



European Commission

Competition

CRAi Annual conference – Brussels Dec 8

Market Definition and SIEC in the EU, in light of the new US and UK Guidelines

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



Introduction

- New US HMG: increased convergence or divergence ?
 - Significant convergence since 2004 (relevant market, counterfactual, unilateral and coordinated effects, potential competition, innovation)
 - Further convergence: less rigid approach towards market definition; treatment of countervailing buyer power;
 - Divergence: presumptions of harm; coordinated effects; anticompetitive buyer power
- Possible insights for market definition in the EU
 - Role of market definition
 - Some (important) technicalities on the hypothetical monopolist test
 - Geographic market definition
- And for SIEC
 - Efficiency and Innovation
 - Failing firm
 - Partial acquisitions

	Market definition	Horizontal	Vertical and Conglomerate
EU	Notice on Market definition (1997)	Horizontal Merger Guidelines (2004)	Non-horizontal Merger Guidelines (2007)
US	Revised Horizontal Merger Guidelines (2010)		Limited enforcement (section 4 of the old 1984 guidelines)



Role of market definition

- “The Agencies’ analysis need not start with market definition”
- “Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects”
- “Where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects”.
- Market definition as a discrete approximation to a continuous problem



Role of market definition in the EU

- “The Commission's assessment of mergers normally entails:
 - (a) definition of the relevant product and geographic markets;
 - (b) competitive assessment of the merger.
- The main purpose of market definition is to identify in a systematic way the immediate competitive constraints facing the merged entity.
- Various considerations leading to the delineation of the relevant markets may also be of importance for the competitive assessment of the merger.
- Market definition can be left open
- But some jurisprudence (Kali & Saltz) : “the relevant market is a necessary precondition for any assessment of the effect of a concentration on competition” – However in the context of a discussion of (collective) dominance



Market definition and unilateral effect

- An “accurate” implementation of the HMT involves the same sort of analysis as the assessment of unilateral effects (except that instead of the two merging firms one looks at different set of candidate products being owned by an hypothetical monopolist)
 - The hypothetical monopolist’s incentive to raise the price on any one product under its control depends on the recapture percentage associated with that product and on the margins it receives on the sales recaptured by the other products it owns
 - The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test.



Role of market definition notice in the EU ?

- 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
- Not to mention state aid



Hypothetical monopolist test

- Some important technicalities
 - Profit maximizing vs. assumed (baseline) prices
 - Single product vs Uniform price increases
 - Profit maximizing cartels
 - Multiplicity
 - Targeted consumers and discrimination

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 ?
 - 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) ?



SIEC

- On efficiencies
 - In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s)
- On Failing firm
 - [third] it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger
 - **Second, there is no less anti-competitive alternative purchase than the notified merger.**
 - [no causality] **...where the competitive structure of the market would deteriorate to at least the same extent in the absence of the merger** (this is a relative requirement)
 - **Third, 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 ?



SIEC

- Section on partial acquisition
- Impact of mergers on innovation
 - reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products”.
 - **Effective competition may be significantly impeded by a merger between two important innovators, for instance between two companies with ‘pipeline’ products related to a specific product market. Similarly, a firm with a relatively small market share may nevertheless be an important competitive force if it has promising pipeline products**
 - US allows for development into new markets (pharma ?)



Conclusion

- EU “merger guidelines” are formally adopted as a Notice. They introduce legitimate expectations and thus Increasing legal certainty and Providing guidance to National Competition Authorities and EU Courts
- EU Merger Control arises out of grand bargain between MS and the Commission.
 - MS delegate enforcement powers but under certain conditions (obligation of consultation, transparency, referral, no de minimis)
- The EU Commission has been granted a margin of discretion (particularly in complex economic matters)
 - This allows for greater flexibility in enforcement policy (e.g. relaxing the role of structural presumptions in favor of a more sophisticated economic analysis – see Ryanair/Air Lingus or ABF/GBI)
 - But also imposes greater responsibility (obligations) to explain (by ref to guidelines) the reasons for clearance or intervention (e.g. coordinated effects or NHMG). Also reflected in:
 - the obligation to publish all decisions
 - The existence of fixed deadlines
 - Questionnaire-based market investigation
- **Convergence is not a goal in itself since merger guidelines must take account of the different institutional environment**