Review of the Merger Regulation

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Prague, June 7, 2003

Overview

- A new Article 2
- A Horizontal Notice
- First impressions
- The economics of mergers
- Topics
  - Paramount market position
  - Market share and concentration thresholds
  - Market entry
  - Furthermore..

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A New Article 2

- Proposed Article 2 (2) reads

  “One or more undertakings shall be deemed to be in a dominant position if, with or without coordinating, they hold the economic power to influence appreciably and sustainably the parameters of competition (…) or appreciably to foreclose competition”

- More economics of market power
  - Option 1: Paramount market position, unilateral effects test
  - Option 2: Non-collusive oligopoly, unilateral effects test
  - Option 3: Oligopoly, coordinated effects test
- No SLC (Australia, Canada, UK, US)

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A Horizontal Notice

- Criteria for the assessment of anti-competitive effects of horizontal mergers
- New entry and potential competition
- Furthermore..
  - Countervailing buyer power
  - Efficiencies
  - Failing firm

First Impressions

- Commission attempts to bring criticism in line
  - From the US, see convergence after *GE/Honeywell*
  - From the CFI, see *Airtours*, *Schneider*, *Tetra*, and *Moulinex*
- Quick and dirty: it’s market power
  - Distinction unilateral effects and coordinated effects is welcome
  - More emphasis on empirics is welcome
  - But how will the tests be applied (“appreciably”, “sustainably”)?
- Significant investment in economics upfront

The Economics of Mergers

The welfare trade-offs

- Two welfare effects:
  - Anti-competitive effects (increase market power)
  - Pro-competitive effects (increase efficiency)
- Competition law: economic analysis as to impact on welfare (welfare trade-off)
- Increase in market power may manifest itself via unilateral effects or coordinated effects

The Economics of Mergers

Unilateral Effects

- Expected price changes as a result of changed incentives for profit maximization
  - Merging companies can impose price rises unilaterally
  - Non-merging market participants can at best anticipate price increase, but not influence it
- Usually associated with level of concentration
  - Rules of thumb presuming price increasing effects to a benchmark market concentration measure
  - For example: Herfindahl-Hirschman Index
  - Starting point only (see US Merger Guidelines)

The Economics of Mergers

Coordinated Effects

- Expected price changes as a result of changed incentives for profit maximization – in a non-competitive setting
  - Merging companies cannot impose price rises unilaterally
  - Non-merging market participants can influence price increase
  - Merger may change incentives to collude (tacitly)
- Usually associated with game theory
  - Market structure conducive to collusion
  - Possibility to detect deviations from collusion
  - Possibility to punish deviations from collusion

The Economics of Mergers

The New Merger Regulation

- Three options in the Proposals
  - Option 1: A merger may create or strengthen dominance (price increase by merging firm without constraints by competitors or customers) – paramount market position, unilateral effects
  - Option 2: A merger may diminish the degree of competition in a non-collusive oligopolistic market (by eliminating competitive constraints on one or more sellers) – non-collusive oligopoly, unilateral effects
  - Option 3: A merger may change the nature of competition in an oligopolistic market to allow collusion (by coordination and increase of price) – oligopoly, coordinated effects

The Economics of Mergers

The New Merger Regulation (2)

- Issue (1): Distinction paramount market position and non-collusive oligopoly?
  - Practical impact of two separate criteria for unilateral effects
  - Lower burden of proof for the Commission in using Option 2 (non-collusive oligopoly)?
  - Relation with Court rulings?
  - Both unilateral and coordinated effects mergers in the same merger?
- And a safe harbor – market share below 25% in the Common Market (relevant market?)

The Economics of Mergers

The New Merger Regulation (3)

- Issue (2): Definition non-collusive oligopoly?
  - Use of market share test for heterogeneous products mergers? Or econometrics?
  - Non-collusive oligopoly in Cournot markets
    - Incentive to reduce output or capacity below the combined pre-merger level? What about rivals' incentives?
    - Level of substitutability between the products of the merging firms and their rivals?
  - Non-collusive oligopoly in Bertrand markets
    - Incentive to raise prices as a result of the loss of competition between the merging firms?
    - Level of substitutability between the products of the merging firms and their rivals?

Topics

Paramount market position

- A new concept?
  - No EU precedent
  - No US precedent
  - German law: a company can be found dominant if it has a paramount market position in relation to its competitors ("überragende Marktstellung"), see Sect. 19(2)(2) ARC
- Very large market share may be indicative of a dominant position, i.e. above 50%
- "Being big" is not the problem?

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Topics

Paramount market position (2)

- Paramount market position – single firm dominance?
- Single firm dominance
  - “Position of economic strength enjoyed by an undertaking which enables it to prevent effective competition (…) by giving it the power to behave to an appreciable extent independent of its competitors, customers and ultimately of its consumers”
- Paramount market position
  - “A firm in such a position will often be able to increase prices, reduce choice and qualities of goods and services, diminish technological innovation (and other possible consequences of a lack of effective competition) without being constrained by actions of its customers and its actual or potential competitors”

Topics

Paramount market position (3)

- Paramount market position – shift towards US position?
- US Merger Guidelines
  - “Market power to a seller is the ability to profitably maintain prices above competitive levels, or lessen competition on dimensions other than price, such as product quality, service, or innovation, for a significant period of time”
- Paramount market position
  - “A firm in such a position will often be able to increase prices, reduce choice and qualities of goods and services, diminish technological innovation (and other possible consequences of a lack of effective competition) without being constrained by actions of its customers and its actual or potential competitors”

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Topics

Market share and concentration thresholds

- Herfindahl-Hirschman Index (HHI) consists of summing the squares of the individual market shares of all firms in the market
- HHI ranges from 0 (atomistic markets) to 10,000 (pure monopoly)
- Advantage over pure market share ratios: greater weight to market shares of larger firms
- Value: first indicator

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Topics

Market share and concentration thresholds (2)

- Safe harbors
  - US Merger Guidelines
    - HHI <1,000
    - HHI <1,800 and Δ HHI <100
    - HHI >1,800 and Δ HHI <50
  - Draft EU Notice
    - HHI < 1,000
    - Market share below 25% Common Market, and close substitutes

Topics

Market share and concentration thresholds (3)

- Likely to raise serious doubts
  - US Merger Guidelines
    - HHI thresholds are exceeded, and
    - Market share above 35%, and
    - Products are close substitutes
  - Draft EU Notice
    - HHI >2,000 and Δ HHI >150 for homogeneous products
    - Market share above 50% is evidence of dominance “save in exceptional circumstances”

Topics

Market share and concentration thresholds (4)

- EU thresholds: overview

	Paramount position	Non-collusive oligopoly		Coordination
		Homogen. Prod.	Heterogen. Prod.	
Unlikely to be investigated	HHI <1,000			
Indication of absence of serious doubts			MS < 25%	
Serious doubts likely		HHI > 2,000 and ΔHHI > 150		
Indication of dominance	MS > 50%			

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Topics

Market share and concentration thresholds (5)

- Illustration (1)

25%	20%	20%	15%	10%	10%
No1	No2	No3	No4	No5	No6

- Post-merger HHI 1,850 => 2,650 (+800)
- Combined market share is 40%
- Serious doubts under both EU and US system
  - US: both HHI and market share thresholds exceeded
  - EU: HHI threshold exceeded and combined market share nearly twice the share of the next largest competitor

Topics

Market share and concentration thresholds (6)

- Illustration (2)

25%	20%	20%	15%	10%	10%
No1	No2	No3	No4	No5	No6

- Post-merger HHI 1,850 => 2,150 (+300)
- Combined market share is 25%
- Doubts only in EU
  - US: HHI thresholds exceeded, but market share below 35%
  - EU: HHI threshold exceeded, in-depth investigation possible

Topics

Market Entry

- Timeliness
  - US Merger Guidelines: “within two years from initial planning to significant market impact”
  - Draft Proposal: “sufficiently quick and persistent to prevent the exercise of market power”
- Likelihood
  - US Merger Guidelines: emphasis on “minimum viable scale”, i.e. the smallest average annual level of sales that the committed entrant must persistently achieve post-merger
  - Draft Proposal: emphasis on entry barriers (legal, technical or strategic)

Topics

Furthermore..

- Countervailing buyer power
  - Ability to switch “immediately” to alternative suppliers (import, vertical integration threat in the upstream market, or sponsor upstream entry)
  - Smaller buyers without buyer power should not be facing significantly higher prices or deteriorated conditions after the merger
  - Buyer power must remain effective after the merger

Topics

Furthermore.. (2)

- Efficiencies
  - Explicitly referred to and discussed as part of Article 2(1)(b)
  - But:
    - Only listed under the means of appraising dominance – once dominance is concluded upon under Article 2(2) and (4), there is no more trade-off possible
    - Efficiencies need to be “of direct benefit to consumers”
  - Defunct as a “defense”
  - Compare Sect. 4 of the US Merger Guidelines

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Topics

Furthermore.. (3)

- Failing firm defense
  - Used in *Kali und Salz*, and *BASF/Pantochim/Eurodiol*
  - No challenge of the merger, if
    - Disappearance of the failing firm, or
    - Acquisition by a competitor would equally lead to market power
  - Is there a causal link between deterioration of the competitive structure post-merger, and the concentration?

Outlook

- Public consultation period over (31 March 2003)
- Consolidated texts to be adopted by end of 2003, in force 1 May 2004?
- What about verticals, conglomerates?