ECONOMIES (EFFICIENCIES) – AN ESSENTIAL CONSIDERATION IN MERGER ANALYSIS

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Abstract:

"While the purport of competition law is to preserve and promote competition, the essential object of competition is to ensure optimal allocation of available resources, produce more while using less resources and thus achieve efficient market outcomes. Generally, the efficiency is accepted as a defense in competition law. Ignorance of economies (efficient use of resources) by competition law and competition enforcement agencies would prejudice the very object of preserving competition. However, one should also acknowledge that scientific quantification and weighing of efficiencies are complex tasks.

Like any other law, the competition law jurisprudence is an evolving organism. In nearly all jurisdictions there were times when merger review was limited to anticipation of acquiring of market power by the combining enterprises. It was not uncommon to see that, sometimes, market power was also confused with market share of the combined entities after merger. With introduction of economic concepts and more and more reliance on economics, the situation is fast changing. In present day competition law jurisprudence, it is no more a mechanical reliance on the anti competitive effects of a merger, but these anti-competitive effects have to be examined in the background of obtaining efficiencies.

No doubt, there is greater realization than ever before to give efficiencies their due. So much so that the in the later merger control regimes such as India, along with efficiencies, even economic development of the country is being taken as a factor for consideration in merger review.

This paper attempts to examine the ongoing evolution by tracing the role of efficiencies in merger (business combinations) analysis in view of the merger control law/guidelines of US, Canada and Australia. The authors conclude that there is a great need for transitional economies to recognize merger efficiencies in their competition law/policy and judiciously apply them."

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ECONOMIES (EFFICIENCIES) – AN ESSENTIAL CONSIDERATION IN MERGER ANALYSIS

"*if neither the courts nor the enforcement agencies are sensitive to these (efficiency) considerations, the system fails to meet a basic test of economic rationality. And without this the whole enforcement system lacks defensible standards and becomes suspect.*"

- *Oliver Williamson*[†]

While the purport of competition law is to preserve and promote competition, the primary rationale behind competition is to ensure optimal allocation of existing resources and thus achieve *efficient* market outcomes.[2] Universally, efficiency is accepted as a justification for approving an outcome provided the welfare consequences of the outcome in question outweigh its ill-effects. Ignorance of economies (efficient use of resources) by competition law and competition enforcement agencies would prejudice the very object of preserving competition. However, one should also acknowledge that scientific quantification and weighing of efficiencies are complex tasks. Further, tradeoff between efficiency and anticompetitive actions is one of the muddled areas of competition jurisprudence.

This paper attempts to trace the role of efficiencies in merger (business combinations) analysis with the regulatory practice in US[3], Canada and Australia as a back drop. Also, the paper attempts to briefly discuss the provisions of Indian Competition Act, 2002 relating to merger efficiencies in a novel way.

A. EFFICIENCIES

Besides the difficulty in quantifying efficiencies, it is also very difficult to define the concept. It is also not appropriate to have an exhaustive definition or explanation that covers all the instances of efficiencies. In general efficiencies are improvements that serve public interest and benefit the society at large. In this regard one may also conclude that any improvement prejudicial to public interest may not be recognized as efficiencies for the purpose of competition law.

ICN Merger Guidelines Work Book[4] reads that "Efficiencies include cost savings, more intensive use of existing capacity, economies of scale or scope, or demand-side

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† "*Economies as an Antitrust Defense: The Welfare Tradeoffs*", The American Economic Review, Vol. 58, No. 1 (Mar., 1968), pp 18-36, at p 34.

[2] OECD, "*Competition Policy and Efficiency Claims in Horizontal Agreements*" (1994), OECD/GD (96)65, at p 1.

[3] The discussion on US position is in line with the "*1992, Horizontal Merger Guidelines (with April 8, 1997, revisions to section 4 on efficiencies)*"

[4] ICN Merger Working Group: Investigation and Analysis Subgroup, "*Merger Guidelines Work Book*" [2006], at p. 62.

efficiencies such as increased network size or product quality. They might also encompass pro-competitive changes in the merged entity's incentives, for example by capturing complementarities in R&D activity, which in turn might increase incentives to invest in product development in innovation markets".

Components of efficiencies, for the purpose of competition law, may be broadly classified as allocative, productive, dynamic, and transactional.[5] All these components evidence better resource management in one way or the other. Significant majority of the mergers are motivated by the possibility of the resulting entity achieving these efficiencies.

i. **Productive efficiency:** These are commonly recognized across jurisdictions which imply higher production with existing or lesser input. These efficiencies reduce cost of production and are quantified scientifically. Productive efficiencies includes

   - *Economies of scale:* These refer to benefits yielded out of larger units of production with existing capital assets. Scale benefits include optimal utilization of captive plants and reduction in cost incurred out of operations and investment in fixed assets. Scale benefits may arise at product-level, plant-level and multi-plant-level.[6]

   - *Economies of scope:* Scope benefits arise when related activities are carried together.[7] Instances of scope benefits include production of two different but related products and production and distribution by the same person. Sources of these efficiencies include common raw materials; complementary technical knowledge; and the reduction or elimination of distribution channels and sales forces.[8]

ii. **Allocative efficiency:** "a market is said to achieve "allocative efficiency" when market processes lead society's resources to be allocated to their highest valued use among all competing uses."[9] In simple terms, allocative efficiencies occur when production is allocated to the highest value buyers. At such an allocation, price of the product would be equal to the marginal cost.

    There may be situations where because of a vertical merger on account of elimination of 'double marginalization' there will be enhanced allocative efficiencies.

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[5] Kolasky, William J. and Andrew R. Dick, "*The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers*", US Department of Justice:http://www.usdoj.gov/atr/hmerger.htm, Celebration of the 20th anniversary of the Guidelines, June 10th 2002, at p. 49.
[6] ICN Merger Working Group: Analytical Framework Subgroup, "*Project on Merger Guidelines*" [2004], Chapter IV at p.17.
[7] John Black, "*A Dictionary of Economics*", Oxford University Press [2005], at p. 136.
[8] *Supra* 4, at p.18.
[9] *Supra* 3.

If we take an example of a vertical merger between the makers of a compressor used in a refrigerator and the makers of refrigerator, a lot of packing material and resources on transportation would be saved and be available to society for use elsewhere. This is also a clear case of enhancement in allocative efficiencies as a result of a merger.

iii. **Dynamic efficiency:** Gains achieved out of innovation are called as dynamic efficiencies. Innovations result in better quality, novel products and better technologies. Innovations lubricate competition by accelerating rivalry and stewardship among competitors. Merger of two small firms may enable the resultant to invest more in Research & Development and innovate. On the other hand merger between innovative firms may monopolize the scarce intellectual properties in the hands of the resulting entity.

iv. **Transactional efficiency**: Mergers may reduce transaction cost incurred by consumers. Vertical mergers often results in transactional efficiencies. Transactional efficiencies also form the platform for achieving other efficiencies. It helps in reducing the price raise due to opportunistic behaviors and holdups.[10] For instance merger between monopoly wholesaler and monopoly retailer reduces the price mark-up by the retailer, which in turn leads to the possibility of reducing the price of the products sold.

In addition to the above specific components, there are other categories of efficiencies that may be found in literatures that deeply discusses the economics behind efficiency.[11] The authors personally find the above discussed aspects of efficiency sufficient to understand treatment of legally recognized efficiencies in mergers.

B. INCORPORATING EFFICIENCIES IN MERGER ANALYSIS

One of the early practices was ignorance of efficiencies as they are considered difficult to quantify.[12] For instance, early practices of United States shows a lesser appreciation bordering on ignorance in so far as the mergers lessening competition were prohibited irrespective of their efficiency achievements.[13] However, as a result of

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[10] *Supra 3,* at p. 59.

[11] ICN Merger Working Group: Analytical Framework Subgroup, "*Project on Merger Guidelines*" [2004], Chapter IV identifies fixed cost savings, promotional efficiencies, pecuniary (or) re-distributive efficiencies, marginal cost savings, demand side network effects and capital cost savings as the other kinds of efficiencies recognized by regulators in different jurisdictions.

[12] Ann-Britt Everett and Thomas W. Ross, "*The Treatment of Efficiencies in Merger Review: An International Comparison*" [2002], Canadian Competition bureau, at p.15 (available at http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/en/01263e.html accessed on 12/01/2009).

[13] In *FTC V. Procter & Gamble Co.,* 386 U. S. 568 (1967), the U.S Supreme Court held that **"***Possible economics cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economics, but it struck the balance in favor of protecting competition***".** Similarly, earlier in *Brown Shoe Co., inc. V. United States*, 370 U. S. 294 (1962), the U.S. Supreme Court held that,- "*we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing*

definite realization that consideration of efficiencies was gaining wide acceptance, US courts started recognizing efficiencies and in 1997, the US merger guidelines were amended to explicitly incorporate efficiency gains as a part of the merger review. With increasing uniformity across the world, jurisdictions recognize efficiencies under the law or regulations that govern merger control. Following are the approaches followed by selected jurisdictions to recognize efficiencies in merger analysis,-

i. Efficiency as a part of substantive assessment test &
ii. Efficiency as a defense
iii. Authorization

While the understandings of efficiencies are similar across jurisdictions, these approaches differ from each other with respect to the stage at which efficiencies are considered.

i. **Efficiency as a part of substantive assessment:** This is the most common method followed in recognizing efficiencies. Under this approach, consideration of efficiencies forms part of the substantive assessment adopted by the jurisdiction. "Substantive lessening of competition" (SLC) is the assessment criterion adopted by all the jurisdictions selected for the purpose of this paper.[14] Under SLC, any merger that actually results or is likely to result in SLC is blocked.

   Efficiency as a part of substantive assessment criterion requires the enforcement agency to consider efficiencies while determining the existence/non-existence of the substantial criterion. Under the approach, a combination resulting in lessening of competition at the same time generating significant efficiencies may be permitted on the ground that the lessening of competition is not substantial. Among the jurisdictions selected, United States and European Union adopt this approach.

ii. **Efficiency as a defense:** Under the approach, efficiencies have no role in determining the substantive criterion of assessment. However, they act as a justification for approving a combination. It is purely a cost-benefit analysis between the positives and negatives of the combination. If the efficiencies generated out-weigh the anti-competitive effects anticipated the combination is approved.

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considerations in favor of decentralization. We must give effect to that decision". These decisions of the U.S. Courts show the conscious disregard to economies in early times.

14 While Substantial Lessening of Competition (SLC) is the phrase used in US Merger Guidelines, the nomenclature of the standard in Australia and Canada are slightly different,- (i) Australia – "effect, or be likely to have the effect, of substantially lessening competition in a market" (S. 50 of Trade Practice Act, 1974) and (ii) Canada – "prevents or lessens, or is likely to prevent or lessen, competition substantially" (S. 92, Competition Act, 1985).

The classic example for this approach is the Canadian practice. While section 93 of the relevant legislation[15] enumerates the list of factors that are to be considered for determining the substantive assessment criterion, section 96 separately deals with efficiency considerations. Relevant portion of the section reads that

> "*The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made*".

It is the obligation of the tribunal not to block a merger if the same generates efficiencies that offsets the anti-competitive effects of the merger. Thus, in every merger reported, the tribunal has to weigh efficiencies with the potential anti-competitive effects. Thus, under defensive approach, efficiency considerations form part of the substantive analysis but is that is separate from the determination of anti-competitive effects.

In the earlier approach, presence of efficiencies leads to a conclusion that the proposed merger is pro-competitive or competition neutral but in the defensive approach, efficiencies acts as a justification for approving a merger.

iii. **Authorization**: Authorization is similar but not identical to efficiency defense. Unlike the defense, authorization is a separate process where the particular merger is given immunity from the operation of the provisions prohibiting anticompetitive merger. Immunity is granted on the grounds of efficiencies. In some the jurisdictions like Germany and United Kingdom[16], this power is vested with the concerned ministries. Among the jurisdictions selected, Australia adopts authorization process.[17] Authorization on the ground of public benefit allows the Australian tribunal to formally consider efficiencies**.**

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[15] [Canadian] Competition Act, 1985

[16] Section 73 of the Fair Trading Act, 1973 empowers the Secretary of State for Trade and Industry to approve mergers in the exceptional cases of public interest.

[17] Section 88 (9) of the Trade Practices Act, 1974 provides for authorization. The provision reads as follows,-

> "*(9) Subject to this Part, the Commission may, upon application by or on behalf of a person:*
> *(a). grant an authorisation to the person to acquire shares in the capital of a body corporate or to acquire assets of a person; or*
> *(b). grant an authorisation to the person to acquire a controlling interest in a body corporate within the meaning of section 50A; and, while such and authorisation remains in force:*
> *(c). in the case of an authorisation under paragraph (a) - section 50 does not prevent the person from acquiring shares or assets in accordance with the authorisation; or*
> *(d). in the case of an authorisation under paragraph (b) - section 50A does not, to the extent specified in the authorisation, apply in relation to the acquisition of that controlling interest.*"

C. MERGER-SPECIFICITY

While efficiencies are considered as a justification for approving mergers, firms should not use efficiencies as a gateway for consummating anticompetitive mergers. This also raises some significant policy issues as to what efficiencies and when they are to be considered. Significant majority of the jurisdictions mandate merger specificity to recognize efficiencies. Specificity implies that the alleged efficiencies cannot be achieved in any manner otherwise than by the merger.

Specificity factor determines that relevance of efficiencies alleged. Precisely, the issues are twofold. Firstly, whether the efficiencies alleged are the direct consequence of the merger. Secondly, is there a possibility of the alleged efficiencies being achieved in any manner otherwise than by the merger? If the alleged efficiencies are unique to the merger, which could not be achieved in any other means, then the efficiencies are more likely to be appreciated.[18] On the other hand if the alleged efficiencies are capable of being achieved otherwise than by the merger then the consideration of efficiencies purely depends on the likelihood of the other means available to the parties to achieve the same.

However, specificity proposition does not make competition authorities to insist and rely upon all the hypothetical probabilities rather they look for those practical probabilities. For instance in U.S. efficiencies "that are practical in the business situation faced by the merging firms will be considered in making this determination; the Agency will not insist upon a less restrictive alternative that is merely theoretical.[19]" Thus, it is not the mere existence of alternative but an alternative that is *practical and less anti-competitive* than the merger.

D. PASS-ON REQUIREMENTS

Pass-on mandate that the efficiencies obtained should be to the benefit of consumers either in terms of lower price or better quality of products/service.[20] Efficiencies passed on to consumers, even if realized by dominant firms, could have significant positive effects on the economy as a whole.[21] Consumer Pass-on requirements are highly integrated to the welfare standard recognized in the regulatory structure. Jurisdictions which follow consumer surplus and/or price standard are most likely to insist that the benefits of efficiencies should pass-on to consumers. We would be in a better position to understand pass-on factor after the forthcoming deliberations on welfare standards.

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[18] *Supra* 2, at p. 64.
[19] Supra 8, at § 4.
[20] § 79-84, European Union, Guidelines on the Horizontal Mergers under the Council Regulation on the Control of Concentration between Undertakings, OJ C 31/5 dated 5.2.2004.
[21] OECD, "*Substantive Criteria Used for the Assessment of Mergers*" [2003], DAFFE/COMP(2003)5, at p.331.

E. EFFECT OF MERGER ON PRICE AND ALLOCATION PATTERNS

The effect of a merger, increasing the market concentration, on the price and resource allocation may be well understood from the following type of diagram explanation. This type of explanation was popularized by Oliver Williamson.[22]

Assume that two firms, each with significant market share, operate in a concentrated market. The said firms merge with each other (horizontal merger). The diagram below presents the impact of the merger on the price and allocation pattern in the market.

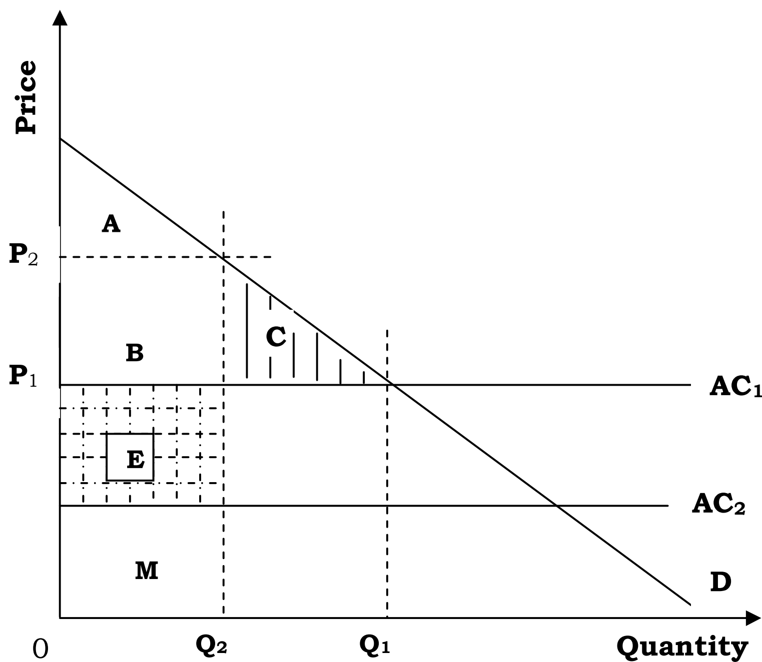

Fig. No. 1: Williamson's model on effects of merger

(*Assumed: Market is a concentrated market and the Merger (Combination) further increases concentration which in turn leads to higher prices.*)

AC_1 = Pre-merger Average cost.
AC_2 = Post-merger Average cost.
D = Demand.

P_1 = Price of the Product before merger.
P_2 = Price of the Product after merger.
Q_1 = Quantity demanded before merger.
Q_2 = Quantity demanded after merger.

A+B+C = Pre-merger Consumer surplus.
B = Surplus gained by firms from consumers (wealth or welfare transfer).
C = **Dead weight loss**. This is the consumer surplus lost in view of the merger.
E = **Efficiency gains**.

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[22] "*Economies as an Antitrust Defense: The Welfare Tradeoffs*", The American Economic Review, Vol. 58, No. 1 (Mar., 1968), pp 18-36.

In the above figure - **D** represents customers' demand for the product. The average cost of production and price of the product before merger are given by $\mathbf{P_1}$ and $\mathbf{AC_1}$ respectively. $\mathbf{Q_1}$ represents the quantity demanded when the price were at $\mathbf{P_1}$ (i.e. before merger). In the pre-merger market scenario it may be noticed that price is equal to cost ($\mathbf{P_1} = \mathbf{AC_1}$).

The merger further increases the market concentration and places the resultant entity in a dominant position. As a result of dominance, the resultant entity achieves pricing power and scale benefits. While the pricing power leads to increased price[23], scale benefits reduce the average cost of production. The increased price and decreased cost are given by $\mathbf{P_2}$ and $\mathbf{AC_2}$ respectively. As a result of increased price the quantity demanded gets reduced from $\mathbf{Q_1}$ to $\mathbf{Q_2}$.

From the above it is clear that the merger had lead to increase in price, reduction in demand and reduction in cost of production. These consequences put together have impact on competition, consumers, stakeholders and society as a whole. Quantification of the differences in price, demand and cost in view of the merger and their impact on the different sects of the society forms the basis of welfare tradeoffs.

Consumer and producer surplus are the predominant measures used by economists to assess the welfare consequences of a merger. *Consumer surplus* [**CS**] refers to the difference between what consumers would have been willing to pay for a particular product and what they actually pay. *Producer surplus* [**PS**] refers to the difference between the revenue collected by the firm and the cost they incur for producing the product. In the figure, **A**+**B**+**C** represent the consumer surplus before the merger, which falls down to **A** after merger due to the raise in price.

The merger increases the price ($\mathbf{P_2}$) and reduces the cost incurred ($\mathbf{AC_2}$) thereby enables the producer to acquire portion **B** from consumers to his benefit. This transfer is commonly called as wealth or welfare transfer. The scale benefit and consequential reduction in cost results in efficiency **E** - represented by the difference between cost before and after the merger ($\mathbf{AC_1} - \mathbf{AC_2}$). Thus, as a result of merger, producer gains surplus [**PS**] represented by **B+E**. On the other hand, increased price reduces the demand for the product from $\mathbf{Q_1}$ to $\mathbf{Q_2}$. Here the reduction in consumption and output (production) is the loss to whole society and is called dead-weight loss (**C**).

F. TRADE-OFF-WELFARE STANDARDS

From the above diagrammatic presentation it is clear that mergers may create and/or transfer wealth. While wealth creation (efficiencies) is the positive aspect of a merger, consequences of wealth transfers may be negative. Enforcement agencies assess the

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[23] For better understanding on how mergers lead to increased price one may refer to Bretrand and Cournot theories of oligopoly.

nature of wealth transfers to approve mergers on the basis of efficiencies. In particular, those mergers that transfer wealth from consumers to producers need cautious scrutiny.

Recognition of efficiencies (wealth created) depends on the nature of regulatory stance followed in the particular jurisdiction i.e. the welfare standard adopted. In simple terms trade-off between efficiencies and anti-competitiveness is based on the welfare *standard* incorporated in the regulatory regime.

Existing literature and the prevailing practice presents the following types of standards that are relevant for the purpose of merger analysis. These standards could be better understood if the same is appreciated in view of Williamson's model.

i). ***Price Standard:*** Where a merger decreases the price of the product/service, the merger would be approved irrespective of its ill effects. This standard requires the benefits of efficiencies to be passed-on to consumer in terms of reduced price. Adoption of price standard is considered as an obsolete practice as the magnitude of efficiencies and consumer benefits other than price reduction are ignored.

ii). ***Consumer-Surplus Standard:*** This is similar but not identical to price standard. Here the requirement of pass-on to consumers is not limited to reduced price but includes other benefits to consumers such as production of novel products, better quality and expansion of existing facilities. Though consumer surplus appears similar to price standard they are much broader than the latter. For instance, a merger reducing price as well as the quality of the product/service may pass price standard but not the consumer-surplus standard.

iii). ***Total-Surplus Standard***: Recognition of efficiencies mandates the quantum of post-merger efficiencies to be greater than the deadweight loss to the society i.e. in Fig. No.1, E should be greater than C. Under this approach, the overall loss and gain of the society would be relevant irrespective of the wealth transferred from consumers to producer. Among the various standards, this approach gives the possibility of giving credence to producer surplus over the consumer surplus. It recognizes efficiencies gains irrespective of consumers' disadvantage.

iv). ***Hills-Down standard:*** The obiter dictum of the Canadian Competition Tribunal in *Hills down case*[24] lead to this approach. Under hills-down

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[24] *Canada (Director of Investigation and Research) v. Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289 (Comp. Trib.). Relevant portion of the decision reads as follows (at p. 95 and 96 of the order),-

standard, efficiencies gained shall be in excess to the loss suffered by consumers, i.e. in the figure, and E shall be greater than B+C. The approach treats the wealth transferred from consumer to producer as a negative cost of the merger and tries to balance consumer and producer surplus equally. This approach ranges somewhere between consumer-surplus and total-surplus standard. However, this approach is not in practice even in Canada.

v). ***Weighed-Surplus Standard*:** This is the most flexible approach that enables the enforcement agency to use its discretion in recognizing any factor that generates welfare. Under the approach the various effects of merger are added together as in total-surplus standard but in each case it is multiplied by some sort of social weight allocated in view its importance.

Reference could be drawn to the decision of Canadian Competition Tribunal in *Superior Propane case*[25]. In the said case, the Canadian regulator dealt with the merger between Canada's two largest propane distributors. The merger was approved despite the anticipated price increase of 8% (around $43 million), dead-weight loss of $3 million and resultant entity achieving 70% of the market share. Canadian Commission predicted that the merger would result in cost saving around $29.2 million and approved the merger on the basis of net efficiency standard. The Canadian regulator applied weighed surplus standard in concluding that efficiencies of the Merger offsets the anticompetitive effects of the merger[26].

F. COMPARATIVE CHART ON ROLE OF EFFICIENCIES IN MERGER ANALYSIS

Comparative Table - Role of efficiencies in Merger Analysis				
Jurisdiction		**Australia**	**Canada**	**U.S.**
Mode of Recognition	Statute	√	√	-
	Guidelines	√	√	√
Method of Treatment	Whether part of substantive test	-	-	√
	Defense	-	√	-
	Authorization	√	-	-
Types of efficiencies	Productive	√	√	√
	Allocative	√	√	√

"Certainly, one interpretation which is open on the basis of the wording of subsection 96(1) is to weigh any alleged efficiency gains against the degree of likelihood that detrimental effects (both wealth transfers and allocative inefficiency) will arise from the substantial lessening of competition."

[25] *Canada (Commissioner of Competition) v. Superior Propane Inc.*, CT-98/02, 2000 Comp. Trib. 15 (Aug. 30, 2000).

[26] Antitrust experts say that Canadian regulator failed to appreciate the wealth transferred from consumers to merging entity as the cost saving (around $29 million) is much lesser than the anticipated price raise and dead-weight loss (around $ 46 million).

recognized	Dynamic	√	√	-
Welfare Standard adopted	Price	-	-	-
	Consumer Surplus	√	-	√
	Total Surplus	√ -Authorization	-	-
	Hills down	-	-	-
	Weighed Surplus	-	√	-
Merger - specificity		√	√	√
Pass-on requirements		√	-	√

Table No.1: Table prepared on the basis of Merger Control Legislation/Guidelines of respective jurisdiction and reports of ICN and OECD.

G. MERGER EFFICIENCIES AND INDIAN COMPETITION ACT, 2002 (AS AMENDED)

Section 5 and 6 of the Competition Act, 2002 ("**Act**") relate to regulation of combinations.[27] Section 5 explains the types of acquisitions, mergers and amalgamations that are 'combinations' for the purpose of the Act. Section 6 prohibits combinations which causes or is likely to cause an *appreciable adverse effect on competition*[28] *("**AAEC**").* Any person who proposes to enter into a combination shall give notice to the Competition Commission of India ("CCI") in the form as may be specified and the fee which may be determined by regulations.[29] Such proposals reported to CCI would not take into effect until either the expiry of two hundred and ten days from the day on which notice was given or the Commission has passed orders on merger[30]

CCI, while determining whether the proposed combination causes or likely to cause AAEC, is mandated to have due regard to all or any of the factors mentioned in section 20(4) of the Act. A holistic reading of these factors shows that CCI would consider both anti-competitive and welfare consequences of the proposed combination. The last five factors mentioned in Section 20(4) of the Act indicate the possibility of CCI considering the welfare consequences in determining whether the combination has or likely to have AAEC in the relevant market. The said five factors are reproduced below for ready reference:

"(j) nature and extent of vertical integration in the market;
(k) possibility of a failing business;
(l) nature and extent of innovation;
(m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;

[27] The provisions relating to combinations including section 5 and 6 are not yet enforced. However these provisions are expected to be enforced anytime nearby.
[28] Section 6(1).
[29] Section 6(2).
[30] Section 6(2A) read with section 31(1).

(n) whether the benefits of the combination outweigh the adverse impact of the combination, if any."

The above factors indicate that they are very wide in their sweep. The very first factor in section 20(4)(j) of the Act is "nature and extent of vertical integration in the market". Vertical integration, in the context of a merger, can have both-positive and negative consequences. If a vertical integration has a possibility of reducing competition in the downstream market by creating monopoly or enhanced market power over the source of raw material or other vital inputs, in that event, the effects of vertical integration are negative. On the other hand, a vertical integration can be pro-competitive if it results in elimination of either "double marginalization" or expenditure on similar or identical activities.

As regards the factor in section 20(4) (l) of the Act "nature and extent of innovation" is concerned, this can also be seen both ways. Sometimes a merger can raise the possibilities of future innovation on account of the possibilities of economics of a scale and scope and incentive to invest in research and development activities. However, this can also be a negative consideration if one of the entities to a merger is having some IPRs which may not be utilized by the other entity to the merger for fear of competition with its own existing line of products. In some cases, the IPRs may be brought into market after a gap of some time period by the acquiring entity with not a sole eye on consumer welfare. In such eventualities, the effect of the combination would be anti-competitive. Further, the Indian competition law also takes into account relative advantage by way of contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition. This is a very wide latitude given to the competition agency. By its very wording, it appears, the CCI has been given authority to clear any combination having or likely to have an appreciable adverse effect on competition if, in the view of CCI, it has relative advantage by way of contribution to the economic development. It is very sweeping authority indeed.

If this last factor of relative advantage to the economic development had left any doubt, the next factor i.e. factor given in Section 20(4) (n) is still more general. It gives CCI a complete freedom to clear combination if in its view the benefits of the combination outweigh the adverse effect of the combination, if any.

Seen in this perspective, the last five factors given in Section 20(4) of the Act indicate that efficiency considerations in Indian law are extremely wide. Firstly, the efficiency considerations are very much a part of the statute. Thus competition law in India recognizes efficiencies *ab-initio* as a part of the substantive assessment criterion. Thus Indian merger control regime incorporates efficiencies as a part of its substantive assessment in case of mergers.

As regards the welfare standards, the authors are of the view that Indian Competition Act follows a standard which is way beyond the total surplus standard. In terms of the provisions given herein, the CCI is under obligation to consider the contribution to the economic development of the combination. This has to be seen along with the preamble of the Act which states that the Act was to promote and sustain competition "keeping in view the economic development of the country". This means that the economic development of country is a supreme goal of the Competition Act, 2002. It does not necessarily limit itself within boundaries of different welfare standards considered by different jurisdictions but it takes them as support but goes much beyond and essentially aims at the development of the country.

H. CONCLUSION

Universally, effective enforcement of competition law is understood as a tool for distributing the welfare generated out of open market and competition thereof. However, enforcement of competition law is not a standalone tool; it presupposes various socio-economic stipulations including pro-market government policies and a pro-competitive market system.

Besides enforcement, the very role of competition law/policy is also dependent on the stage of the economy. For instance, in developing economies, vigorous enforcement of competition law may prejudice industrial policies that are aimed at economic growth. In these economies competition law shall supplement, not contradict, economic growth.[31] Thus, there is a need for developing/transitional economies such as India to recognize economies (efficiencies) that facilitate development. In Indian context, the consideration of efficiencies has been taken to higher level where the law has given great flexibility to the competition authority in evaluation of the efficiencies without tying them to any pre-decided notions or types of efficiencies. It is very wide. It is open to include allocative, productive, dynamic and transactional efficiencies. Therefore, the authors also of that the view role of efficiencies in merger analysis changes with the change in the stage of the economy and it should be in consonance with the stage of development of the economy.

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[31] Reference could be made to the decision of the Israelian Antitrust Tribunal in *Plywood producers vs. Director of Israeli Competition Authority*. In the said decision, the tribunal approved an anticompetitive agreement irrespective of the corresponding raise in the price of plywood. The agreement was approved on account of increased productive efficiency and increased exports. *See* Michal S. Gal, "*The Ecology of Antitrust: Preconditions for Competition Law Enforcement in Developing Countries*" (2004). Competition, Competitiveness and Development, pp. 20-38.

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