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EE 403

Law & Economics

The Economics of Competition Law III

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Per se rule vs Rule of reason.

- Price fixing by a cartel is illegal per se. This means that the behavior need only be proved to have existed; there is no allowable defense.
- If a certain practice does not qualify as a per se offense, the rule of reason applies. This term refers to the tests of “inherent effect” and “evident purpose.”
- For example, a merger between two firms in the same market is not necessarily harmful or beneficial. Hence the court must then look to the “inherent effect” of the merger and its “evident purpose” or intent.
- A merger would be judged as legal or not depending on an evaluation of the evidence concerning the actual intent of the firms to monopolize the market and their ability to realize any such intent.

Economic Analysis of Legal Categories

- The merger results in
 - a deadweight loss in consumers' surplus equal to triangle A_1
 - cost savings, which is shown by the rectangle A_2
- The argument could be made that the antitrust authority should compare the loss of A_1 with the gain of A_2 . If A_2 exceeds A_1 , the merger should be permitted, and not otherwise.

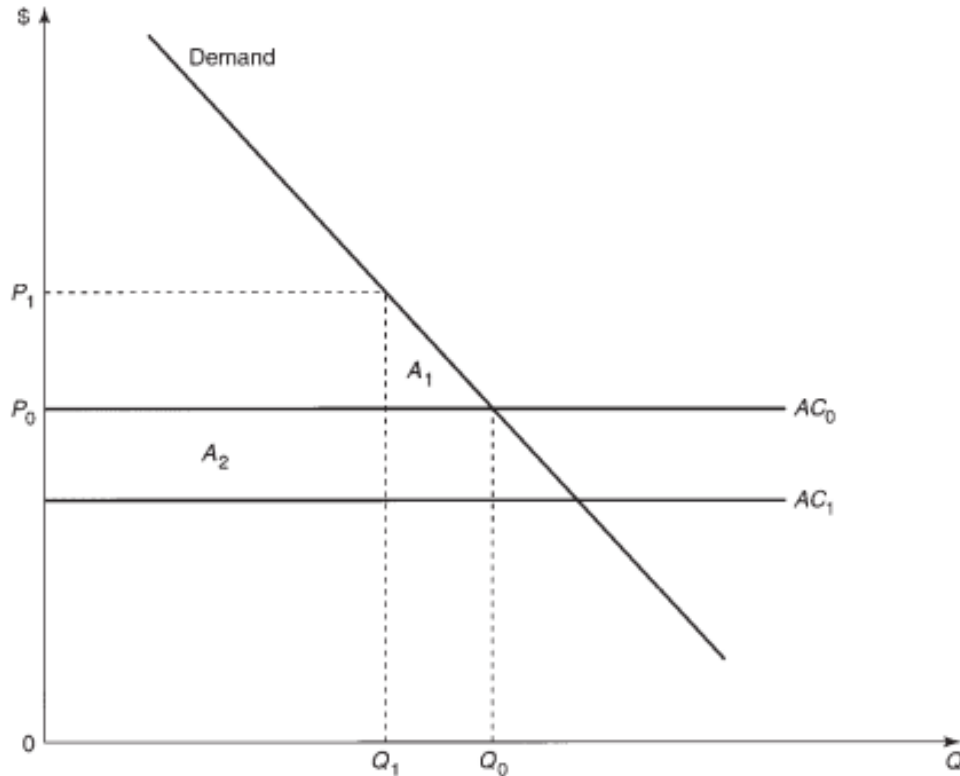


Figure 5.12
Benefits (A_2) and Costs (A_1) to Society of Merger

The “Per se” rule

- Restraints analyzed under the per se rule are those that are always (or almost always) so inherently anticompetitive and damaging to the market that they warrant condemnation without further inquiry into their effects on the market or the existence of an objective competitive justification.
- a plaintiff is only required to prove that the specific anticompetitive conduct actually took place. The plaintiff does not need to demonstrate the conduct’s competitive unreasonableness or negative competitive effects.
- defendants are not entitled to justify their behavior based on any objective competitive justifications.
- a plaintiff has less responsibility to analyze the market where the restraint is deemed per se anticompetitive.

Cartel → Per Se Rule

- A cartel, in contrast to a merger that integrates the productive activities of the firms, can lead only to the area A_1 losses. Cost savings are quite unlikely without actual integration.
- Hence it is sensible to place cartels that attempt to fix prices or allocate markets in the per se category. The “inherent nature” of price fixing is to suppress competition, and there are no beneficial effects.

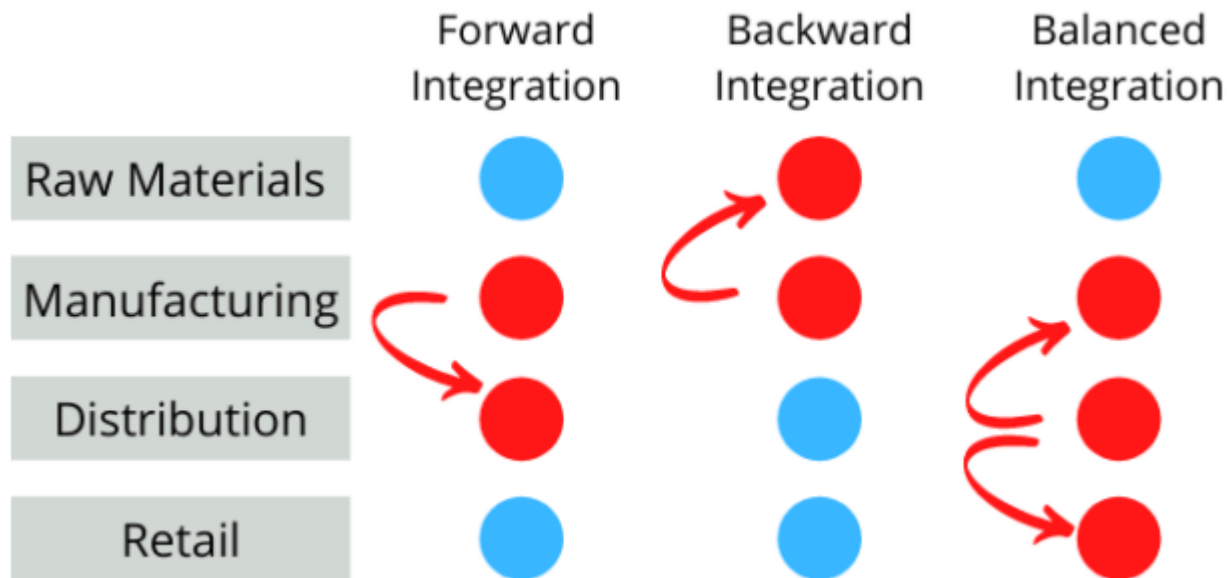
Mergers

- A horizontal merger is defined as one in which rivals in the same market form one company.



Mergers

- A vertical merger is one between two firms with potential or actual buyer-seller relationships.



Mergers

- Conglomerate merger
 - Product extension (Pepsico + Pizza Hut)
 - Market extension merger (two firms selling the same product but in separate geographic markets. (2 local telephone services in no overlapping regions.)
 - Pure conglomerate mergers between firms with no obvious relationship of any kind. (tobacco + oil company)

Reasons for Mergers

- Monopoly
- Economies
 - Pecuniary economies are monetary savings from buying goods or services more cheaply.
 - Real economies represent true resource savings because of increased specialization or scale economies or sharing capital in the joint production of some goods. Economies in, research and development. Marketing can be improved in certain cases through the pooling of sales forces, the use of common advertising campaigns, and so on.

Guideline

- In evaluating horizontal mergers, the Agency will consider both the post-merger market concentration and the increase in concentration resulting from the merger.
 - a) Post-Merger HHI Below 1000. The Agency regards markets in this region to be unconcentrated. Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.

Guideline

b) Post-Merger HHI Between 1000 and 1800. The Agency regards markets in this region to be moderately concentrated. Mergers producing an increase in the HHI of less than 100 points in moderately concentrated markets post-merger are unlikely to have adverse competitive consequences and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 100 points in moderately concentrated markets post-merger potentially raise significant competitive concerns

Guideline

c) Post-Merger HHI Above 1800. The Agency regards markets in this region to be highly concentrated. Mergers producing an increase in the HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns

- Where the post-merger HHI exceeds 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise.

Staples – Office Depot (1997)



Staples – Office Depot (1997)

- 2 largest office superstore chains in USA → agree to merge.
- FTC voted 4 to 1 to oppose the merger [it was likely to harm competition and lead to higher prices in “the market for the sale of consumable office supplies sold through office superstores”]

Background

- Office superstore (OSS) → low-cost source of office supplies.
- Office Depot → approx. 500 stores in 8 states, sales \$6.1 billion.
- Staples → about 550 stores in 28 states, sales \$4 billion.
- There are 23 competing OSS at the time but OfficeMax was the only close rival



Staples – Office Depot (1997)



FTC Argument

Market Definition

- OSS → broad range of products and maintained large amounts of stock → one-stop-shopping opportunity that was not provided by other retailers or mail-order.
- OSS regard each other as their primary competitors [evidence from internal docs]
- Non-OSS retailers have little effect on OSS's price changes. → if merge , non-OSS would not prevent the merged OSS from raising price → non-OSS should not be included in the relevant market.
- Suppliers that compete in the same market have similar prices for the same (basket of) products. [a survey reported that in Detroit all three OSS had virtually identical prices , prices differ by from 0.4% to 2%.]

Staples – Office Depot (1997)



FTC Argument

Merger’s likely anticompetitive consequences

- Office Depot was the main constraint on Staple’s prices. (CEO testified)
- Percentage of Staples Stores [From Staple’s own documents]

Year	Staples Only	Staples & Office Depot	Staples & Office Max	All three	Total
1995	17%	29%	37%	17%	100%
2000	12%	7%	12%	69%	100%

- Predicted that retail margins would decline by 1.5% by 2000 due to competitive pressure. [Staple’s documents]
- Staple’s office supplies prices were 11.6% lower in markets where Staples faced only Office Max.

Table 7.2

Average Price Differential for Different Office Superstore Market Structures

Benchmark Market Structure	Comparison Market Structure	Price Reduction (Percent)
Staples only	Staples + Office Depot	11.6
Staples + OfficeMax	Staples + OfficeMax + Office Depot	4.9
Office Depot only	Office Depot + Staples	8.6
Office Depot + OfficeMax	Office Depot + OfficeMax + Staples	2.5

Source: Serdar Dalkir and Frederick R. Warren-Boulton, “Prices, Market Definition, and the Effect of Merger: Staples-Office Depot (1997),” in John E. Kwoka, Jr., and Lawrence J. White, eds., *The Antitrust Revolution: The Role of Economics*, 4th ed. (New York: Oxford University Press, 2004).

Staples – Office Depot (1997)



FTC Argument

Merger's likely anticompetitive consequences

- Stock-Market Event Study :
 - Merge → raises product prices → raise the prices of merging parties and their rivals.
 - Merge → more efficient → lower rival's share price
 - the merger would raise the value of OfficeMax's shares by 12%
- Entry
 - Significant sunk costs.
 - Insufficient demand for more OSS.
 - Incumbents have economies of scale in advertising [more stores]

Staples – Office Depot (1997)

Staples Argument

Market Definition

- FTC's market def. was based exclusively on the identity of the seller and not on the characteristics of the product or services supplied by seller.
- Retail product market is defined by the nature of the product being retailed; office supplies sold by and OSS are not different from those sold by other retailers. ➔ same market










Efficiencies

- Merger would increase the total volume of their purchases ➔ lower prices.
- Merger would lower admin, marketing and distribution costs.
- Blocking merger would impose losses on consumers and shareholders

Entry

- Stores could be constructed within months
- low sunk cost because products did not decay

Merger: Coca-Cola and Dr. Pepper (Antitrust Revolution (1989) pp 80 -95)

Producers	Share
Coca-Cola Co. 	37.4%
Pepsi Co. 	28.9%
Philip Morris (Seven Up) 	5.7%
Dr. Pepper Co. 	4.6%
R.J.Reynolds (Sunkist, Canada Dry)  	3.0%
Royal Crown Cola 	2.9%
Procter & Gamble (Hines Root Beer)  	1.8%
Others (including supermarket brand)	15.7%

Merger: Coca-Cola and Dr. Pepper (Antitrust Revolution (1989) pp 80 -95)

- Feb 20, 1987 Coca-Cola announced its intentions to purchase the Dr. Pepper Company and merge the operations.
- 3.5 weeks earlier, Pepsi Co. had announced its intentions to purchase the Seven-Up Company (subsidiary of the Philip Morris Corp.)
- Trade Commission in June 1986 decided that these mergers were likely to be anticompetitive and declared its preliminary decision to oppose them.
- Pepsi Co called off the mergers but not Coca-Cola

Merger: Coca-Cola and Dr. Pepper (Antitrust Revolution (1989) pp 80 -95)



FTC Arguments

Market Definition → based on deposition (สัมภาษณ์) and discovery (เอกสาร) evidence →
Carbonated soft drink (CSD) concentrate and CSD itself.

- CSD company executives indicated that their primary competitors were other CSD producers.
- Their pricing and marketing strategies were developed with an eye toward other CSD producers not toward the sellers of fruit juices , milk , coffee, tea or other beverages.
- when asked if they (executives) thought the CSD producers could collectively raise prices of CSD by 10% and not be thwarted by consumer's switching to other beverages → answer is “NO”
- Cost of CSD concentrate was only one-tenth of the retail price of CSD & little room for substitution of other inputs → considerable room for an industry wide increase in the price of concentrate. (well beyond 5%) that would not decrease sales.

Merger: Coca-Cola and Dr. Pepper (Antitrust Revolution (1989) pp 80 -95)



FTC Arguments

Market Definition

- Since the merging entities were sellers of CSD concentrate, the FTC claimed that CSD concentrate was a market.
- With respect to geography → Nationwide (United States) and individual local areas.

Level of concentration

- With the merger, HHI for this national market would have risen by 342 points to a level of 2,646.
- For all 91 local areas, post merger HHIs would have been above 1,200 and for 81 areas the postmerger HHI would have been above 1,800. Of these 81 areas, 66 would have experienced HHI increases of over 100 points → exceeding the Merger Guidelines's criteria.

Merger: Coca-Cola and Dr. Pepper (Antitrust Revolution (1989) pp 80 -95)



FTC Arguments

Entry

- Though no specialized resources or talents were required for CSD formulation and production, substantial sums were required for the advertising and promotion of new soft drink → investment that are highly risky and they are sunk. (unlike investment in plant and equipment that can be recovered.)
- New Bottlers have to battle for the supermarket shelf space.
- Limited number of buttons on vending machine and spigots at a fountain posed entry barriers for smaller entrants.

Merger: Coca-Cola and Dr. Pepper (Antitrust Revolution (1989) pp 80 -95)



Coca-Cola's Arguments

Market Definition.

- Coke competed against all other beverages.
- Because beverage manufacturers typically operated and sold their product nationa-wide the geographic market should be the entire United States.
- In this larger market, CSD was only 25 percent of all beverage consumption and the post-merger HHI was only 739 well below the Merger Guidelines' minimum decision point of 1,000 → merger did not increase the likelihood of the exercise of market power.

Merger: Coca-Cola and Dr. Pepper (Antitrust Revolution (1989) pp 80 -95)



Coca-Cola's Arguments

Entry

- No specialized resources
- Economies of scale were not significant.
- Easy to develop a flavor and produce concentrate
- Point out recent entrants who were capable of expanding their sales.

Structural characteristics of the market

- Difficult to coordinate their behavior and raise prices because there are too many product types and sizes and too many promotional opportunity. Difficult for anyone firm to monitor the others in any informal understanding to raise prices or reduce promotion, and each firm would have and incentive to cheat on any such arrangement.

Efficiencies

- cost savings and efficiencies.



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Trade Competition Act B.E. 2560 (2017)

**The Trade Competition Commission Notice on
Guidelines for the Assessment of **Market Definition and
Market Shares** B.E. 2561 (2018)**

Definitions:

“**Relevant Market**” means relevant product market and relevant geographic market;

“**Relevant Product Market**” means a market comprises of all products or services which are interchangeable or substitutable by consumers, when products’ characteristics, prices, or intended use are considered;

“**Relevant Geographic Market**” means a market comprises of the area in which products or services are interchangeable or substitutable by consumers and subject to the similar conditions of competition;

The Trade Competition Commission Notice on Guidelines for the Assessment of **Market Definition and Market Shares B.E. 2561 (2018)**

Chapter 1 Principles of Identifying Market Definition

Section 5. To identify market definition, conditions that may restrict competition of products or services in terms of demand substitutability, supply substitutability, and potential competition shall be considered together.

Section 6. Demand substitutability shall consider consumers' perception and perspective on the extent of products or services that are interchangeable or substitutable, by reasons of products'/services' characteristics, prices, or intended uses and geographic reason.

The Trade Competition Commission Notice on Guidelines for the Assessment of **Market Definition and Market Shares B.E. 2561 (2018)**

Chapter 1 Principles of Identifying Market Definition

Section 7. Supply substitutability shall consider suppliers' abilities to switch from a product or service in question to other related products or services without incurring significant increase in costs or risks resulted from the change in price of that product or service.

Section 8. Potential competition shall consider all possible factors and circumstances that may affect conditions for market access of a relevant product market resulting in the level of competition in that market.

Section 12

- If the demand substitutability cannot be assessed by using what described in 10 and 11, the assessment of demand substitutability shall be identified by using a **SSNIP test** or an economic test for a switch to alternative products or service when there is a **Small but Significant and Non-transitory Increase in Price** which have the following steps:
 - (1) **Determining the range of products or services** which are viewed as substitutes by consumers by starting from the type of products or services in question that the undertakings involved sell **and the area in which they sell** such products or service;
 - (2) Then, additional products or services and areas will be included in (1) and the assessment **should evaluate the consumers' response to an approximately 10 percent increase in the price** of such product or service in question whether significant numbers of consumers would switch to readily available substitutes or to suppliers located elsewhere within the additional products or services and areas included;
 - (3) **Additional products or services and areas shall be continuously included into the assessment until consumers can no longer switch to alternative products or services or to supplier located elsewhere.**

**The Trade Competition Commission Notice on
Guidelines for the Assessment of **Market Definition and
Market Shares** B.E. 2561 (2018)**

Market Share (section 15)

The assessment of market share of each undertaking in relevant market shall be expressed in the percentage of quantity sold, sales revenue, quantity produced, or production capacity of such product or service, where applicable.

The Trade Competition Commission Notice on Criteria for being an Undertaking with Dominant Position B.E. 2561 (2018)

Any undertaking with market share and sales revenue as follow shall be deemed as an undertaking with dominant position:

(1) An undertaking in a market of a particular product or service that has market share in the preceding year of 50 percent or more and has sales revenue of one billion (1,000,000,000) baht or more, OR

(2) First largest three (3) undertakings in a market of a particular product or service that have combined market shares of 75 percent or more and each and every undertaking has sales revenue of one billion (1,000,000,000) baht or more;

The provision in paragraph 1 (2) above shall not be applied to any undertaking with market share in the preceding year lower than 10 percent.

The calculation of market share and sales of a business operator shall include market share and sales from other business operators within a single economic entity per the Rules for the Assessment of Undertakings under Common Policy Relations or Common Controlling Interests.



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Abuses of a dominant position

Section 50 of the Act

prohibits a business operator from abusing its dominant position by engaging in the following conduct:

1. setting unfair purchasing or selling prices (e.g. predatory pricing, pricing below cost, price discrimination, margin squeeze, excessive pricing or otherwise maintaining purchasing or selling prices without justifiable reasons);
2. imposing unfair conditions on trading partners which limit (i) the service, production, purchase or sale of the product; (ii) the opportunity to purchase or sell products, receive or provide services; or (iii) the opportunity to procure loans from other business operators (e.g. fidelity discounts, exclusive dealing,
3. quantity forcing, tying arrangement, resale price maintenance, refusal to supply);
4. suspending, reducing, or limiting service provision, production, sale, delivery, or import without justifiable reasons, or destroying or causing damage to goods in order to reduce the quantity to be lower than market demand; or
5. intervening in others' business operation without justifiable reasons.



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Prohibition of unfair trade practices

Section 57 of the Act

The prohibited practices

1. unfair obstruction of business operations;
2. abuses of a superior market or bargaining power (which, arguably, is a lower standard than “abuses of a dominant position”);
3. imposing unfair trading conditions; and
4. Any other practices to be determined by the TCC.

Merger control

Sections 51 to 53 of the Act

Post-merger notification is required for mergers that may cause a substantial reduction of competition in a particular market. The acquirer or the surviving entities (as the case may be) must notify the merger to the TCC after closing in relation to transactions where the value of sales achieved by any of the merging parties or the value of their combined sales reaches one billion baht (approx. US\$30 million) or more in the relevant market, and which do not cause a monopoly or result in a dominant position. A post-merger notification must be filed within seven days after the completion of the transaction.



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Pre-merger clearance is required to be obtained by the acquirer or the merging parties from the TCC when a merger may result in a monopoly or a dominant position (as these notions are defined in the TCC's *Notification on Criteria for being an undertaking with a dominant position (2020)*). The TCC has 90 days (extendable by 15 days) from the receipt of such filing to issue a decision, and may impose any conditions for clearance. Parties who disagree with the decision of the TCC may appeal to the Administrative Court within 60 days from the receipt of the decision.

Sanctions



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<u>Offense</u>	<u>Criminal penalty</u>	<u>Administrative penalty</u>
Abuse of market dominance (s.50)	Fine: ≤ 10% of revenue in the year of offence and/or Imprisonment : ≤ 2 years <u>First year:</u> Fine: ≤ 1M THB and/or Imprisonment ≤ 2 years	
Agreement between competitors (s.54)		
Merger of business (s.51-53)		(notification) Fine: ≤ 200,000 , Daily ≤ 10,000 THB (permission) Fine: 0.5% of value of merger transaction
Agreement with other business operators (s.55-56)		Fine: ≤ 10% of revenue in the year of offence <u>First year:</u> Fine: ≤ 1M THB
Agreement with business operator in a foreign country (s.58)		
Unfair practice (s.57)		