Theory of harm in unilateral effects cases in oligopolistic markets

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Giulio Federico
Merger Coordinator, Chief Economist Team, DG Competition

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
Summary of 2011-2013 interventions

- Unilateral Horizontal: 5
- Unilateral Non-horizontal: 3
- Unilateral Horizontal (w/ dominance): 28
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...

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

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

*Ability to price above competitive level*

*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

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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
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