Economic analysis of unilateral effects

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Analytical framework
Unilateral effects

Horizontal Unilateral Effects

Legal test
Elimination of important competitive constraints (ICC)
(not only dominance)

Pre-merger
If the acquiror raises prices, it would lose at least some of its sales to the target

Post merger
The acquiror would no longer be constrained by the target (i.e., it would re-capture the sales that pre-merger it would have lost to the target)
Non-merging firms could also benefit from the merger
Factors to be considered

- Market shares
- Closeness of competition
- Customers’ ability to switch
- Competitors’ ability to expand output
- Merged entity’s ability to hinder competitors’ expansion
- Important competitive force

Not exhaustive list
Not all elements need to be present

Market shares & concentration levels

- **First useful indication** of market structure and competitive strength of various players
- **Market shares**

  - **Dominance cases**
    - 50% or more: presumption of dominance (rebuttable)
  - **"Gap cases"**
    - Between 40 and 50%: potentially problematic
  - **Presumption of no problem (rebuttable)**
    - Below 40%: typically less problematic but no safe harbour
    - Below 25%: typically no problem

- **Concentration levels**
  - HHI index
### Closeness of competition

The higher the **degree of substitutability** between the merging firms' products, the more likely it is that the merging firms will raise prices significantly.

<table>
<thead>
<tr>
<th>Key points</th>
<th>Investigative tools</th>
</tr>
</thead>
<tbody>
<tr>
<td>Homogeneous vs <strong>differentiated</strong> product markets</td>
<td><strong>Qualitative</strong>: internal documents</td>
</tr>
<tr>
<td><strong>Relative approach</strong>, not binary exercise: the merging firms need not be one another’s closest competitors (or closer competitors to one another than their market shares would suggest)</td>
<td><strong>Quantitative</strong>: customer surveys, analysis of purchasing patterns, estimation of the cross-price elasticities of the products involved, diversion ratios</td>
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### Hutchison 3G UK/Telefonica UK

Merger eliminates competition between Three & O2, which are close competitors in the retail market.

<table>
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<th>Evidence</th>
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<td><strong>Qualitative</strong>: market investigation, internal documents</td>
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<tr>
<td><strong>Quantitative</strong>: diversion ratio</td>
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</table>
Facebook/WhatsApp

Merger eliminates competition between Facebook & WhatsApp, which are NOT close competitors in the market for consumer communication apps

**Evidence**

**Qualitative:** product differences which limit substitutability, "multi-homing" suggest complementarity

Important competitive force (ICF)

**Legal test**

Firms having more of an influence on the competitive process than their market shares or similar measures would suggest (not only "maverick")

**Examples**

Recent entrant Innovation

**Investigative tools**

**Qualitative:** history, offering analysis, internal documents

**Quantitative:** gross adds, pricing analysis
Hutchison 3G UK/Telefonica UK

Merger eliminates competition between Three & O2, which are important competitors in the retail market

<table>
<thead>
<tr>
<th>Three – ICF or ICC</th>
<th>O2 - ICC</th>
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</thead>
<tbody>
<tr>
<td>History of a classic maverick and most innovative player</td>
<td>Market leader by subscribers</td>
</tr>
<tr>
<td>Lowest prices in direct channel and strong gross adds</td>
<td>Competitive offers also through giffgaff &amp; Tesco Mobile</td>
</tr>
<tr>
<td>Most reliable network and good network quality</td>
<td>Best brand and customer loyalty</td>
</tr>
<tr>
<td>Profitable business today &amp; going forward</td>
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</tr>
<tr>
<td>No capacity constraints in near future</td>
<td>Ability to compete unlikely to be materially impacted by capacity constraints</td>
</tr>
</tbody>
</table>

Economic tools
1. Economic tools in merger control

The classical analysis (I)

1. Defining the relevant market

2. Assessment based on market shares and market concentration (HHI)
   » "Safe harbour" HHI thresholds (the European Commission)
   » HHI < 1.000
   » 1.000 < HHI < 2.000, delta < 250
   » HHI > 2.000, delta < 150

» Assumption: Market shares measure competitive pressure

» Change in market shares/HHI = “unilateral effects”:
   » Large change in HHI = Indication of sign. weakening of competition
The classical analysis (II): Imaginary Example

NB! Market shares do not tell us whether the parties are actually close competitors when products are differentiated.

The new economic tools (I)

- Focuses on how a merger changes the pricing incentives:
  - Before merger: Profit maximizing on the basis of own products
  - After merger: Profit max. on the basis of own and acquired products

- Effects of the merger:
  1. Incentive to increase prices due to decreased competitive pressure
  2. Incentive to lower prices due to merger specific efficiencies

- UPP (Upward Pricing Pressure)
  - Direction of the price change

- IPR (Illustrative Price Rise)
  - Estimate of the exp. price change

Based on:
  - Diversion ratios
  - Closeness of competition
  - Margins
  - Relative prices
  - Merger specific efficiencies
The new economic tools (II)

» Direct focus on the competitive pressure eliminated due to the merger
» Simple and intuitive method compared to merger simulation models:
  » Easy to communicate to non-economists
  » Possible to do within the time limits of a merger review

» Differs from the classical analysis based on market definition and a subsequent assessment based on market shares and the degree of market concentration
» Supplement to the overall assessment:
  » For instance, dynamic responses are not taken into account

Economic analyses – unilateral effects

Diversion ratios (I)

» Closeness of competition between the merging parties
» Indicates the degree of competition lost due to the merger
» How large a share of the customers lost in case of a price increase are lost to the other merging party?

\[
D_{AB} = \frac{\delta q_B / \delta p_A}{\delta q_A / \delta p_A}
\]

» A number between 0 (not close competitors) and 1 (close competitors)
Diversion ratios – a basic example

Q: Where would you go if Shop A were to close?

Diversion ratios

- Shop A (25 pct.)
- Shop B (10 pct.)
- Shop C (5 pct.)
- Shop D (20 pct.)
- Shop E (40 pct.)

Half of the customers in Shop B would go to Shop A if Shop B were to close.

3. The merger between Arcus and Pernod Ricard
The transaction

» On 31 July 2012, Arcus notified the acquisition of:
  • Pernod Ricard’s Danish aquavit brands
  • Gammel Dansk

» Arcus: Norwegian alcohol producer. Sells Linie Aquavit in Denmark

» Pernod Ricard:
  Second largest alcohol producer worldwide
  Leading producer in Denmark: Rød Aalborg, Brøndums, Gammel Dansk m.v. + Malteserkreuz in Germany

Market shares

» Significant increase in the concentration level

» The counterfactual was status quo

» Relevant to further investigate the risk of unilateral effects

Economic analyses – unilateral effects
Diversion ratios – consumer survey

» 1,007 respondents that bought an aquavit within the last year
» Asked what aquavit they bought last time – and what they would have bought if this aquavit had been sold out
» Used in assessment of unilateral effects, in market definition and in the assessment of remedies

Figure 5: Diversion ration from Arcus to Pernod Ricard Denmark
IPR: How will Arcus set prices after the merger?

Diversion ratio
\[ D = 53 \text{ pct.} \]

Profit
\[ M = XX \text{ pct.} \]

Efficiencies

\[
IPR = \frac{DM}{2(1 - D)} - \frac{E(1 - M)}{2}
\]

IPR = 3-5 pct. (8-12 % with isoelastic demand curve)

Remedy

» Divestment of Brøndums
» HHI decreased
» Diversion ratios:
  » Brøndum is a strong brand
Break 😊

Efficiencies
General principle

Balancing exercise
Do efficiencies counter-act possible adverse effects on competition?

Mergers may enhance the ability and incentives of the combined entity to behave pro-competitively.
Put forward by the parties, Commission assess Right of defense

Cumulative conditions

- Consumer benefits
- Merger-specificity
- Verifiability

Consumer benefits

- **Pass-on** of efficiencies to consumers
  - Reductions in variable or marginal costs (as opposed to fixed costs) more likely to be passed on and result in lower prices
  - Pass-on related to competitive pressure from remaining players/entry (less likely for monopoly)
- Efficiencies must be **timely** (the later, the less weight)
- Benefits to consumers should occur on the **same market as the harm**
- **Challenges**: quantification/order of magnitude, timeliness and likelihood
Merger specificity

- Efficiencies as **direct consequence** of the merger
- Efficiencies cannot be achieved to a similar extent by **less anti-competitive alternatives**
  - Alternatives reasonably practical in the business situation (eg. JV, production agreements)

Verifiability

- Reasonable certainty that efficiencies are **likely to materialize** and **substantial enough** to counteract harm
  - **Quantification** where reasonably possible, or
  - If data not available, a **clearly identifiable** positive impact, not a marginal one (=**substantial**)
- **No prescribed pieces of evidence**
  - Pre-merger internal documents or studies independently verified by a third party not required
### Deutsche Boerse/NYSE-Euronext

**The merger would have created a near monopoly in European financial derivatives**

<table>
<thead>
<tr>
<th><strong>Parties</strong></th>
<th><strong>Commission</strong></th>
</tr>
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<tbody>
<tr>
<td><strong>Collateral savings</strong> (EUR 3 billion): combination of parties’ margin pools. Arise automatically on the side of customers and therefore no need for &quot;pass on&quot;</td>
<td>Conditions not met, but for collateral savings</td>
</tr>
<tr>
<td><strong>Liquidity benefits</strong>: through the reduction of bid-ask spread</td>
<td>- <strong>Verifiable</strong>, but the actual cost savings would be EUR 155 million</td>
</tr>
<tr>
<td><strong>IT savings</strong>: through the combination of networks</td>
<td>- <strong>Merger Specific</strong></td>
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<tr>
<td></td>
<td>- <strong>Passed-on</strong>: savings accrue on customer side, yet limited because of claw-back (price response to cost savings)</td>
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<tr>
<td></td>
<td>In any event <strong>not enough to outweigh the harm</strong></td>
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### Hutchison 3G UK/Telefonica UK

**The merger reduced competition in the market, hampered the development of the UK mobile network infrastructure as well as the ability of mobile virtual operators to compete**

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<th><strong>Parties</strong></th>
<th><strong>Commission</strong></th>
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<tbody>
<tr>
<td><strong>Absent merger</strong>, parties face: Incremental costs of capacity expansions (invest to keep up with demand) Additional &quot;costs&quot; of progressive network congestion (quality decrease despite investment) <strong>Post-merger</strong> Increased market power (↑ price) Network consolidation eliminates network costs (↓ price)</td>
<td>Merged entity can deploy the joint spectrum on a denser network</td>
</tr>
<tr>
<td></td>
<td>- Some incremental network cost reductions conceivable</td>
</tr>
<tr>
<td></td>
<td>However, configuration of final consolidation plan was unclear</td>
</tr>
<tr>
<td></td>
<td><strong>Conclusion</strong></td>
</tr>
<tr>
<td></td>
<td>Efficiencies are possible but not verified and in any event unlikely to offset the price effects</td>
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<tr>
<td></td>
<td><strong>Net effect</strong>: ↓ price</td>
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Case study
Comparing experiences of EU and MOFCOM review of the ABBOTT LABORATORIES / ST JUDE MEDICAL merger case

Eleonora Ocello (DG COMP, European Commission)
In a nutshell

Phase I clearance subject to remedies

**Substance**
Acquisition of St Jude Medical Inc. by Abbott Laboratories
Largely complementary businesses but
- Horizontal overlaps in cardiovascular products
- Possible conglomerate links

**Procedure**
03.10.16 - Notification
23.11.16 - Decision adopted
22.12.16 - Buyer approval

**Other jurisdictions**
- US FTC
- Canadian CB
- South Africa CC
- Brazilian CADE
- MOFCOM

Procedure in detail

<table>
<thead>
<tr>
<th>Case allocation</th>
<th>Notification</th>
<th>Remedy submission</th>
<th>Decision adopted</th>
<th>Buyer approval</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spring 2016</td>
<td>3 October 2016</td>
<td></td>
<td></td>
<td>22 December 2016</td>
</tr>
</tbody>
</table>

Day20
- Pre-notification contacts with third parties
- Market investigation
- Remedy Deadline 31 October

Day25
- Market test

Day35
- Phase I deadline (including remedy extension) 23 November 2016
- Phase I deadline (without remedy extension) 9 November
- Divestiture + Monitoring
- Monitoring

Pre-notification

Phase I

Remedy implementation
Horizontal Unilateral Effects (1)

Vessel closure devices (VCDs)
Market-to-market overlap

**Market definition**
- Segmentation small-hole vs large-hole VCDs left open – *St Jude does not offer large-hole VCDs*
- Excluding manual compression, closure assistance devices and surgical suturing
- National scope

**Competitive assessment**
- High market shares: [50-60]% EEA and >40% in 23 countries
- >40% in 21 countries for small-hole VCDs only
- Parties are close competitors
- Concerns raised by doctors
  - → SERIOUS DOUBTS

Horizontal Unilateral Effects (2)

Transseptal sheaths
Market-to-pipeline overlap

**Market definition**
- Segmentation steerable and flexible left open – *Abbott has only a pipeline steerable product in the EEA*
- Segmentation by size left open
- National scope

**Competitive assessment**
- St Jude has very high market shares
- Abbott could become close competitor and exert significant pressure
- Unlikely alternative entry
  - → SERIOUS DOUBTS
### Horizontal Unilateral Effects (3)

**Structural heart Pipeline-to-pipeline overlap**

#### Market definition
- Devices for treatment of different medical conditions constitutes a separate market – in particular **transcatheter mitral valve (TMV)**
- Segmentation repair vs replacement (TMVR) left open
- EEA scope

#### Competitive assessment
- **Both parties are developing TMVR**, St Jude is at much earlier stage of development
- Parties are **not close competitors**
- Many other **alternative** products being developed and at more advance stage
- Only **conglomerate** concerns raised voiced

### Conglomerate Unilateral Effects

#### Large-hole VCDs and other cardiovascular devices
- **Leveraging Abbott’s strong position in large-hole VCDs via bundling**
- **Lack of ability to foreclose**
  - No issue of technical compatibility
  - No commercial link
  - Customer multi-sourcing
  - VCDs no driver of customer/doctor choice
- **Lack of incentives to foreclose**
- **No impact on competition**
- Reaction of competitors

#### Coronary imaging & coronary interventional devices
- **Leveraging St Jude’s strong position in imaging via bundling**
- **Lack of ability to foreclose**
  - No issue of technical compatibility
  - No commercial link
  - Customer multi-sourcing
- **Lack of incentives to foreclose**
- **No impact on competition**
- Reaction of competitors
Commitments

Structural divestment

**Description**
- St Jude’s VCD business
- Part of production facility
- Manufacturing equipment
- Personnel, IPRs, customer records
- Abbott’s transseptal sheath business
- Shareholding in developer company
- Transitional agreement

**Assessment**
- Complete removal of the overlap
- Include all relevant assets
- Positive market test
- Purchaser criteria ensure sale to suitable purchaser which will preserve competition

**Buyer identified already during the procedure, but not fix-it-first**