

Presentation at the Portuguese Competition Authority,
Lisbon May 13th, 2005



The Use of Economics in Merger Analysis

Lars-Hendrik Röller

Chief Economist
European Commission, DG Competition

(*) The views expressed are those of the author and
do not necessarily reflect those of the European Commission



The Chief Economist at DG COMP

- The EU Model
- Complex Cases and General Policy Instruments with Economic Content
- Opinion of the CE
- “final advice” of the CE
- The “EAGCP”



The Role of Economics in EC Competition Policy

- Merger Control
- Antitrust (Art. 81 & 82)
- Control of State Aid



Economics in Merger Control Methodology - General Remarks

- The role of “theory”
- What kind of evidence
 - Facts
 - Reduced-Form Evidence
 - Natural Experiments
 - Econometrics & Simulations

=> Identify the “Theory of Harm”
- Sectoral Focus (DG COMP re-organization)
- Best Practice for empirical evidence

Objective of merger control

- The policy standard:
 - EU : intervention required when a merger would “significantly impede effective competition”

The objective of merger control is to protect customers from the possible negative consequences of mergers (to prevent market power)



EC Merger Control – Background

- Guidelines complement the new EC Merger Regulation
- Both texts have become applicable on 1.05.04.
- Background: reform of the EU merger control system (in place since 1990).
- On the substantive side, the two main issues underlying this reform were:
 - **Scope of the “dominance” test (Art. 2 ECMR)**
New test: whether a merger “would significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position”
 - **Role of efficiencies in merger analysis**

Market definition

- Market definition is a key element in merger control
 - provides for a context
 - aim is to identify the extent to which customers have alternative sources of supply
 - relevant product market
 - relevant geographic market
- Antitrust market may be different from the companies' own understanding of the "marketplace"
 - the customer is the focus of our attention
- "SSNIP test": a framework for market definition
 - see also EC Notice on the definition of the relevant market



Guidelines – at a glance

- Central question: will the merger enhance the level of market power
- Distinction: unilateral (“non-coordinated”) effects and co-ordinated effects (para. 22)
- Consideration of countervailing factors: buyer power, entry analysis, efficiencies



(i) Non-coordinated effects

- A merger may remove important competitive constraints on one or more sellers, who consequently have increased market power → unilateral (or non-coordinated, or multilateral) effects of a merger
- Unilateral effects may arise, in particular, when the merger leads to a dominant position
 - In such cases, single firm dominance “typically” associated with the new entity having an appreciably larger market share than the next competitor post-merger (para. 25)



(i) Non-coordinated effects (2)

■ Potentially important factors:

- Merging firms have large market shares
- Merging firms are close competitors
- Customers have limited possibilities of switching supplier
- Competitors unlikely to increase supply if prices increase
- Merged entity able to hinder expansion by competitors
- Merger eliminates an important competitive force

→ All are factors familiar to the traditional question of dominance



(ii) Co-ordinated effects

- A merger may create or reinforce a situation where competition is reduced by co-ordination among market players → co-ordinated effects of a merger
- Co-ordination more likely to emerge in markets where it is fairly easy to establish the terms of co-ordination and where co-ordination is sustainable. Sustainability requires that
 - the companies involved can monitor each other's market behaviour (market transparency)
 - there is a credible 'deterrence mechanism' (disciplining mechanism) to ensure adherence
 - outsiders and customers cannot undermine the co-ordination



Market share and concentration (HHI) levels

Two sets of indicators:

- Market share indicators
 - HHI indicators
-
- Market share indicators
 - Very Established by case law (interpretation of the dominance concept)
 - large market shares – 50% or more – may in themselves be evidence of the existence of a dominant market position
 - Limited market share leads to presumption of compatibility. An indication: market share below 25%.

HHI



- Commission “unlikely to identify competition concerns” when
 - $HHI < 1000$ (such cases normally do not require extensive analysis)
 - $1000 < HHI < 2000$ and $\Delta < 250$
 - $HHI > 2000$ and $\Delta < 150$

- “Soft Safe Harbour” approach



Countervailing factors

- Countervailing buyer power (Section V)
- Entry (Section VI)
 - The relevant criterion is whether decreased competitive pressure would make entry sufficiently profitable to make it likely
 - Entry has to be likely, timely and sufficient to deter or defeat any potential anti-competitive effects of the merger
- Efficiencies (Section VII)
 - See next slides
- Failing Firm Defence (Section VIII)



Efficiencies

The case for efficiencies

- Event study evidence
 - Case studies (Ex: airlines, banking)
- ⇒ On average gain in market power, but not in efficiency
- ⇒ This suggests an explicit efficiency defense



Potential Pitfalls...

- Can we accurately take efficiencies into account?
- Are parties willing to provide the evidence?
- Are they too speculative?
- What sort of evidence (fixed vs. marginal costs, scale and scope, innovation, etc.)....?

=> Cautious approach



Potential Advantages....

- Approach is rooted in economic analysis of competitive effects and efficiencies
- Modern Economic Analysis has advanced (Analysis of Competitive Effects, Empirical methods: Econometrics, Simulations, “reduced form” evidence)
- Reduce potential Type I and Type II errors
- Incentives aligned
 - => parties have an incentive to claim efficiencies



Efficiencies – The Guidelines Approach

- Approach to efficiencies in the Guidelines (Section VII): open but cautious
- Focus lies on the “ability and incentive of the merged entity to act pro-competitively for the benefit of consumers”
- Consumer welfare objective derives from Article 2(1)(b) EECMR.
- Economic - effects based – integrated approach
- Focus on intermediate cases (Reduce type I (and type II) errors)



Efficiencies – Three Conditions

- Three conditions for efficiencies:
 - benefit to consumers timely, and substantial, likely to be realized
 - “The relevant benchmark in assessing efficiency claims is that **consumers will not be worse off** as a result of the merger.”
 - In principle, **in** the relevant market
 - Efficiencies may take **various forms** (cost savings leading to lower prices; synergies leading to new or improved products). Marginal costs “more likely to be relevant” to the assessment than fixed costs.
 - merger-specificity
 - efficiencies are relevant to the competitive assessment when they are a direct consequence of the notified merger (**causation**)
 - verifiability
 - Parties must **provide relevant information** demonstrating the claimed efficiencies are merger-specific and likely to be realised, and must show to what extent consumers will benefit.



Efficiencies – Empirical Evidence

- burden of proof (parties must demonstrate three conditions)
- quantification, when possible
 - Data on costs and synergies
 - Internal documents
 - Historical examples
 - pre-merger experts studies / industry reports
 - Sliding Scale...
 - MREs
 - Econometric evidence
 - Simulations



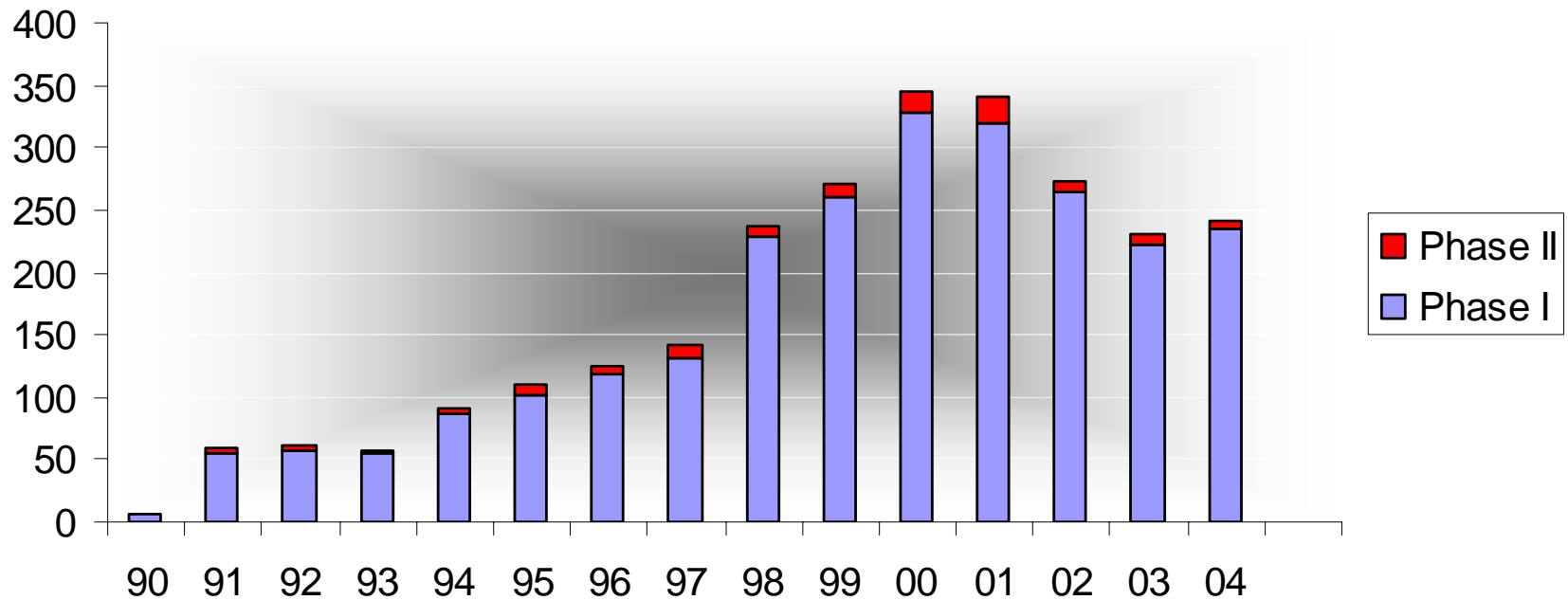
Overall Merger Control

- Approach is based on sound economics
- Strong similarities with US Guidelines

Some Data on Merger Control

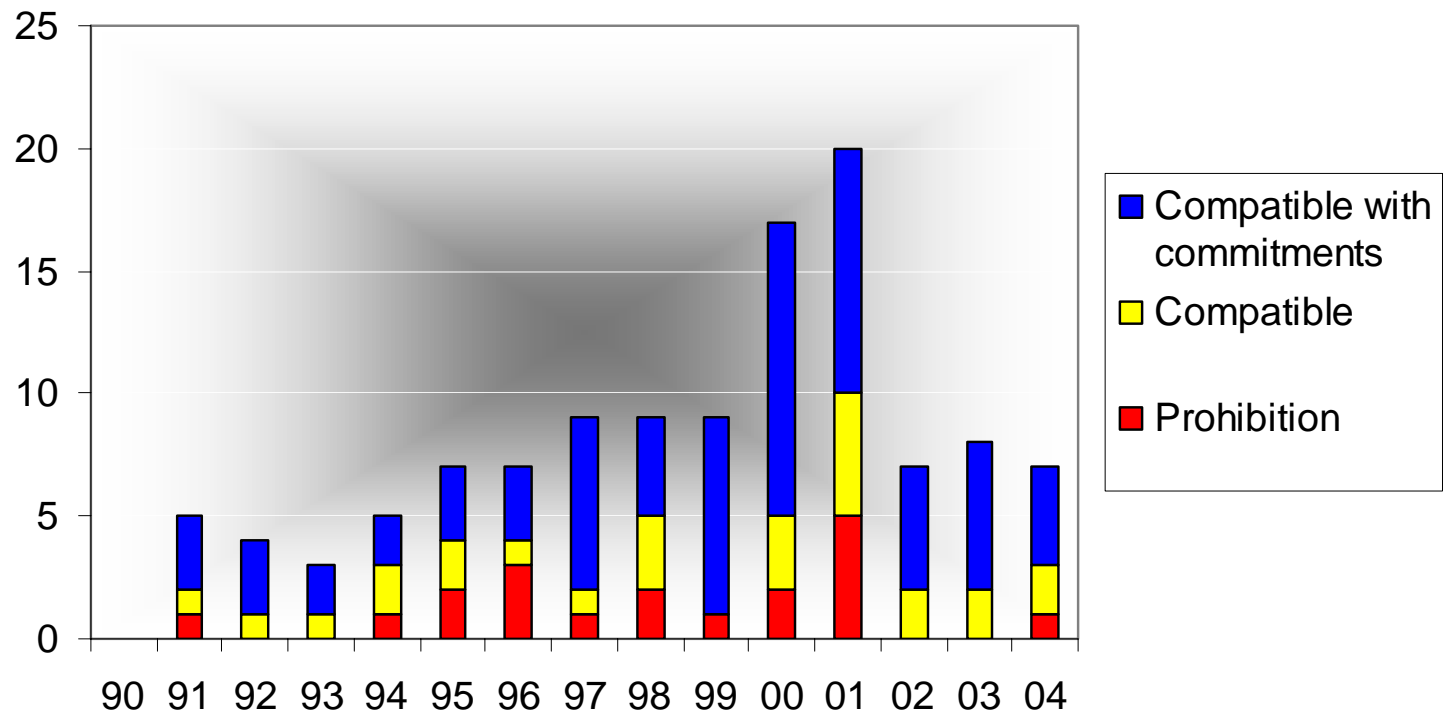


Number of Final Phase I and II Decisions

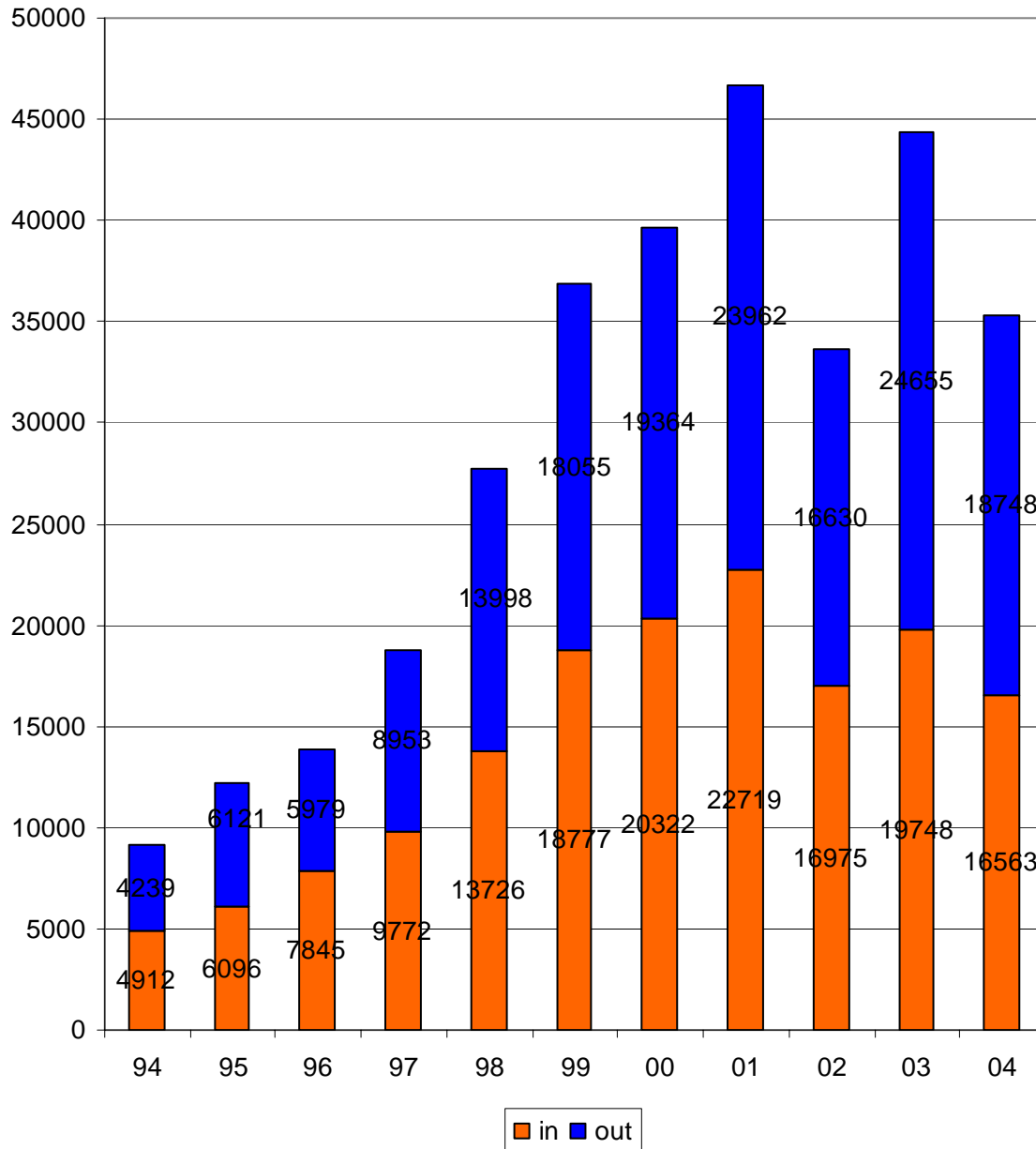




Phase II Decisions



TOTAL REGISTERED INCOMING + OUTGOING MAIL
Merger Registry
Period : 01/01/1994 - 31/10/2004



Current and Future Developments and Priorities



- Non-horizontal Guidelines
- Art. 82 Guidelines: Effects based approach
- The Control of State Aid

Challenges for economics and economists in competition policy



- political agenda is based on economic performance (Lisbon process): competitiveness (European champions, emphasis on market failures in state aid).
- demonstrate effective enforcement (reduce type I and II errors) – the “more economic approach”
- predictability & legal certainty
- communicate – crucially important in the EU context, the role of the Courts, modernization of antitrust.
- capacity building