Can Analysis of Dominance be taken UPPwards?
Possible Lessons from Mergers

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Today’s essay question

- Over the last decade we have seen major progress in merger rules and the quality of analysis in merger cases.
- There is even a growing consensus that we now know (more or less) what we are doing, and that economics and law are well integrated.
- By contrast, while there have also been substantial developments in the assessment of abuse of dominance, we still see substantial concerns.
- **Are there any possible lessons for abuse of dominance cases from mergers?**
Mergers: A brief (EU) history

- 2004 reforms to EU Merger Regulation: Test changes from dominance test to SIEC test (ie Does the merger Significantly Impede Effective Competition – roughly same as SLC)

- Provided DGComp with a clear remit to assess unilateral effects mergers, recognising that this had previously been a ‘gap’

- Since then in EU, hugely increased use of quantitative (and qualitative) merger analysis techniques, both complex (merger simulation) and simplified (UPP measures)
Mergers: key lessons

✝ Now fully accepted that there had been a gap!

✝ Focus on unilateral effects has led to an improved understanding of differentiated goods markets and recognition that competitive effects of horizontal mergers are not well proxied by market shares. Why?

➤ Markets hard to delineate, with any clear (1,0) line a false cut-off, and (depending on how this is done):

➤ Competitive constraints between firms can vary substantially within a market

➤ There can be strong competitive constraints from outside
The SSNIP paradox

Firm A

Firm B

Firm C
The SSNIP test paradox

- Merger of A and B would raise prices by > 5%.
- SSNIP test thus implies a 2-to-1 merger in “the market for A and B”
The SSNIP paradox

But also a 2-to-1 merger in “the market for A and C”
The SSNIP paradox

- And maybe even also a 2-to-1 merger in “the market for B and C”
The SSNIP paradox - implications

- Risk of finding different markets depending on starting point
- Risk of defining markets that seem overly narrow from a common sense (=legal?) viewpoint

Firm A
Firm B
Firm C
Mergers: a revised approach

- Market definition still important as the process for identifying competitive constraints, but in differentiated goods markets:
  - relevant market may not be narrowest that satisfies the SSNIP test and may not be unique
  - market shares may be a useful starting point, but may not be a reliable guide to merger effects

- Key is to assess directly competitive constraints between players, and how these are likely to be altered by merger

- Many factors to consider, but strong focus on upward pricing pressure (UPP) arising from merger
UPP: The basic concept

Firm B \(\xrightarrow{D_{AB}}\) Firm A \(\xrightarrow{D_{AC}}\) Firm C

Other firms including outside ‘market’
UPP: The basic concept

- Value of sales internalised by the merger is given by:
  \[ D_{AB} \times M_B \]  
  (known as the Gross UPP Index)
- This can be translated into:
  - A cost efficiency needed to outweigh the GUPPI (UPP), or
  - An Illustrative Price Rise (IPR), although this requires assumptions on pass-through rate
Abuse of dominance: A brief (EU) history

- Perceived problem that Art 102 (then 82) was overly legalistic and form-based. Approach gave (some) legal certainty but distinguished badly between true economic harm and pro-competitive behaviour (i.e., too many false +ves and –ves).

- Long debate followed around other possible tests, including:
  - Intent: The profit sacrifice test
  - Likely Anticompetitive Effect: The efficient competitor test
  - Incentive/recoupment test ≈ consumer harm test

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- Long debate followed around other possible tests, including:
  - Intent: The profit sacrifice test \( (\approx p < \text{Average Avoidable Cost, AAC}) \)
  - Likely Anticompetitive Effect: The efficient competitor test \( (\approx p < \text{LRAIC}) \)
  - Incentive/recoupment test \( \approx \) consumer harm test \( (\approx \text{Dominance}) \)

Recall the essay question:

- Are there any possible lessons for abuse of dominance cases from mergers?
- Obvious secondary question: Are there really strong parallels?
Parallels are stronger than they may first seem

Simple horizontal merger case, giving rise to an SIEC

1. Firm A buys Firm B
2. Removes Firm B from market
3. Substantially lessens competition
   \[ p \uparrow \quad q \downarrow \quad \text{etc} \]

Simple exclusionary abuse case, with full foreclosure

1. Firm A acts to foreclose B
2. Removes Firm B from market
3. Substantially harms competition
   \[ p \uparrow \quad q \downarrow \quad \text{etc} \]
Another gap?

Suppose:

- Firm A merges with its closest competitor Firm B, thereby removing Firm B from the market.
- A merger between Firms A and B is shown to create an SLC and is therefore blocked.
- This is true even though Firm A still faces some competition from (more distant) competitors Firms C and D.

Now suppose Firm A acts to foreclose Firm B instead.

- Success of an abuse case could hang on whether Firm A can be shown to have prior dominance. May be very hard!
Why require dominance for abuse?

**Historical rationale:** When abuse was assessed in a form-based way, a dominance requirement was important for distinguishing better between truly harmful behaviour and pro-competitive behaviour, so reducing false +ves/-ves.

- **But** the link with dominance highly imperfect, and we now have a more economic approach to assessing abuse cases, which directly reduces false +ves/-ves!

**Test of incentive/recoupment/consumer harm:** Foreclosing a competitor will only be profitable (and harm consumers) if it substantially lessens competition. More likely with dominance.

- **But** isn’t SLC a better, and more direct, test?
An idea to ponder

- It may be hard to remove the dominance requirement, but an alternative would be:

- To link dominance more closely to the associated abuse (just as market definition is linked to merger starting point), and

- To refocus far more on two key elements:

  1. Ability to foreclose

  2. Likely substantial lessening of competition (SLC) post-foreclosure

- The latter would enable the use of existing merger techniques
Dominance in the case law: A recap

- Single firm dominance was defined early by ECJ in United Brands and Hoffmann-La Roche as:

  “a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers”

- Much concern about latter half of this definition, since firms are rarely truly independent, even to ‘an appreciable extent’

- More usually, focus is on first half, and the ability to “prevent effective competition” is commonly equated to SMP
Arguably, the two steps in my ‘idea to ponder’ fit well with both halves of United Brands definition:

- **Ability to foreclose** ≈ “a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market”

- **Likely (unilateral effects) SLC post-foreclosure** ≈ “affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers”
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