CHAPTER 5 - ASSESSMENT OF MARKET ENTRY AND EXPANSION (BARRIERS TO ENTRY)[1]

I. INTRODUCTION

1. As stated in Chapter 1, even a merger that materially increases market concentration may not be anticompetitive if new firms would enter the market (or expand production) and prevent incumbents from exercising market power. In theory, if entry is easy, the monopoly rents resulting from an anticompetitive post-merger reduction in output and increase in price will attract new firms to the market and force prices back down to competitive levels. If entry is not easy, however – if there are "barriers to entry" – then new entry may not dissipate the post-merger exercise of market power within a reasonable period of time. In such cases, legal intervention to prevent an otherwise anticompetitive merger may be necessary.
2. There is broad agreement among jurisdictions on this basic concept. Each of the "core" merger enforcement guidelines surveyed for this report require competition authorities to consider whether market entry or expansion would deter or counteract the anticompetitive effects of a merger. Most guidelines expressly require that, to be effective, entry must be (i) likely, (ii) timely and (iii) of sufficient nature, scale and scope to constrain anticompetitive effects.
3. Having stated the widely accepted theory, however, the more difficult question for policy-makers is how best to assess the actual likely effect of entry or expansion in respect to an actual merger. Complex judgments have to be made about whether sufficient entry likely would occur on a timely basis and act as an effective

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competitive constraint, given the requirements and costs of entry and the likely responses of incumbent firms.

4. Countries have adopted somewhat different analytical constructs by which to make these judgments, which they continue to evolve. For example, many jurisdictions (but not all) distinguish between entry in the short term and entry in the medium term. They treat the former as a form of supply-side substitution considered in defining the relevant market (the EU position) or identifying participants in the market (the U.S. position), and consider the latter in their competitive assessment of the merger. (See discussion in Chapter 2, Market Definition.) In addition, the U.S. and Brazilian guidelines, for example, employ a "minimum viable scale (MVS)" analysis to help determine the probability of competitively effective entry which others do not.

5. It is not clear that these differences in approach necessarily result in different outcomes. No one approach seems clearly more likely in practice than the others to answer correctly the common entry question all countries ask, although there are advantages and disadvantages to each. The ICN should monitor experience under the guidelines—many of which have only recently been adopted—to determine whether material differences arise in practice. In addition, individual jurisdictions should consider whether more concrete guidance can be given as to how they assess and weight various factors affecting the likelihood and competitive sufficiency of entry.

6. This chapter describes how various countries assess entry and expansion in examining the likely competitive effects of horizontal mergers, including a

discussion of the possible forms of new entry and the three key elements of: (i) likelihood, (ii) sufficiency, and (iii) timeliness.[2]

II. SOURCES OF NEW ENTRY

7. In general, a range of entry responses are possible, from so-called "hit and run" entry involving relatively low cost of entry and exit, to entry over the longer-run that involves significant costs of entry and exit. The difference may be described in terms of timing and/or investment. Some supply responses occur in the short run with little or no investment required and provide for the immediate possibility to participate in the market (this is short-term entry). Other supply responses, however, are likely to occur over a longer period and may require more significant investment (this is medium-term entry).

8. As noted above, many guidelines attempt to distinguish between the two concepts, although in practice the distinction has proved to be more blurred. Some jurisdictions (like the EU) refer to this distinction as supply-side substitution (short-term entry) versus potential entry (medium-term entry).[3] Others (like the United States and Brazil) refer to the distinction as "uncommitted" entry versus

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2 This chapter does not discuss the substantive analysis of mergers that involve the acquisition of a potential entrant or that may be anticompetitive because they create "barriers to entry" (e.g., "vertical" mergers involving the acquisition of control over a scarce input needed to enter an upstream or downstream market), except insofar as the merger itself makes entry that would constrain its potential anti-competitive effects less likely. It should also be noted that, in some jurisdictions, approval of a merger may be conditioned on an undertaking by the merged entity designed to facilitate post-merger entry that would constrain anticompetitive pricing. *See, e.g.,* Case No. 08012.005846/99, Brahma/Antarctica, Decision of the Brazilian CADE - Administrative Council for Economic Development (Mar. 30, 2000) (requiring merged entity to provide access to its distribution network in order to facilitate new entry). Discussion of such remedial provisions are beyond the scope of this chapter.

3 European Commission Notice on the definition of relevant market for the purposes of Community competition law, [1997] O.J. C 372/5, ¶¶ 23 - 24. See also discussions of the adaptation of existing facilities, at para. 16, *infra*. It is not surprising that considerations that are relevant to defining the relevant market may also be relevant in analyzing potential entry (imports are thus often an important factor in defining the relevant geographic market). On the other hand, it may sometimes be difficult to distinguish the assessment of the relevant market from the analysis of potential competition (*e.g.*, in the case of supply-side substitution).

"committed" entry.[4] Uncommitted entrants are treated as current market participants and assigned market shares where possible.

9. Applying the distinction can help to guide and shorten analysis. For example, when a merger occurs in a market in which entry requires little by way of sunk investment, and the number of prospective entrants are not limited, there may be no need to look for committed or medium-term entrants.[5] But it is not essential to distinguish the two concepts in order to arrive at the correct result, and many jurisdictions have chosen not to do so, perhaps because of the practical difficulties that may be entailed in distinguishing whether entry is committed or uncommitted (or short-term or medium-term).

10. In general terms, new entry (committed or uncommitted) can take several forms.[6] While most of the merger guidelines surveyed for this report provide extensive guidance on barriers to entry and expansion, they do not provide similar detail in regard to the form of entry. A few guidelines include a non-exhaustive list of entry alternatives,[7] but do not rank them in order of importance for the competitive

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4 See Brazil SEAE/SDE Joint Resolution No. 50, Guidelines for the Analysis of Horizontal Merger Concentration (Aug. 1, 2001) (hereinafter, "Brazil Guidelines"), ¶¶ 50, 51; U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (Apr. 8, 1997) (hereinafter, "U.S Guidelines"), ¶ 3.0.

5 See Jonathan B. Baker, Responding to Developments in Economics and the Courts: Entry in the Merger Guidelines (2002) at 19, available at http://www.usdoj.gov/atr/hmerger/11252.pdf (hereinafter, "Baker").

6 See list of sources of potential competition in XXIst Report on Competition Policy (1991) ("XXIst Report") at 363 - 365.

7 United Kingdom, Merger References: Competition Commission Guidelines, June 2003 (hereinafter, "U.K. Guidelines"), ¶ 3.46; New Zealand, Commerce Commission, Mergers and Acquisitions Guidelines (hereinafter, "New Zealand Guidelines"), ¶ 6.1. The European Commission ("EC") takes the view that "the most realistic and strong potential competition" is the expansion of capacity by established competitors and potential imports from another geographic market. See XXIst Report at 365. However, the EC has not ranked the various sources of entry in its recent Draft European Commission Notice on the Appraisal of Horizontal Mergers Under the Council Regulation on The Control of Concentrations Between Undertakings, COM (2002), December 11, 2002, Adopted by the European Commission on December 16, 2003 [To Be Effective May 1, 2004] (hereinafter, "Draft EC guidelines").

assessment.[8] In any case, entry must result in actual or potential competition that limits the market power acquired by the undertaking resulting from a concentration.

11. ***Imports from other regions***. Imports are often considered in delimiting the relevant geographical market, *i.e.*, whether a market is national in scope. In cases where the level of imports does not justify the delimitation of a wider geographic market than the national one, the level of imports may also be taken into account to evaluate the possibility of potential competition.[9] Australia, in particular, often considers imports to be a decisive factor in the approval of a concentration.[10] In some instances, imports may be the only additional potential competitive constraint—for example, where additional capacity can only be expected from the "de-bottlenecking" of existing producers' facilities and new companies are not expected to enter the market.[11]

12. Competition authorities consider a number of factors in determining whether customers would switch to imported products in response to an anticompetitive price increase, including factors such as tariff and non-tariff barriers to international

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8 Cf. (Canada, Merger Enforcement Guidelines (Mar. 1991) ("Canada Guidelines") ¶ 4.6.1 (In assessing the likelihood of future entry, Canada generally begins by assessing firms that appear to have an entry advantage, i.e., fringe firms already in the market and firms that sell the relevant product in a geographically adjacent market, control technology or assets that can be used to produce the relevant product, already operate in vertically-related markets, sell through similar distribution networks, or use similar marketing and promotional methods; such firms "are typically the most important sources of potential competition").

9 Case No COMP/M. 2662, *Danish Crown / Steff-Houlberg*, Decision of the European Commission (Feb. 14, 2002), ¶¶ 30-37.

10 See Australian Competition and Consumer Commission, Merger Guidelines (June 1999) (hereinafter, "Australian Guidelines") ¶ 5.111 ("The Commission has not objected to any merger where comparable and competitive imports have had a sustained market share of 10 percent or more for at least three years, and–as an indicative guideline–it is unlikely to do so. However, it should be emphasized that it is not the historical share of imports that is significant, but their potential to constrain the price and output decisions of the merged firm.") See also, Japan, Guidelines for Interpretation on the Stipulation Concerning M&As (1998) (hereinafter, "Japan Guidelines"), 3.B.(2)(b); Brazil Guidelines at ¶ 44.

11 Case No. COMP/M.2389, *Shell - DEA*, Decision of the European Commission (Dec. 20, 2001), ¶ 72; Case No. IV/M.1313, *Danish Crown /Vestjyske Slagterier*, Decision of the European Commission (Mar. 9, 1999), ¶¶ 150 - 151.

trade, consumer preferences,[12] security issues, transport costs, the effect of exchange rates, the apparent current price impact of imports, the extent to which imports are independent of domestic suppliers for distribution, and whether existing supply routes could accommodate significant expansion without significant sunk cost investment.[13] Australia generally will not challenge a merger where imports have accounted for at least ten percent or more market sales for at least three years.[14] As a rule of thumb, Brazil will consider imports to be a sufficient market force to prevent anticompetitive behavior where they would increase within one year to at least 30 percent of the total market demand.[15]

13. ***Expansion of capacity***. The expansion of capacity or the use of excess capacity by firms already in the relevant market can in some cases also constrain anticompetitive price increases by the merged entity.[16] Expansion of capacity can occur through capacity "creep," de-bottlenecking, roundout or "brownfield" expansion at existing sites, or new so-called "Greenfield" projects. In each case, competition authorities undertake a detailed assessment of the ability of individual firms to expand their capacity.[17] For example, the addition of new capacity may

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[12] See, e.g., Case No. IV/M.113, *Courtaulds/SNIA*, Decision of the European Commission (Dec. 19, 1991), ¶ 24; Case No. COMP/M. 2662, *Danish Crown / Steff-Houlberg*, Decision of the European Commission (Feb. 14, 2002), ¶ 30-37.

[13] See, e.g., Australia Guidelines ¶ 5.112; Brazil Guidelines ¶ 44; Germany, Principles of Interpretation (Oct. 2000) (hereinafter, "Germany Guidelines") ¶¶ 5.2, 5.4. See also, e.g., Case No. COMP/M.1813, *Industrie Kapital(Nordkem) Dino*, Decision of the European Commission (Jul. 12, 2000), ¶ 106.

[14] Australia Guidelines ¶ 5.111.

[15] Brazil Guidelines ¶ 43.

[16] See, e.g., Canada Guidelines ¶ 4.6.1; New Zealand Guidelines ¶ 6.1; Finland Merger Guidelines (Sept. 15, 1998) (hereinafter, "Finland Guidelines"), 43-45. See also Case No. IV/M.042, *Alcatel / Telettra*, Decision of the European Commission (Apr. 12, 1991), ¶¶ 38 – 40; Case No. IV/M.315, *Mannesmann/Vallourec/Ilva*, Decision of the European Commission (Jan. 31, 1994) [1994] OJ L102/15, ¶¶ 116 – 124. Conversely, where competitors lack the capacity to deal with a short-term increase in demand, expansion of capacity may not constitute a source of new entry. See *Tetra Pak/Alfa-Laval*, ¶ 3.3.

[17] Compare New Zealand Guidelines at ¶ 6.1.

not be taken into account where it is intended primarily to cover the internal needs of the major integrated producers.[18]

14. ***Entry of new competitors into the relevant product market***. Firms that are not already operating in the relevant market or in markets related to the relevant market may enter *de novo*.[19] Such entry can occur through taking over existing capacity and using it in new or more productive ways, or through building new capacity.[20] New entrants can adopt aggressive pricing strategies that the incumbents would have to match.[21]

15. ***Entry of In-House Capacity Into the Merchant Market***. A further potential source of new entry comes from vertically integrated firms that might choose to expand into the merchant market, using existing excess capacity or adding to its in-house capacity.[22] In extreme cases, a company might spin off its in-house production facilities, turning it into a new "independent" merchant supplier.

16. ***Adaptation of existing facilities***. There is some discussion about the extent to which the adaptation of existing facilities may form part of the entry analysis.[23]

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18 See, e.g., Case No. COMP/M.1693, *Alcoa/Reynolds*, Decision of the European Commission (May 3, 2002), ¶¶ 30, 35.

19 See, e.g., U.K. Guidelines ¶ 3.46. See also, Case No. COMP/M.1915, *The Post Office/TPG/SPPL*, Decision of the European Commission (Mar. 13, 2001), ¶¶ 75 – 83.

20 U.K. Guidelines ¶ 3.46.

21 See Case No. IV/M.727, *BP/Mobil*, Decision of the European Commission (Aug. 7, 1996), ¶ 40.

22 See, e.g., U.K. Guidelines ¶ 3.46. Examples of backwards integration concern in particular the automotive industry: Case No. IV/M.134, *Mannesmann / Boge*, Decision of the European Commission (Sept. 21, 1991), ¶ 30; Case No. IV/M.149, *Lucas/Eaton*, Decision of the European Commission (Dec. 9, 1991), ¶ 37; Case No. IV/M. 139, *Viag/EB-Brühl*, Decision of the European Commission (Nov. 19, 1991), ¶ 19. See also Case No. IV/M.1597, *Castrol/Carless*, Decision of the European Commission (Dec. 14, 1999), ¶ 28; Case No. IV/M.1599, *DuPont/Teijin*, Decision of the European Commission (Nov. 24, 1999), ¶ 22. It is also possible that a customer having some in-house production of a product or service will respond to an anticompetitive price increase by turning to self-supply or increased self-supply.

23 New Zealand Guidelines ¶ 6.1.

The European Commission, for example, considers the reallocation of production facilities as one possible form of entry,[24] while in many instances the adaptation of facilities may be labeled as supply-side substitution that is taken into account when defining the market, as discussed above. There is a suggestion that in order to be considered as part of market definition, such supply responses generally should be likely to occur within one year of the price rise (although the exact time period will depend on the nature of the market considered). In addition, such entry should not involve significant sunk investment in plant, equipment, skills, or marketing.[25] Similarly, where (i) a seller would be likely to face significant difficulty in distributing or marketing the relevant product, or (ii) new production or distribution facilities would be required to produce or sell on a significant scale, the possibility of adapting facilities may not be assessed for market definition purposes, but rather will be assessed in considering the likelihood of entry.[26] In either event, the underlying issue is to assess the extent to which the supply-side response can be expected to act as a competitive constraint on the perceived anti-competitive effects of a merger.

III. STANDARDS FOR ASSESSING THE LIKELY COMPETITIVE IMPACT OF ENTRY

A. The Likelihood That Entry Will Occur

17. In theory, a merger that results in reduced output and higher prices can attract new entry or expansion that would not have occurred at pre-merger prices. The notion is that new firms can enter or expand in the market to fill demand resulting from the

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24 Draft EC Guidelines ¶ 84. See also Case No. IV/M.1357, *Nordic Capital/Hilding Anders*, Decision of the European Commission (Feb. 4, 1999), ¶ 27.

25 See, e.g., U.K. Guidelines ¶ 2.21.

26 See, e.g., Canada Guidelines ¶¶ 3.2.2.7, 4.6.1.

merged firm's contraction in output without driving market prices below pre-merger levels. Such entry is likely to occur, however, only if firms have access to the assets they need to enter and compete and if entry would be profitable over a sustained period considering all of the costs and risks involved. In general, entry is more likely to occur where sunk costs and the risks of entry are low.

18. The likelihood of new entry is examined on a case-by-case basis, considering the structure and economic circumstances of the relevant market and the likely behavior of economically rational firms. In some jurisdictions, this analysis involves attempting to identify specific firms that would likely enter the relevant market.[27] New Zealand, for example, states that it will not attempt to identify specific firms that might enter where barriers to entry in a market are clearly low, but that where barriers are higher "the Commission may seek to identify specific businesses that might enter.[28] The guidelines of other jurisdictions (such as the draft EC guidelines) do not require that specific new entrants be identified. The U.S. guidelines state, for example, that U.S. competition authorities will assess the likelihood of new entry "without attempting to identify who might be potential entrants."[29] Even in the United States, however, identifying actual firms as likely new entrants will at the least be persuasive and may be necessary to overcome evidence tending to indicate that sufficient and timely entry would not likely occur. In practice, an otherwise anticompetitive merger may not be approved based on

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27 See, e.g., Australia Guidelines ¶ 5.128.

28 New Zealand Guidelines ¶ 6.1. See also Germany Guidelines ¶ 5 ("Market entry is . . . not a firm-related, but a market-related structural criterion.").

29 U.S Guidelines ¶ 3.1.

asserted ease of entry if the merging parties fail to identify any potential entrants that can confirm that entry would likely occur.[30]

19. **More than A Mere Possibility That Entry Will Occur.** The mere possibility that entry *could* occur is not sufficient to overcome anticompetitive concerns.[31] The guidelines examined for this report variously require that entry be "likely in commercial terms,"[32] "probable . . . in concrete terms,"[33] or established to a "high probability."[34] In assessing entry, competition authorities generally consider all available evidence, including the experience of firms that have recently entered or left the market, evidence of planned entry or expansion, direct observations on the costs and risks associated with entry, the opinions of firms identified as potential entrants, and economic modeling.

20. Every jurisdiction seeks to answer the same basic question: Would a firm or firms likely enter the relevant market in response to an anticompetitive merger given all of the requirements, costs and risks of entry? Although most jurisdictions thus examine the likelihood of entry in terms of the costs and risks of entry, they employ somewhat different analytical constructs to do so.

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30 See, e.g., The Irish Competition Authority, Notice in Respect of Guidelines for Merger Analysis Decision No. N/02/004 (Dec. 16, 2002) (hereinafter, "Ireland Guidelines") ¶ 5.8 (Although "it is not necessary to identify named potential entrants, . . . [s]uch evidence would be useful if available"); Canada Guidelines ¶ 4.6.1 (will assess both "identified" and "unknown" potential entrants). See also Case No. COMP/M. 2187, CVC/Lenzig (Oct. 17, 2002) at ¶¶ 200-201.

31 See, e.g., New Zealand Guidelines ¶ 6.3.

32 Id.

33 Germany Guidelines ¶ 5.

34 Draft EC Guidelines ¶ 80. The European Commission is "unlikely to find competition concerns" when there is "strong evidence" that entry would be likely, timely, and sufficient. See also Case No. IV/330, *McCormick/CPC/Rabobank/Ostmann,* Decision of the European Commission (Oct. 23, 1993), ¶¶ 53-56 ("concrete plans").

21. **Approaches Focusing On Barriers To Entry.** The EU and many other jurisdictions seek to determine the likelihood of entry by assessing the existence of barriers to entry and perceived advantages enjoyed by incumbent firms versus entrants. Thus, for example, the draft EC guidelines state that, in examining the likelihood of entry, the European Commission "will have particular regard to the existence of barriers to entry to the relevant market, that is to the features of the market which may give the incumbent firms a decisive advantage over potential competitors."[35]

22. The draft EC guidelines identify three classes of barriers:

(1) *Legal advantages*, where regulatory barriers created by law limit the number of market participants, e.g., by restricting the number of licensees;[36]

(2) *Technical advantages*, such as "preferred access" to tangible and intangible assets needed to compete successfully. For example, entrants may have difficulty obtaining essential inputs, or patents might protect products or processes. "Other factors" that may constitute barriers to entry include economies of scale or scope, the need for distribution and sales networks, and access to important technologies.[37]

(3) *Strategic advantages* enjoyed by incumbent firms, such as established reputations, consumer loyalty, and close relationships with customers and suppliers. Strategic barriers also include situations where

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35 Draft EC Guidelines ¶ 80.

36 See, e.g., Case No. COMP/M.1795, *Vodafone Airtouch/Mannesmann*, Decision of the European Commission (Apr. 2000) ¶¶ 28-29.

37 See, e.g., Case No. COMP/M.2690, *Solvay/Montedison – Ausimont*, Decision of the European Commission (Apr. 9, 2002), ¶¶ 31, 63, 87-88.

entrants must invest heavily in advertising and promotion, incumbent firms already have substantial excess capacity, or customers face a high cost of switching away from incumbent suppliers.[38]

23. The draft EC guidelines and most other guidelines also consider the effect of potential responses to entry by incumbent firms,[39] whether the relevant market is growing or declining,[40] and history of entry in the industry.[41] For example, the draft EC guidelines state that entry is likely to be more difficult where incumbent firms are able closely to monitor which customers the entrant is trying to acquire and to protect their market positions by offering "targeted pre-emptive price reductions to those customers."[42] In addition, the draft EC guidelines appear to give significant probative weight to past history of entry, stating that entry "would appear to be less likely in the future" where "previous attempts . . . have been unsuccessful, perhaps due to deterring behavior by incumbents."[43]

24. The U.K., German, and Finnish guidelines are similar in structure to the draft EC guidelines, identifying classes of entry barriers and a list of factors bearing on the existence of barriers to entry.[44] The guidelines of other countries, such as those of

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38 Draft EC Guidelines ¶ 81. See, e.g., Case No. COMP/M.2544, *Masterfoods/Royal Canin,* Decision of the European Commission (Feb. 15, 2002), ¶ 55; Case No. COMP/M.2608, Decision of the European Commission, *INA/FAG* (Oct. 18, 2001) ¶ 31; Case No. COMP/M.2698, Decision of the European Commission, *Promatech/Sulzer* (Jul. 24, 2002) ¶¶ 78-80.

39 Id. at ¶ 82.

40 Id. at ¶ 83.

41 Id. at ¶ 85.

42 Id. at ¶ 82. Compare U.S. Guidelines ¶ 3.3 (The availability of sales opportunities for potential entrants may be limited by "any anticipated sales expansion by incumbents in reaction to entry, either generalized or targeted at customers approached by the entrant, that utilizes prior irreversible investments in excess production capacity").

43 Id. at ¶ 85.

44 See U.K. Guidelines at ¶¶ 3.49-3.56; Germany Guidelines ¶¶ 5.1-5.3; Finland Guidelines, 44-45.

Australia, Canada, Ireland, and New Zealand, also consider the same sorts of impediments to entry, without specifically classifying them. In all cases, analysis is framed in terms of the costs and risk of entry. Entry is considered to be unlikely when the sunk costs of entry are high and incumbent firms would likely pursue strategies designed to deter entry—e.g., by utilizing existing excess capacity, "launching predatory price or non-price initiatives,"[45] or locking up customers through long-term exclusive contracts.[46] These guidelines also highlight the importance of past history of entry and entry attempts.[47] Australia, for example, will have "particular regard to evidence of past success or failure of new entrants in establishing themselves as mainstream competitors in the relevant market."[48]

25. The guidelines of several jurisdictions also note that the merger itself may have increased the difficulty, and accordingly decreased the likelihood, of additional new entry. The U.K. guidelines, for example, state that the merger may have decreased the likelihood of new entry by "eliminating an entity which might provide an effective means of access to the market to other firms;"[49] increasing the perception by potential entrants that entry or expansion would be risky insofar as

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45 U.K. Guidelines ¶¶ 3.48. The U.S. guidelines do not consider the possibility that incumbents would engage in unlawful predatory actions to defeat new entry, but do consider the ability of incumbents to limit sales opportunities available to new entrants through output responses using existing excess capacity. See note 55, *infra*.

46 See Germany Guidelines ¶ 5.3. The U.K. Guidelines are unclear about the scale of entry that will be assumed in assessing likelihood, suggesting both that entry should be at a level to replace one or more firms in the market and that entrants should obtain a "significant share of the relevant market (usually considered as 5 percent)." See U.K. Guidelines ¶¶ 3.48, 3.56.

47 See, e.g., U.K. Guidelines ¶ 3.57; Germany Guidelines ¶ 5.4.

48 Australian Guidelines ¶ 5.128. See also Ireland Guidelines ¶¶ 5.7, 5.8; Canada Guidelines ¶ 4.6.1 ("However, the fact that entry has or has not occurred in the past does not in and of itself indicate that additional new entry would likely take place in response to a material price increase or other change in the market brought about by a merger"); New Zealand Guidelines ¶ 6.1; Finland Guidelines, 44-45. See also Baker at 20 (noting that ambiguity of evidence that entry either has or has not occurred in the past).

49 U.K. Guidelines ¶ 3.53.

the merged entity, because it is larger, more aggressively defends its market position;[50] or eliminating the most likely entrant or entrants into the market (e.g., a firm or firms operating in an adjacent market).[51]

26. **The U.S. and Brazilian "MVS" Approach.** The U.S. and Brazilian guidelines generally assess the same market factors bearing on the likelihood of new entry as other guidelines, but do so within a more highly specified, quantitative framework. These guidelines start with the proposition that entry would be profitable only if an entrant can secure at least pre-merger prices. Entry presumably would not occur if it would only drive prices below pre-merger prices, either because the minimum scale at which new firms would have to enter is larger than the expected merger-related reduction in output, or because incumbent firms have existing excess capacity they would use in response to attempted new entry.[52]

27. Pursuant to their guidelines, U.S. and Brazilian enforcers estimate the minimum viable scale (or MVS) of entry under various possible entry scenarios and compare it to the size of the sales opportunity available to new entrants.[53] MVS will be relatively large when the fixed costs of entry are large and largely sunk, and assets will be underutilized for a significant period of time while the new entrant attains market acceptance and grows sales.[54] As a rule of thumb, the available sales opportunity is assumed to be about five percent of total market sales, although

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50 Id. ¶ 3.54.

51 Id. ¶ 3.55.

52 U.S. Guidelines ¶ 3.3.

53 MVS is the smallest annual level of sales an entrant must achieve to cover its costs (i.e., its "break-even point"), including an appropriate rate of return on invested capital. U.S. enforcers consider as a cost of entry any introductory price discounts the entrant may need to offer to break into the market. U.S. Guidelines ¶ 3.1.

54 U.S. Guidelines ¶ 3.4.

greater or lesser sales opportunity may be used depending on the facts.[55] Thus, if MVS exceeds five percent of the market, entry may not be likely.[56]

28. A potentially key aspect of the MVS approach is its assumption that multiple entry is generally possible and that individual entrants may flexibly chose their scale of entry.[57] It is thus not assumed either that there is a single profitable entry plan, or that entry by a single firm occurring at a level below the minimum efficient level of entry is "non-optimal" entry that cannot constrain anticompetitive effects of a merger.

29. In addition, although the U.S. guidelines include recent historical entry (and exit) patterns as a "useful starting point" for understanding what is required for various entry alternatives to occur,[58] U.S. competition authorities will not assume from the mere occurrence or absence of recent entry that post-merger entry is either likely or unlikely.[59] The Brazilian antitrust authorities have adopted the same analysis.[60]

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55 Id. at n.32. Factors that might alter the five percent presumption include projected long-term growth or decline in the market, the extent of forward contracting or vertical integration by incumbent firms (which will shrink sales opportunities) or entrants (which may increase sales opportunities), the likely output response of incumbent firms to entry using existing excess capacity, and the ability of entrants to capture a share of expected growth in market demand given the "relative appeal, acceptability and reputation" of their products versus the products of incumbent firms. Id. at ¶ 3.3 and nn. 31-34. The ability of entrants to divert sales from incumbent firms in a differentiated products market where unilateral effects are of concern is addressed by U.S. authorities in considering the sufficiency of entry, discussed at paras. 30-34, infra.

56 The U.S. Guidelines have been criticized for adopting a highly quantitative methodology that is difficult to apply given the limits of reasonably available information and implies a false degree of mathematical certainty. In practice, however, MVS is not applied in this manner, and U.S. competition authorities apply a qualitative analysis very similar to that applied by the EU and other jurisdictions. Defenders of the U.S. Guidelines thus note that they provide a "fully-specified" and logically consistent approach that helps to focus the government's inquiry on the relevant factors and frame the qualitative evidence (such as the testimony of industry witnesses) to which the government (and courts) inevitably will turn. See, e.g., Baker at 19-20. See also Janusz A. Ordover & Jonathan B. Baker, *Entry Analysis Under the 1992 Horizontal Merger Guidelines,* 61 ANTITRUST L.J. 139, 145 (1992).

57 See U.S. Guidelines at ¶ 3.4. It has been suggested that the five-percent benchmark for available sales may be too high with respect to mergers raising unilateral effects concerns. See Gregory J. Werden & Luke M. Froeb, *The Entry Inducing Effects of Horizontal Mergers: An Exploratory Analysis*, 46 INDUS. ECON. 525 (1998).

58 Id. at ¶ 3.1.

59 See Baker at 20-21.

60 See Brazil Guidelines ¶ 45.

B. THE SUFFICIENCY OF NEW ENTRY

30. Virtually all of the guidelines surveyed for this report recognize that entry must also be sufficient in its nature, magnitude, and scope effectively to deter or counteract anticompetitive effects.[61] As stated in the New Zealand guidelines, "if the only viable entry occurs at the fringe of the market, and fails to attack the incumbent's core business, then entry cannot be seen as being an effective constraint."[62] In other words, new entrants must be capable of diverting sufficient sales from incumbent firms to make any attempted anticompetitive price increase by them unprofitable. This proposition drives analysis of the likely sufficiency of new entry.

31. In most jurisdictions, analysis of the sufficiency of entry is closely related to analysis of the likelihood of new entry, and the guidelines provide little additional guidance regarding analysis of sufficiency. [63]

32. Under the U.S. guidelines, entry that is deemed to be likely is assumed also to be sufficient, with two exceptions: (a) where incumbent firms can limit entrants' access to key assets needed for entry at competitive levels; or (b) where entrants are unable to respond to localized competitive effects of the merger, *viz.* in mergers in differentiated product markets characterized by unilateral effects.[64]

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61 See, e.g., U.S. Guidelines ¶ 3.0 (entry must be "sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern"); New Zealand Guidelines ¶ 6.3 ("if it is to constrain market participants, the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner"); Draft EC Guidelines ¶¶ 79, 86 (entry must be "sufficient in its magnitude and scope"); U.K. Guidelines ¶ 3.45 (entry must be "likely to have an impact"); Australia Guidelines ¶ 5.126 (entry must be "on a sufficient scale and . . . offer a product sufficiently attractive for consumers to be effective"); Canada Guidelines ¶ 4.1 ("sufficient entry" must occur to "ensure that a material price increase would not likely be sustainable in a substantial part of the relevant market"); Finland Guidelines p. 43.

62 New Zealand Guidelines ¶ 6.2, citing Prof. M. Brunt, "Australian and New Zealand Competition Law and Policy," 19th Fordham Conference on International Antitrust Law and Policy (1992), 31.

63 The U.S. guidelines, for example, explicitly state, "committed entry generally will be sufficient . . . whenever entry is likely . . . ." U.S. Guidelines ¶ 3.4. Other guidelines do not separately discuss the criteria for determining sufficiency, but assume in assessing likelihood that new entrants would have to achieve a certain scale and scope in order to be profitable and competitive. See, e.g., Canada Guidelines ¶ 4.6.1.

64 See U.S Guidelines ¶ 3.4.

33. Other jurisdictions similarly provide that, even entry that would be profitable may not be *sufficient* if the amount of business the new entrant or entrants can contest would be so small or so isolated that incumbent firms could still profitably raise prices to a significant portion of the market. This might be the case for a number of reasons. For example, a new entrant nevertheless may lack sufficient access to assets required to achieve the level of sales needed to discipline incumbent firms.[65] It may be geographically limited. Or, its products may lack the quality or other attributes needed to attract a significant number of customers. New Zealand, for example, "is of the view that entry that might occur only at relatively low volumes, or in localized areas, is not likely to represent a sufficient constraint to alleviate concerns about a lessening of competition."[66] Such "niche," or fringe, entry is generally considered to be insufficient to constrain the anticompetitive effects of a merger.[67]

34. Entry also must be sufficient to deter or counteract the specific competitive effect of concern. Where the likely competitive effect of the merger is not uniform across the relevant market, the new entrant must be able to respond to the localized anticompetitive effects. For example, if the competitive effect of concern would be geographically isolated, the new entrant must be able to respond to demand within the geographic area of concern.[68] Or, where the competitive concern is a unilateral price increase resulting from a merger between producers of differentiated

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65 See, e.g., U.S. Guidelines ¶¶ 3.0, 3.4 ("constraints on availability of essential assets, due to incumbent control, [may] make it impossible for entry profitably to achieve the necessary level of sales").

66 New Zealand Guidelines ¶ 6.3. See also U.K. Guidelines ¶ 3.52 ("entry of firms producing niche products will not necessarily constrain incumbent firms' ability to exercise their market power"); Draft EC Guidelines ¶ 86 ("entry into some market 'niche' may not be a credible constraint").

67 See, e.g., Draft EC Guidelines ¶ 86; New Zealand Guidelines ¶ 6.2.

68 See New Zealand Guidelines ¶ 6.3.

products, the new entrant must be able to offer a product that is directly competitive with the merging firms' products and sufficiently attractive that a substantial number of the merged firms' customers would switch to it in response to an anticompetitive price increase.[69]

C. TIMELINESS OF ENTRY

35. An important aspect in assessing entry conditions involves determining the time it would take for a potential competitor to respond to a material price increase or other change in the market brought about by a merger and become an effective competitor.[70] There is general agreement among the guidelines that the relevant time period must be short enough to deter or counteract the merged entity from exploiting its market power.[71]

36. The majority of merger guidelines consider that effective entry is that which is likely to have an impact on the market within a two-year period, although this may vary according to the circumstances.[72] This time scale implies the recognition that potential entrants require more time than firms already operating on the relevant market—who are typically identified on the basis of a one year response time—to learn about and assess new opportunities, develop products and marketing plans, build facilities, qualify as acceptable sources of supply for buyers, and achieve a sufficient level of sales to prevent or eliminate a material price increase.[73]

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69 See U.S. Guidelines ¶ 3.4; Ireland Guidelines ¶ 5.5.

70 *See, e.g.,* Canada Guidelines ¶ 4.6.2.

71 See, e.g., Draft EC Guidelines¶ 86; Germany Guidelines at ¶ 5; U.S. Guidelines ¶ 3.2.

72 *See, e.g.,* Australia Guidelines ¶ 5.126; Canada Guidelines ¶ 4.6.2; Ireland Guidelines ¶ 5.3; New Zealand Guidelines ¶ 6.3; U.S. Guidelines ¶ 3.2.

73 See, e.g., Canada Guidelines ¶ 4.6.2.

37. Most of the merger guidelines surveyed for this report agree that what is considered as an adequately short period will vary according to the circumstances, dynamics, and characteristics of the relevant market. The relevant time period may be shorter or longer, depending on the special features of a given market.[74] For example, in markets where goods and services are supplied and purchased on long-term contracts, buyers may not immediately be exposed to the anticompetitive effects of a merger. In such cases, the competition analysis in regard to the relevant time period to be considered generally begins from the time when these contracts come up for renewal.[75] As further example, where the relevant product is a durable good, consumers may defer purchases by making additional investments to extend the life of previously purchased goods that may then cause entry to take place over a longer period. In such markets, entry does not need to occur as swiftly to be effective.[76]

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74 See, e.g., Draft EC Guidelines ¶ 86; Ireland Guidelines ¶ 5.3. Although the draft EC Guidelines do not specify a time limit, in general, a five-year period clearly falls outside the time frame used by the European Commission to assess the impact of potential entry on a proposed merger. Case No. COMP/M.1693, *Alcoa/Reynolds*, Decision of the European Commission (May 3, 2002), ¶ 31.

75 See, e.g., New Zealand Guidelines ¶ 6.3.

76 See, e.g., U.S. Guidelines ¶ 3.2; Australia Guidelines ¶ 5.127.

Annexe: Overview of Basic Approaches to Entry in Selected Jurisdictions

Australia -- Australian Competition and Consumer Commission, Merger Guidelines, June 1999

Responses that Qualify as Entry	Guidelines provide that sunk costs (costs unrecoverable upon exit) place entrants at a disadvantage. Implies consideration of committed entry, as opposed to simple supply side substitution.
Sources of Entry Considered	Not addressed in guidelines.
Likelihood	Sunk costs must permit entry to exist on an efficient and competitive scale for it to be sufficiently likely.
Sufficiency	Whether post-entry prices will support sufficient entry depends on the minimum efficient scale of entry, cost penalties associated with sub-optimal plant utilization, price elasticity of demand and market growth.
Timeliness	Entry is timely if it is likely to have a market impact within a two-year period.
Standard Employed	There must be real pressure on established firms' profits for entry to be easy.
Other Factors	Minimum efficient scale of operation considered by Commission in evaluation of barriers to entry.

Brazil – SEAE/SDE Joint Resolution No. 50, Guidelines for the Analysis of Horizontal Merger Concentration, August 1, 2001

Responses that Qualify as Entry	Responses ranging from committed entry to supply-side substitution are considered in entry analysis.
Sources of Entry Considered	Expansion of production facilities (existing capacity); capacity expansion (new capacity); entry of new competitors onto the relevant product market; supply-side substitution or adaptation of existing facilities by firms in adjacent markets.
Likelihood	Entry is sufficiently likely when it is economically profitable at pre-merger prices (i.e. minimum scale does not exceed sales opportunities at pre-merger prices.)
Sufficiency	Entry is considered sufficient when it allows all sales opportunities created by the merger to be exploited by potential entrants.
Timeliness	Entry of a potential competitor into the market within two years may be sufficient.
Standard Employed	The probability of exercising market power is practically non-existent when new entry is "easy" and "sufficient."
Other Factors	Barriers to entry are not ranked in order of importance.

Canada -- Merger Enforcement Guidelines, Competition Bureau, March 1991

Responses that Qualify as Entry	Guidelines' examination of sunk costs in assessment of entry impediments implies consideration of committed entrants.
Sources of Entry Considered	Establishment of new production facilities by existing competitors; supply-side substitution by firms in adjacent markets; potential new competitors.
Likelihood	More likely where there are firms with an inherent advantage (i.e. fringe firms already in the market, firms in adjacent geographic markets, firms that use similar or related facilities, firms that sell in related upstream or downstream markets and firms that sell through similar distribution channels or employ similar marketing or promotional methods).
Sufficiency	The scale of the new entrant must be sufficient to ensure that a material price increase, or other change brought about in the relevant market by the merger, could not be sustained for more that two years
Timeliness	Must be achieved in within two years.
Standard Employed	New entry is more likely to occur when a market is in its growth stage than when it is stagnating or declining.
Other Factors	Entry is considered where, as a result of new entry, a material price increase would not likely be sustainable in a substantial part of the relevant market for more than two years.

European Union – Draft European Commission Notice on the Appraisal of Horizontal Mergers Under the Council Regulation on The Control of Concentrations Between Undertakings, COM (2002), December 11, 2002, Adopted by the European Commission on December 16, 2003 [To Be Effective May 1, 2004]

Responses that Qualify as Entry	Entry is considered to be particularly likely if suppliers in other markets already possess production facilities that could be used to enter the market, i.e. reallocation of production facilities.
Sources of Entry Considered	The most realistic and potential competition comes from the expansion of capacity by established competitors.
Likelihood	There must be a high probability of success.
Sufficiency	Entry that might occur only at relatively low volumes, in localized areas, or in "niche" products generally will not represent a sufficient constraint to alleviate concerns about market power.
Timeliness	No hard deadline – timeliness depends on the characteristics and dynamics of market, and on the capabilities of potential entrants -- must be sufficiently quick and persistent to prevent the exercise of market power.
Standard Employed	It is not likely that the Commission will find barriers to entry in an industry that has experienced frequent and successful examples of entry.
Other Factors	The likely evolution of the market should be taken into account when assessing whether or not entry would be

	profitable.

Finland -- Finnish Merger Guidelines, September 15, 1998

Responses that Qualify as Entry	Undertakings already present in the market may pose a threat of potential competition if they have a possibility to increase their production, i.e. supply-side substitution.
Sources of Entry Considered	Potential competition from market participants that may increase production, or from participants in adjacent product or geographic markets that may alter production or expand their geographical scope are taken into account.
Likelihood	In order to be sufficiently likely, entry must be "economically rational."
Sufficiency	Entry must be sufficient and likely to defeat any attempts by the combined firm to exercise market power.
Timeliness	Entry must occur within a reasonably short timeframe.
Standard Employed	Barriers do not need to block entry completely for an indefinite period for market power to succeed. It is sufficient that they delay or restrict entry during a period of time that is significant in relation to functioning competition.
Other Factors	The significance of potential competition depends on whether entry is possible, economically rational, and whether is it so extensive and rapid as to prevent the use of market power.

Germany -- Bundeskartellamt General Policy Division, The Principles of Interpretation, October 2000

Responses that Qualify as Entry	Guidelines focus on barriers to entry rather than competitor or potential competitor responses.
Sources of Entry Considered	Potential foreign and domestic competitors are considered, however foreign firms may face additional barriers in particular markets.
Likelihood	Entry must be possible and probable; and it must be possible to express in sufficiently concrete terms.
Sufficiency	Entry will be sufficient if it counteracts or prevents the use of market power by the merged firm.
Timeliness	The time period must be short enough to dissuade the merged entity from exploiting its market power.
Standard Employed	High barriers to entry need not completely exclude the possibility of others entering the market for market power to succeed. Entry barriers will be considered where it is unlikely that entry will be sufficient to counteract the market power of the merged firm.
Other Factors	Entry will be considered a constraint on anticompetitive post-merger effects when it is probable, timely and will occur at a quantity, price and scale sufficient to counteract an anticompetitive price increase. Markets working to full capacity with good customer relations provide little incentive for potential competitors to enter.

Ireland – The Competition Authority, Notice in Respect of Guidelines for Merger Analysis, December 16, 2002

Responses that Qualify as Entry	Not addressed in guidelines.
Sources of Entry Considered	Not addressed in guidelines.
Likelihood	Entry is sufficiently likely if it would be profitable at existing prices.
Sufficiency	To be of sufficient scope, the new entrant must be able to respond to localized sales opportunities, and must be able to return prices to their pre-merger levels, and thus deter the merged firm from raising prices.
Timeliness	Entry is considered timely only if it would occur within two years.
Standard Employed	The burden of showing that entry will ameliorate the effects of any competitive concerns relating to the merger rests with the merging parties.
Other Factors	The efficient scale of the entrant is considered, as is evidence of past successful entry into the market.

Japan -- Guidelines for Interpretation on the Stipulation that "The Effect May Be Substantially to Restrain Competition in a Particular Field of Trade" Concerning M&As, 1998

Responses that Qualify as Entry	Not addressed in guidelines.
Sources of Entry Considered	Companies that can supply the goods without major alteration of production facilities, and entry into the domestic market by foreign companies will be considered.
Likelihood	Not addressed in guidelines.
Sufficiency	Not addressed in guidelines.
Timeliness	Not addressed in guidelines.
Standard Employed	The turnover of competitors, increases or decreases in the number of competitors and other changes and the trends in the top-three firm concentration ratio are considered to determine the extent of entry barriers.
Other Factors	Legal restrictions on entry are considered along with minimum funding requirements, geographic scope of the market, specialized technical knowledge requirements, the availability of raw materials, and other general conditions of the market.

New Zealand -- New Zealand, Commerce Commission, Mergers and Acquisitions Guidelines, January 1, 2004

Responses that Qualify as Entry	Guidelines' examination of sunk costs in assessment of entry impediments implies consideration of committed entrants.
Sources of Entry Considered	New competitors coming onto the market with new capacity, new competitors that take over existing capacity, altering production or geographical range of activity to meet consumer needs, or adaptation of existing facilities or technologies are recognized as potential sources of new entry.
Likelihood	The mere possibility of entry is an insufficient constraint on the exercise of market power. Entry must be likely in commercial terms (i.e. entrants must have a reasonable prospect of achieving a satisfactory investment return).
Sufficiency	The threat of new entry must be at a scale and scope that would cause market participants to react in a significant manner. Entry that might occur only at relatively low volumes, or in localized areas is not considered to represent a sufficient constraint to alleviate concerns about market power.
Timeliness	Entry must be likely to have an impact on the market within a two-year period.
Standard Employed	The overall obstacle to entry posed by the aggregation of the various barriers is relevant in determining whether entry is relatively easy or not, and therefore whether potential entry would prevent a substantial lessening of competition.
Other Factors	The threat of market entry or expansion can constrain the post-merger exercise of market power if it is likely, sufficient in extent and timely (the *let* test).

Romania -- Guidelines on Relevant Market Definition With A View To Determining the Significant Market Share, March 21, 1997

Responses that Qualify as Entry	Guidelines address relevant market definition only.
Sources of Entry Considered	Not Applicable
Likelihood	
Sufficiency	
Timeliness	
Standard Employed	
Other Factors	

United Kingdom -- United Kingdom, Merger References: Competition Commission Guidelines, June 2003

Responses that Qualify as Entry	Entry typically requires investment in production assets and takes longer to establish than supply-side substitution.
Sources of Entry Considered	Existing firms that build new capacity are a potential new source of entry. Other sources include new competitors, and backward or forward integration.
Likelihood	Factors affecting likelihood include the costs of unsuccessful entry and the probability that incumbent firms will pursue strategies designed to deter entry.
Sufficiency	To be sufficient, entry must have impact on the potential for existing firms to exercise market power.
Timeliness	No hard deadline; must be achieved within a timetable that bears on the incentives and decisions of the incumbents.
Standard Employed	A substantial lessening of competition as a result of a merger is unlikely where entry is easy.
Other Factors	In considering historical evidence, relevant factors include survival rates and the effects that entry or expansion had on competition in the market (i.e. whether it had an impact on the competitive landscape).

United States -- 1992 Horizontal Merger Guidelines

Responses that Qualify as Entry	Guidelines' focus is on committed entrants with expenditure of significant sunk costs.
Sources of Entry Considered	Incumbent expansion, or using prior irreversible investments in excess production capacity.
Likelihood	Entry is likely if it would be profitable at pre-merger prices, and unlikely if the minimum viable scale is greater than likely sales opportunities.
Sufficiency	Where an incumbent controls required assets, entry would not be sufficient to return market to pre-merger prices.
Timeliness	Two years from planning to significant market impact.
Standard Employed	Where entry would be timely, likely and sufficient, a merger raises no antitrust concerns and ordinarily requires no further analysis.
Other Factors	Specific potential entrants do not need to be identified. However, recent examples of entry, successful or unsuccessful, may provide a useful starting point for identifying the necessary actions, time requirements, and characteristics of possible entry alternatives.

POSTSCRIPT

The European Commission (EC) has since adopted final Guidelines on the assessment of horizontal mergers, accompanying the amended EC Merger Regulation, which shall enter into force on 1 May, 2004.[77] Structuring the entry analysis more clearly around the three sub-headings likelihood, sufficiency and timeliness, the EC reiterates that the entry analysis is an important element of its overall competitive assessment of mergers. When examining the likelihood of entry, the EC takes the view that the central issue is whether entry would be sufficiently profitable taking into account the price effects of injecting additional output into the market and the potential responses of incumbents. It describes in familiar terms the various forms of barriers to entry. However, it now appears to downplay the importance of the record of entries, stating that past examples of entry and exit may provide "useful" information about the size of entry barriers.[78] The draft Guidelines had suggested that the EC would give more significant probative weight to past history of entry.

In regard to the timeliness of entry, the EC Guidelines indicate that entry is normally considered timely if it occurs within two years, although it emphasizes that the appropriate time period will depend on the characteristics and dynamics of the market.[79]

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[77] Article 2(3) of the Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings [2004] O.J. L 24/1, available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_024/l_02420040129en00010022.pdf.

[78] EC Guidelines at ¶ 70.

[79] EC Guidelines at ¶ 74.