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?*

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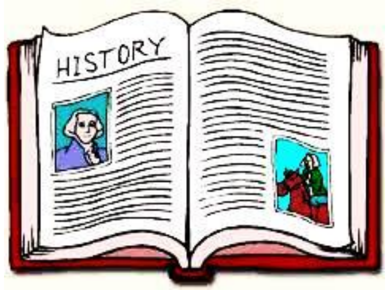
Mergers:
A brief (EU) history



- 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

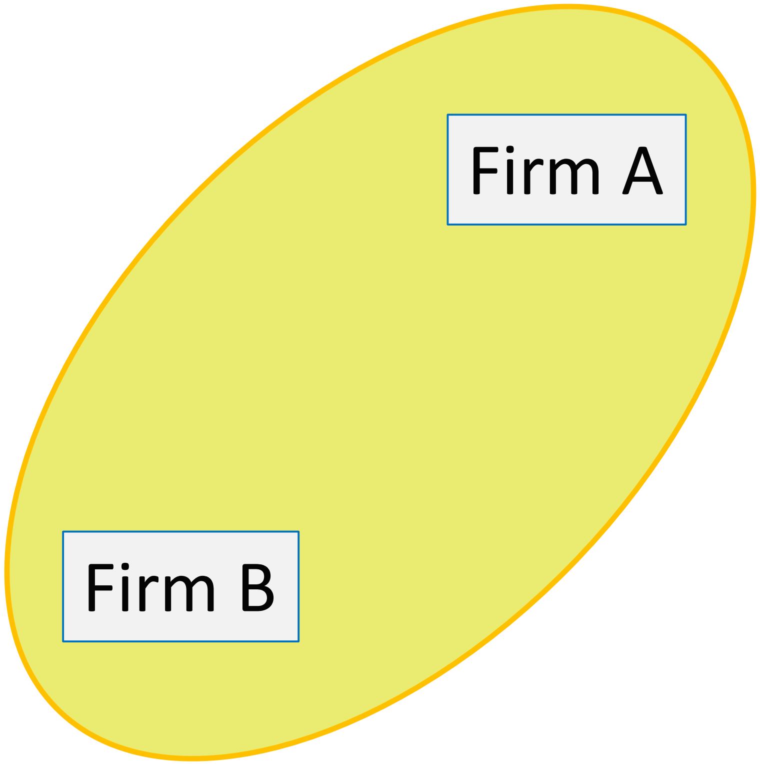
The SSNIP paradox

Firm A

Firm B

Firm C

The SSNIP test paradox

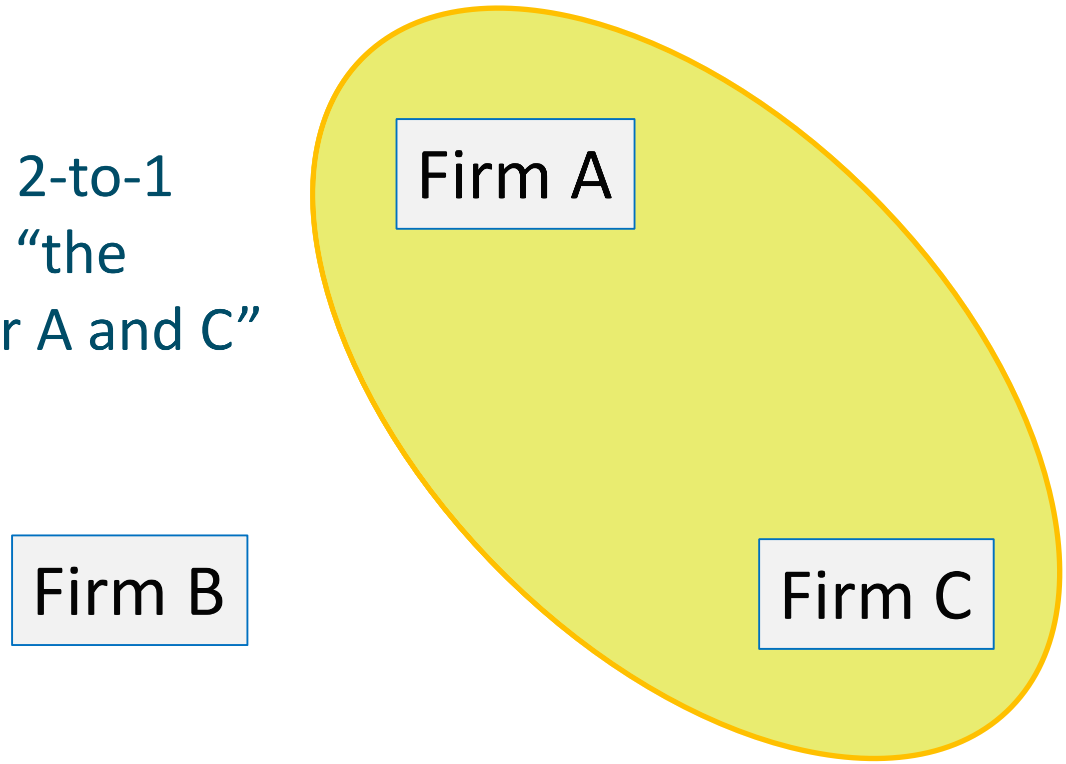


- Merger of A and B would raise prices by > 5%.
- SSNIP test thus implies a 2-to-1 merger in “the market for A and B”

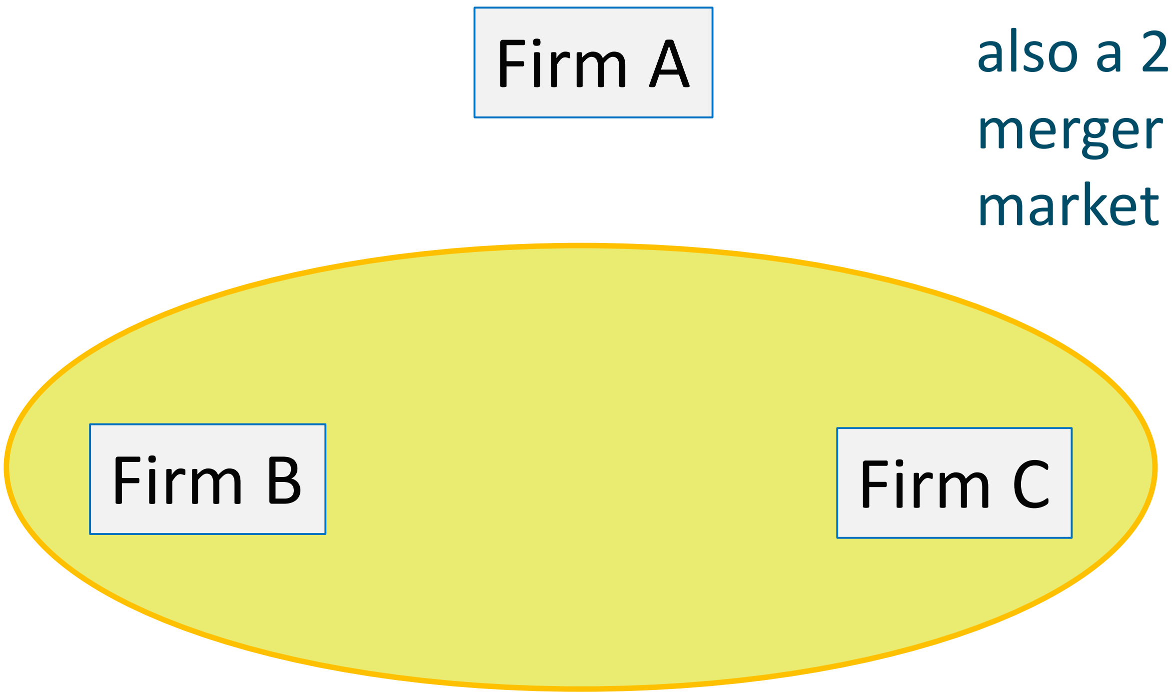
Firm C

The SSNIP paradox

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



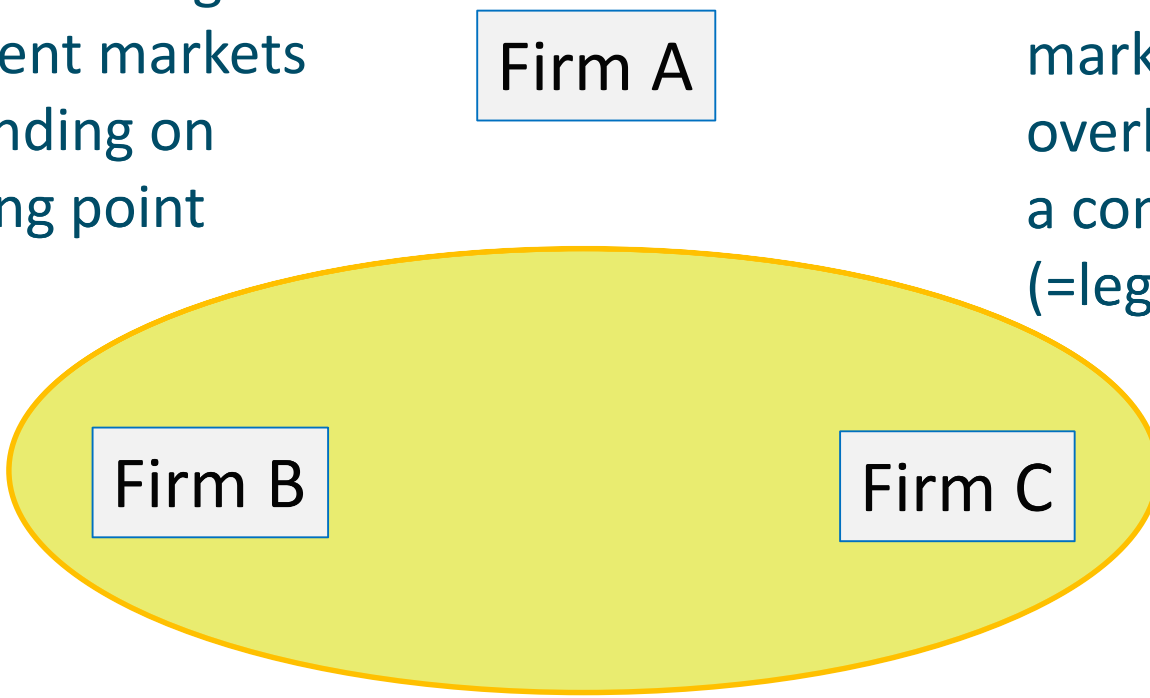
The SSNIP paradox



- 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

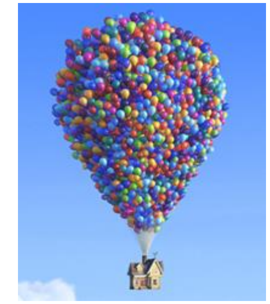


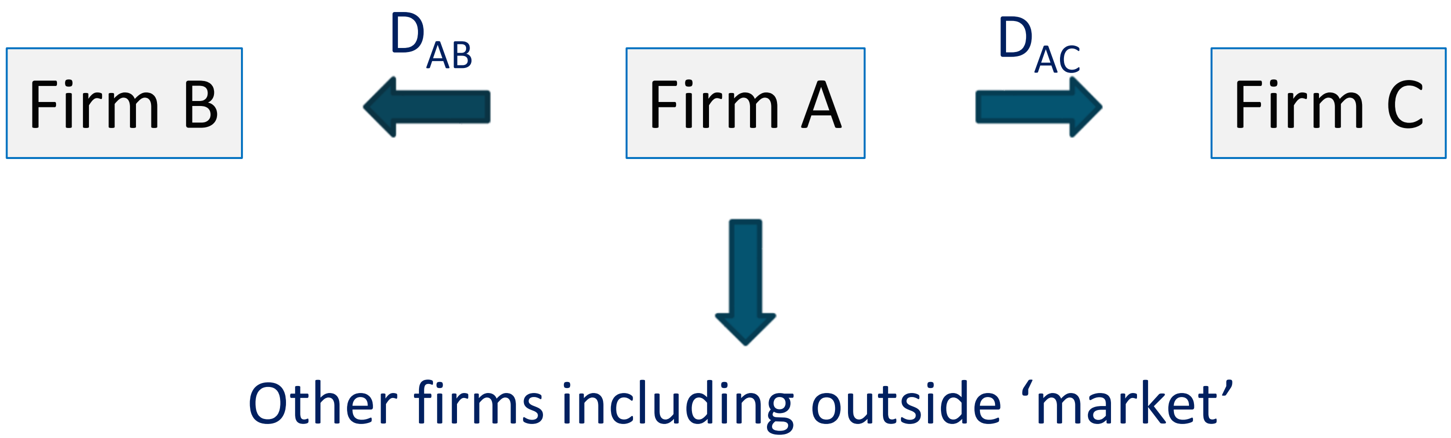
- Risk of defining markets that seem overly narrow from a common sense (=legal?) viewpoint

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





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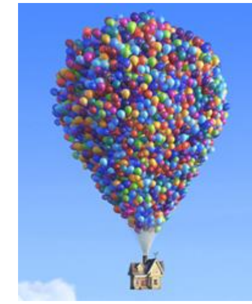
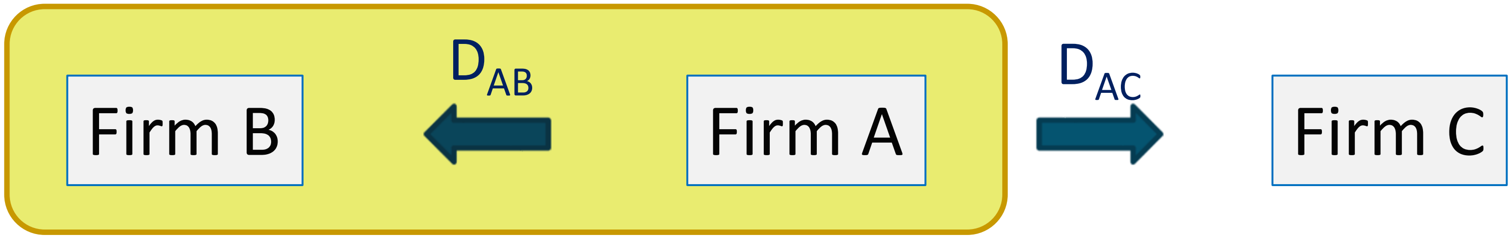


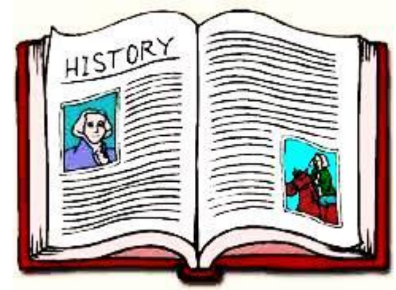


- Value of sales internalised by the merger is given by:

  D_{AB} x 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 (ie 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
- Article 102 Guidance on Enforcement Priorities (Dec 2008) signaled a far more economic approach

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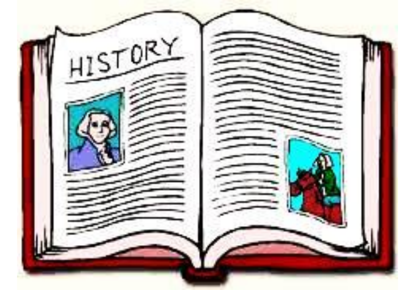

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- Long debate followed around other possible tests, including:
  - Intent: The profit sacrifice test (≈ $p <$ Average Avoidable Cost, AAC)
  - Likely Anticompetitive Effect: The efficient competitor test (≈ $p <$ LRAIC)
  - Incentive/recoupment test ≈ consumer harm test (≈ Dominance)
- Article 102 Guidance on Enforcement Priorities (Dec 2008) signaled a far more economic approach

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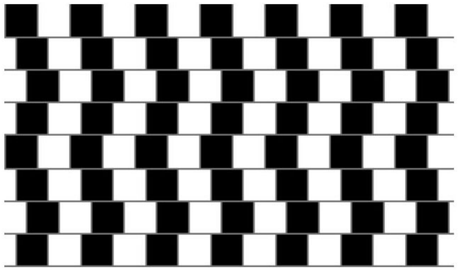
Recall the essay question:

- *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

Firm A buys Firm B → Removes Firm B from market → Substantially lessens competition

$p\uparrow$
$q\downarrow$
etc

- Simple exclusionary abuse case, with full foreclosure

Firm A acts to foreclose B → Removes Firm B from market → Substantially harms competition

$p\uparrow$
$q\downarrow$
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

Making sense of *United Brands?*

- 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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