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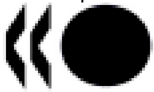

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DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

ROUNDTABLE ON SUBSTANTIVE CRITERIA USED FOR MERGER ASSESSMENT

-- Note by Lithuania --

This document is submitted by the Lithuanian delegation to the Competition Committee FOR DISCUSSION under Item XIII at its forthcoming meeting on 23-24 October 2002.

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ROUNDTABLE ON SUBSTANTIVE CRITERIA USED FOR ASSESSMENT

Note by Lithuania

1. General objectives of the law on competition

1. The main objective of the Law on Competition of the Republic of Lithuania is "to protect freedom of fair competition in the Republic of Lithuania", however, aforementioned law does not provide the definition of what constitutes competition. While competition is often understood as a situation in a market in which sellers of a product or service independently strive for the patronage of buyers in order to achieve a particular business objective, for example, profits, sales and/or market share, it is well known from the mainstream economic theory that such process results in a situation characterized by the absence of market power. Therefore the law does not preclude the Competition Council of the Republic of Lithuania to rely on the mainstream economic theory which equates competition with the absence of market power. Furthermore, the main objective of the law creates a strong predisposition to use such test for merger review purposes that would allow the detection of a substantial increase of market power.

2. Nature of the substantive test

2. Lithuanian Competition law further establishes that the Competition Council is entrusted with merger review powers in the territory of the Republic of Lithuania. According to the law, the substantive test in merger review is creation or strengthening of a dominant position. The Competition Council either allows a merger to go through if it does not raise competition concerns or it takes a decision "to refuse to grant a permission to implement concentration <…> in order to prevent creation or strengthening of a dominant position." On the other hand, the Competition Council can "permit the implementation of concentration attaching to its decision conditions and obligations for the participating undertakings or controlling persons in order to prevent creation or strengthening of a dominant position." According to the definition of the law:

> **Dominant position** means the position of one or more undertakings in the relevant market directly facing no competition or enabling it to make unilateral decisive influence in such relevant market by effectively restricting competition. Unless proved otherwise, the undertaking with the market share of not less than 40% shall be considered to have a dominant position in the relevant market. Unless proved otherwise, each of a group of three or a smaller number of undertakings with the largest shares of the relevant market, jointly holding 70% or more of the relevant market shall be considered to enjoy a dominant position

3. The presence of a unilateral decisive influence implies insufficient competition. The latter implies the existence of a substantial market power. Therefore, the creation of dominance implies substantial increase in market power which is equivalent to substantial decrease of competition. The Competition Council takes a view that it could interpret both dominance test and substantial lessening of competition test as being equivalent under most circumstances. The widespread belief about alleged differences of the tests most likely stems from the difference in methods that various competition authorities rely on in their predictions of post-merger changes. It is worth emphasizing that the definition of a dominant position provided in the Lithuanian law does include collective dominance. However,

market share test creates nothing more than strong presumptions that can be disputed even by the competition authority itself.

3. Possibility for a particular test to make a difference in specific merger reviews

4.. The possibility for a particular test to make a difference in specific merger reviews will be discussed with the help of the following examples.

a) Hypothetical situation of a series of small mergers which appears to be leading to the creation of a firm having significant market power, e.g. a series of small mergers used to build a chain of distributors;

5. In this case particular firm would gain significant market power. Such market power being not only significant but also substantial should not be able to escape detection by either dominance test or SLC. However, a problem could arise with the practical application of any test if any small merger would be analyzed in isolation and treated as neither being a substantial lessening of competition nor a creation or strengthening of a dominant position.

b) in the pre-merger situation there is little in the way of competition in the pertinent market - e.g. the market is currently regulated but is scheduled to be liberalised; few sellers have much in the way of excess capacity and there are significant barriers to entry; there is a tight oligopoly characterised by a high degree of conscious parallelism; or some other factor has the effect of reducing current competition to a very low level;

c) a merger is expected to lead to anti-competitive co-ordination among firms among whom there are no structural links;

6. Both pre-merger situations seem to be known under a variety of names among them are collective dominance, oligopolistic dominance, and coordinated interaction. Both the dominance test (augmented by the notion of collective dominance) and the SLC test (with due attention to coordinated effects) should be suitable for addressing aforementioned problem. In most conceivable cases a merger in such a market should strengthen oligopolistic dominance and substantially lessen competition either because of enhancing ability to act unilaterally or facilitating collusion.

d) although the merged entity will not have a dominant position (or something closely analogous), it is nonetheless expected to be able to profitably raise price post-merger despite expected increases in output by competitors.

7. Economic theory suggests that profitable price increase could be executed either by a single firm that has enough unilateral market power or by a group of firms that have enough market power collectively and are able to sustain collusive equilibrium in the market. The presented example does not seem to fit any of those situations. Nevertheless, in a market of differentiated products it is easy to make a mistake by including into relevant market too many substitutes. A thoroughly investigated by the FTC and subsequently blocked merger of office superstores in the U.S.A. in 1997 serves as perfect example of how an antitrust agency can avoid such a mistake. Despite office superstore’s sales accounting for only 6% of the total office supply sales only office superstores were included into a relevant antitrust market after rigorous econometric studies.

8. Sometimes a case is made in favor of the SLC test as being efficiency friendly in contrast to dominance test which is allegedly hostile towards efficiencies. In our view, analysis of merger specific efficiencies should not be influenced by the choice of the test. Merger specific efficiencies that result in marginal cost reduction should be taken into account when it is possible to predict with enough confidence their impact on future prices. Merger specific efficiencies should not raise objections on the grounds of creating or strengthening dominant position when market power is actually decreasing (at least when measured with respect to pre-merger marginal costs) and consumers' surplus increases. Nevertheless, the real issue remains whether producer surplus increase should be compared with deadweight loss when it is absolutely clear that a merger will result in a profitable price increase despite merger specific efficiencies.

4. Broader policy concerns

9. In our opinion, none of the tests make a difference in the roles played by market definition and concentration data in merger assessment. For both tests SSNIP is an acceptable method to define a relevant market. However, danger arises to misapply market definition or market concentration data when it is not possible to make a rigorous test and products are differentiated. If too many distant substitutes are mistakenly included into a relevant market then both tests will be based on false market shares or concentration indices.

10. Both tests are capable of creating legal certainty only when being consistently applied by practitioners. On the other hand, a better explanation of the methods and criteria used in predicting unilateral and coordinated increases of market power should help to enhance legal certainty concerning any particular test.