Theory of harm in unilateral effects cases in oligopolistic markets

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Disclaimer: the views expressed are those of the speaker only and cannot be regarded as stating an official position of the European Commission.

Outline

Theories of harm under the **SIEC** test

Horizontal unilateral effects: key features and role of dominance

Economic applications and **case-studies**

Theories of harm under the SIEC test

Horizontal Unilateral Effects

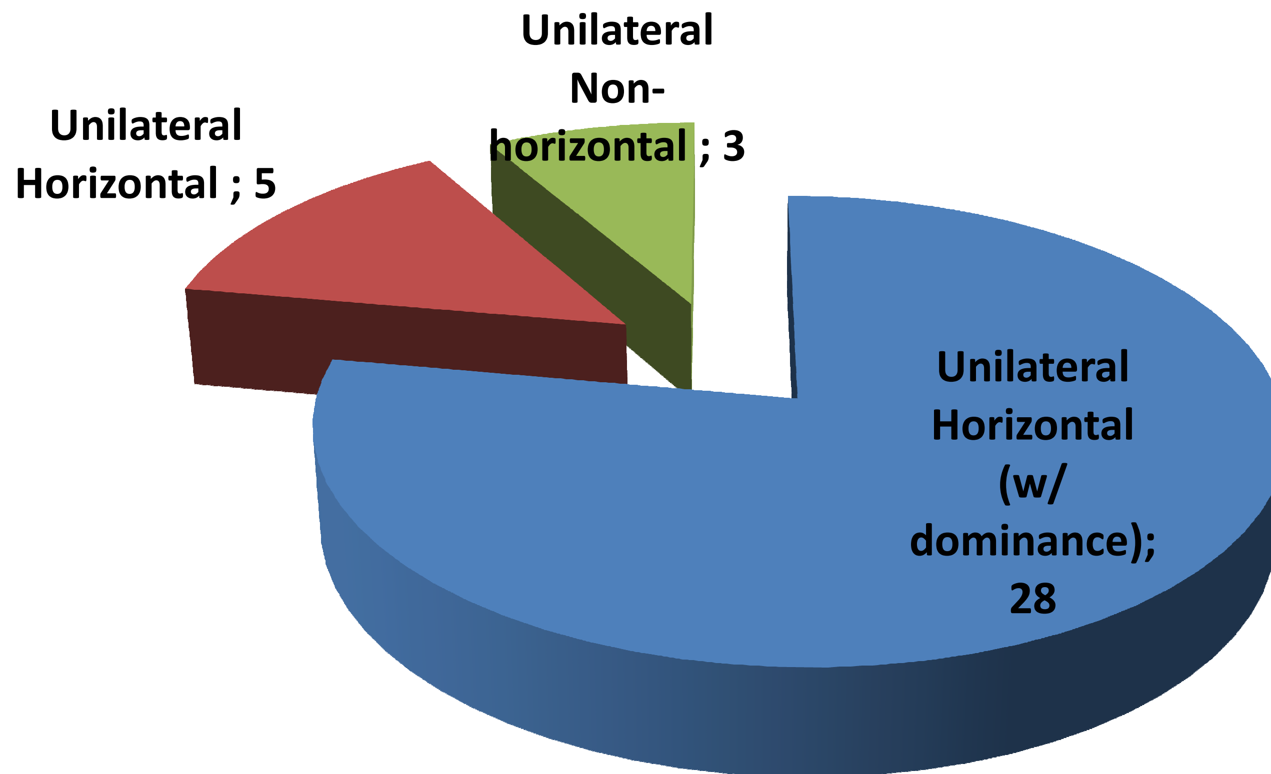
Horizontal Coordinated Effects

Non-Horizontal Unilateral Effects

Most prevalent area of enforcement

European
Commission

Summary of 2011-2013 interventions



What are Horizontal Unilateral Effects?

- SIEC derives directly from loss of competition between the merging parties
- A price increase by the merged entity is profitable even if other firms do not change their conduct
- Precise economic mechanism depends on type of market (e.g. differentiated v homogenous products) but fundamental theory of harm is the same

What is the role of non-merging parties?

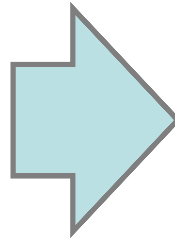
- Oligopoly interaction is an essential feature of Horizontal Unilateral Effects
- Absent strong efficiencies, non-merging parties typically benefit from loss of competition between merging parties
  - Merger leads to higher demand for their products and typically higher output/prices
- Reaction by non-merging parties may thus reinforce effects of the merger
- No coordination required for these effects

Dominance reinforces unilateral effects…

<u>Features of dominance</u>

- Size / market share
- Weak constraints from non-merging parties
- Limited buyer power
- Barriers to entry

Ability to price above competitive level



<u>Implications for SIEC</u>

- Larger benefits from price increases
- No ability to respond to price increase
- Inelastic demand
- Non-transitory increase in market power

Creation/strengthening of dominance implies a SIEC

… but it is not a necessary condition

Possible features of *lack* of dominance

- Large non-merging parties
- Relatively limited combined market share

Implications for SIEC

- Non-merging parties may be *able* to offset a price increase, but may not face *incentives* to do so
- Merger of close competitors and/or removal of dynamic firm can still lead to price effects

Role of dominance in theory of harm

- Creation/strengthening of dominance is a *sufficient* but not *necessary* condition for SIEC
- The fundamental theory of harm captured by Horizontal Unilateral Effects is the same with or without dominance, but dominance reinforces likely effects
- SIEC extends beyond the concept of dominance to capture all anti-competitive non-coordinated effects in an oligopoly (Recital 25 ECMR)
- Some intuitions on dominance from exclusionary theories of harm (e.g. Art 102) do not necessarily carry across to Horizontal Unilateral Effects

Applications

Type of market	Case Study
Differentiated Products	*H3G/Orange*
Individualised pricing (tenders)	*UPS / TNT* (+ *Western Digital / Hitachi*)
Homogeneous goods	*Outokumpu / Inoxum* (+ *EDF/British Energy*)

Differentiated Products

- Merger of competitors in differentiated product market can lead to upwards pressure on prices
  - Pre-merger: firm A does not take into account impact of its pricing decision on the profits of firm B
  - Post-merger: owner of firm A now faces incentives to set higher prices since the resulting diversion of (some) volumes to firm B increases B's profits
- Overall pricing pressure is a function of the margins earned by each party, and diversion between the two

Case study: *H3G/Orange*

- 4-to-3 merger in a tight oligopoly market with absolute barriers to entry
- Parties have a limited share of total subscribers (<30%), but significantly higher share of new subscribers (40-50%), also reflected in diversion ratios between them (in the 20-40% range)
- Application of UPP techniques indicates likelihood of significant price effects
- Oligopoly reaction from rivals would accentuate these price effects

Tenders

- Horizontal mergers directly lead to prices increase for tenders where the parties are preferred option and runner-up
- More generally, a merger changes the trade-off between probability of a bid being accepted, and profit earned if successful
  - With uncertainty over relative positions, upwards pricing pressure can apply widely across bids
- Provided that merging parties are sufficiently close competitors, price effects can arise even in presence of a significant non-merging party

Case study: *UPS/TNT*

- Merger brought together 2 of the 3 top integrators for express parcel delivery in the EEA
- Fedex a more distant competitor due to reliance on international extra-EEA services, as also indicated by bidding data
- Non-integrators not a strong constraint for express services, given focus on deferred/domestic
- Analysis of tender data, and of pricing/coverage across EEA countries indicates likelihood of price increases

European Commission

Competition with homogenous goods

- A horizontal merger may increase incentives for withholding and/or re-direction of capacity
- Incentives driven, *inter alia*, by
  - Size of "infra-marginal" benefit from output withholding
  - Reduction of overall spare capacity faced by merged entity
  - Ability and incentives by rivals to increase output at competitive conditions
  - Price responsiveness of demand

Case study: *Outokumpu/Inoxum*

- 4-to-3 merger created market leader in European market for stainless steel (>50% of sales/capacity)
- Countervailing factors include potential response from imports (20%+ of EEA demand), and spare capacity available to rivals (20%+ EEA demand)
- Commission set out calibrated model of capacity-constrained price competition which indicated significant price effects
- Finding of SIEC based on dominance in this case, but analytical framework does not require it (e.g. *EDF/British Energy*)

Conclusion

- Unilateral horizontal effects most prevalent theory of harm in recent merger enforcement by Commission
- Theory of harm rests on non-coordinated oligopoly interaction
- Dominance can reinforce size and likelihood of anti-competitive effects but it is not a necessary condition for a SIEC
- Presence of large non-merging parties does not necessarily mitigate concerns