimal company bureaucracy and record-keeping which makes investigations of regulators difficult.

B.1. Elimination of Double Marginalization

8.9. Elimination of double marginalization can be relevant to both vertical and conglomerate mergers. For vertical mergers, double marginalization occurs at *successive* levels of the supply chain.

> **Example: EDM in Vertical Mergers**
> Pre-merger, a wholesale coffee roaster with some market power sets a price above cost (i.e., a margin) without considering the price a retail café charges. A retail café with some market power buys the coffee and also adds a margin when setting price. The final price to consumers includes the two markups. If the wholesale and retail entities merge, their profit maximizing price to final consumers may be lower.

8.10. Merging parties claiming lower consumer prices must demonstrate their EDM calculations showing lower prices and any other efficiencies. For conglomerate mergers, double marginalization occurs through merging the production of complementary products.

> **Example: EDM in Conglomerate Mergers**
> Suppose there are two independent entities, one supplies salt, the other pepper to a single buying entity downstream. Both salt and pepper producers operate in competitive markets so charge the downstream monopolist the competitive price.
>
> Suppose now that both the salt and the pepper producers have some market power. So, both add a mark-up and charge above cost – and so the monopolist downstream buys less of each product. But because they are complements, increasing the price of salt means the downstream monopolist will buy less salt *and* less pepper. The salt producer does not take account of the impact of increasing the price of salt on the pepper producer. And vice versa. So, the downstream monopolist buys less salt and pepper and charges more to final customers. If the salt and pepper producers merge, then they work together to sell the downstream monopolist more and then share the increased combined profits.

8.11. In assessing claims of reduced prices due to EDM, the merging parties must demonstrate:

8.11.1. The likely reduction in downstream prices due to EDM, how double mark-ups are reduced and how the savings will be passed on to benefit final consumers.

8.11.2. That an agreement between the merging parties is not possible (EDM can also be reduced by contract).

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7.87.3 That these benefits are greater than costs to consumers from the merger.

C. Failing Entities/Exiting Assets

8.12. Under Chapter IV, Section 21(b) of the PCA and Rule 4, Section 10 of the IRR, when a party to a merger or acquisition agreement is faced with actual or imminent financial failure, and the agreement represents the least anti-competitive arrangement among the known alternatives for the failing entity's assets, the PCC may exempt from prohibition an otherwise anti-competitive merger. This applies to both non-horizontal mergers and horizontal mergers. For example, a supplier or buyer of the failing entity may buy the failing entity (a vertical merger) despite some likely anti-competitive impact, for example from foreclosure. But if the resulting anti-competitive harm is less than without the merger then PCC will allow the merger.

8.13. 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 this case, the counterfactual (the competitive situation absent the merger) may be adjusted to reflect such likelihood.

8.14. The basis for concluding that a merger with a failing entity does not harm competition is that the competition provided by a failing entity would be lost even without the merger and, consequently, the competitive situation post-merger may be no worse than the counterfactual (e.g., no merger but failing entity exists the market). The Commission may conclude, based on the failing entity doctrine, that the merger has no causal connection with worsened competitive conditions in the future.

8.15. The burden of proof of exit lies on the merging parties, who also hold the relevant evidence. In the absence of sufficient evidential support for exit, the Commission cannot make use of the failing entity analysis.

8.16. Entities, despite temporary difficulties, may be able to survive and continue competing. The fact that an entity has not been profitable does not necessarily mean that it is a "failing entity." For instance, an entity 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.

8.17. The material tests for showing that one of the merging parties is failing are that (a) the entity 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 anti- competitive alternative outcome than the merger in question; and (d) the entity and its assets would exit the market in the imminent future absent the merger.

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8.18. Merging parties should provide as evidence profit and loss and cash flow information, recent balance sheets and analysis of the most recent statutory accounts, the timing and nature of the entity's financial obligations, the relationship between the company's costs and its revenues, the likely ability of the entity to obtain new revenues or new customers, and the current and future availability of key inputs. Prospective financial information and forecast information for the current year should also be provided.

8.19. The PCC shall also assess whether the failing entity has unsuccessfully sought in good faith any credible alternative offers of acquisition of the entity or its assets that would retain the assets in the relevant market and pose less harm to competition than the merger in question. The parties are required to provide evidence that there is sufficient awareness regarding the sale of the entity or its assets to attract the attention of likely prospective purchasers. The PCC will consider other offers to purchase the assets of the failing entity above the liquidation value of those assets (net of the costs associated with the liquidation process) as credible alternative offers even if these are not commercially preferable.

8.20. The PCC shall likewise consider whether the failure of the entity and the liquidation of its assets could be a less anti-competitive alternative to the merger since the remaining entities in the market would compete for the failing entity's market share and assets that otherwise would have been transferred wholesale to a single purchaser.

9. Remedies

9.1. If the PCC establishes that a non-horizontal merger or an anticipated merger, if carried into effect, will or may be expected to substantially restrict, lessen or prevent competition, the PCC may decide to prohibit the merger. Alternatively, it may decide to approve the merger only when the pertinent party or parties modify the merger agreement or enter into legally enforceable agreements to remedy, mitigate or prevent the anti-competitive effects resulting from the merger.

9.2. In this regard, there are two types of remedies that the PCC may consider: structural remedies and behavioral remedies.

9.2.1. Structural remedies are measures that directly alter market structure and address issues that give rise to competition problems. Basic forms of this type are divestitures (forced sale of business units or assets, either in full or partial), licensing (compulsory licensing of legal rights, usually intellectual property rights), rescission (undoing a completed transaction) and dissolution (ending a legal entity).

9.2.2. Behavioral remedies are measures that directly alter the behavior of an entity. The PCC may also impose behavioral remedies to prevent a merged entity from

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behaving anti-competitively.

9.2.3. Structural remedies may also be supported by behavioral remedies. For instance, to ensure that a partial divestment remedy would lead to a situation where a viable and effective competitor will emerge, the merged entity may be prohibited in the interim from communicating with the former clients of the divested business.

9.3. In determining the remedy or set of remedies that would be appropriate, reasonable and practicable to address the adverse effects of the merger on competition, the PCC will take into account the adequacy and effectiveness of the action in preventing, remedying or mitigating the anti-competitive effects of the merger.

10. Decision

10.1. If the PCC determines that the merger is not likely to result in SLC, the PCC shall issue a decision approving the merger.

10.2. If the PCC determines that the merger or acquisition is prohibited under Section 20 of the PCA and Section 9 of the IRR, and does not qualify for exemption under Section 21 of the PCA and Section 10 of the IRR, the PCC may:

10.2.1. Prohibit the implementation of the agreement;

10.2.2. Prohibit the implementation of the agreement unless and until it is modified by changes specified by the PCC; or

10.2.3. Prohibit the implementation of the agreement unless and until the pertinent party or parties enter into legally enforceable agreements specified by the PCC.

10.3. The PCC's decision approving the merger may not be challenged under the PCA, unless it was obtained on the basis of fraud or false material information.

11. Interpretation

11.1. Any legal concept, definition or clause provided under the PCA, IRR, these Guidelines, as well as applicable rules and guidelines issued by the PCC, shall exclusively apply in the conduct of merger review, to the exclusion of other laws, decrees, executive orders, and regulation inconsistent therewith.