IBA conference – Merger regulation after 20 years

SIEC and beyond

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*The views expressed are my own and do not necessarily reflect those of DG COMP or the European Commission

SIEC

- SIEC closed the gap : unilateral effects – significant price increase can arise even if the merger firms are not "dominant"
- Which also allows for a conceptual clarification :
  - Collective dominance is associated with coordinated effects – the prospect that firms will coordinate behaviour in a framework of repeated interactions
  - As distinct from unilateral effects (static incentive to increase price as part of the lost consumers are recaptured by others products under the control of the merged entity
- Allowed for a more deeper analysis of effects (closeness of competition) and associated use of economic evidence
- Which was essential for vertical and conglomerate mergers (where many of the effects cannot be presumed and would have been difficult to handle with dominance)
- And beyond : development of necessary complements : NHMG and best practice of the submission of economic evidence

Has it worked ?

- Gap cases (Unilever/Sarah Lee), focused analysis of coordinated effects (ABF/GBI), detailed analysis of effects in NH mergers (Tom Tom/Tele Atlas)
- Ex post analysis of the factors that determines the outcome (Mahlstein, 2010)
  - There is a break in the Commission narrative in 2004
  - Increments in market shares matter more (effect is however non linear); the competitive position of competitors starts to matter. Proxies for competitive constraints matter more.
  - Coordinated effects are only mentioned when they are determinative
  - Commission decisions become more predictable (or at least more consistently argued)
- Outcomes are less related to political economy variables – nationality/size of the firm,scope of the market .. (Duso et al., 2010)

And beyond ?

- Further clarify the link between market definition and unilateral effects (taking inspiration from the US/UK guidelines)
- Improve the notice on market definition : market definition for merger and for antitrust case differ
- Competitive constraints exercised on the merged entity (so that the HMT test refers to prices increases above the current level"
- In abuse of dominance case, concern that observed prices reflect the exercise of market power (so the HMT refers to price increases above a competitive level)
- Techniques which attempt to estimate whether a price increase would be profitable under a particular counterfactual in terms of ownership/control (either a merger or a hypothetical monopolist) are less directly informative
- An abuse may be about the exclusion of a product that acts as a competitive constraint, not about its control (and the internalization of the constraint).
- In the same way that market definition and the analysis of unilateral effects can be integrated, the analysis of dominance and the abuse can be integrated

And beyond

- Some important technicalities on the monopolist test
  - Profit maximizing vs. assumed (baseline) prices
  - Single product vs Uniform price increases
  - Profit maximizing cartels
  - Multiplicity
  - Targeted consumers and discrimination
- Geographic market definition
  - Geographic market definition based on the location of suppliers : relevant when customers buy directly from the supplier.

    Sales made by the suppliers in the relevant market are counted, regardless of the location of the customer making the purchase ?
  - Geographic market definition based on the location of targeted consumers : relevant when the supplier delivers to the customer

    Geographic markets encompass the region into which sales are made.
  - Distinction to be introduced in the MD notice (which is relatively terse on geographic market definition and emphasized homogenous conditions of competition) ?

Conclusion

- And efficiencies ?
  - Few cases in which efficiencies claims have been made (6 out of 37 phase II cases since 2004, Roeller, 2010).
  - Because legal advisers are concerned that it sends a signal that the parties anticipate that they have a weak case ?
- Failing firm
  - In the absence of a merger, the assets of the failing firm would inevitably exit the market (this is an absolute requirement)
  - Wider question : why should one acquire a failing firm ? To preempt another buyer ? Or because of efficiencies ?
- Innovation

Back up slides

Single vs Uniform SSNIP

- Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ("hypothetical monopolist") likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on **at least one product in the market**, including at least one product sold by one of the merging firms.

- The question to be answered is whether the parties' customers would switch to readily available substitutes or to suppliers located elsewhere in response to a hypothetical small (in the range 5 % to 10 %) but permanent relative price increase in the products and areas being considered.

Profit maximizing and single product

- Farrel and Shapiro argue that a unilateral price increase may often lead to broader markets. They show that "with symmetric linear demand the profitability of a single-product SSNIP is a sufficient, but not necessary, condition for the profitability of a uniform SSNIP".
  - The intuition is that "the catch-up second single-product SSNIP that turns a unilateral SSNIP into a uniform SSNIP is always more profitable for the hypothetical monopolist than was the first unilateral SSNIP. The absolute loss of sales of the product whose price is rising is the same in each, but in the catch-up SSNIP (a) sales recaptured within the market generate a higher margin, and (b) the price increase applies on a larger starting base of unit sales.

- However the single-product SSNIP test may lead to a narrower market definition than the uniform SSNIP test if the asymmetry between those two products is sufficiently large (Sorgard, 2010)
  - Intuition: if one increases the price on a product with a large market share, only a small fraction of sales is expected to be diverted to a product with a small share (and possibly a relatively lower margin). On the other hand, it is plausible that the large product can recapture a large fraction of lost sales for a product with a small market share (and at a relatively higher margin).
  - There is here a risk that markets would be overly narrow, potentially leading to the products of the merging firms being in separate markets.

- Close connection to the unilateral effect but issue of multiplicity and administrability (may draw excessive attention to market definition..)

Hypothetical monopolist

- "the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market".
  - With complements, the incentive to raise price will be less and markets will be broader
  - With substitutes, markets will be narrower
- Smallest market principle is "softened"
  - One may not be able to identify the "next best substitute" at each stage in the algorithm, but the outcome of the iterative algorithm can be sensitive to this determination.
  - …the Agencies may evaluate a merger in any relevant market satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects…
  - According the notice on MD, "if under conceivable alternative market definition, the operation in question does not raise competition concerns, the question of market definition will be left open"
  - Also when the operation raises concern ?

Hypothetical monopolist

- Targeted Customers and Price Discrimination:
  - Focus on differential pricing and arbitrage
  - In EU notice on MD no reference to customers segments as a relevant dimension - but implicit recognition that customers that have difficulties in switching may be harmed even if others are not (e.g. buyers that used to dual source from the merging parties)
- Geographic market definition
  - Geographic market definition based on the location of suppliers : relevant when customers buy directly from the supplier.

    Sales made by the suppliers in the relevant market are counted, regardless of the location of the customer making the purchase ?
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Policy relevance of RMP?

- Note that the merger does not "lessen" competition. It simply allows the merged entity to commit to a strategy.
  - Ø Should this be challenged provided the monopoly was achieved legitimately?
- Across many industries monopolists often find a mechanism to resolve the ex-ante commitment problem (e.g. reputation, exclusivity agreements, asset specific investments).
- Key assumptions are non-linear pricing and contract incompleteness
  - Ø But in practice: the more complex the pricing structure the less incomplete the contract.
- Other difficulties that affect enforcement policy:
  - Ø Multiple equilibria. This reduces predictability.
  - Ø No explanation of how vertical integration might foreclose an equally efficient competitor. This narrows its scope.