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I. INTRODUCTION

Since the Commission first tackled the oligopoly issue under the Merger Regulation, there has been considerable development of the Commission's policy in this area and, also, very significant clarifications from the Court of Justice and the Court of First Instance. To begin with, the Commission published guidelines² for its assessment of coordinated effects under the merger regulation.

Quite naturally, the oligopoly issue has arisen often, not to say systematically, since nowadays most markets do present an oligopolistic structure of supply. This is even more valid if we consider the relatively narrow relevant antitrust markets, which are typically defined by reference to substitution in demand. More often than not, leading groups of less than four suppliers account for a large combined share of output in almost any antitrust market. However, is an oligopoly in a collective dominant position? The decision in the *Airtours/ First Choice* case³ vastly extended the boundaries of the situations under which the Commission found this may be the case.

II. THE ISSUE OF OLIGOPOLIES

Let's recall that an oligopoly is defined as a group of suppliers where each one is aware that his competitive actions will prompt identifiable reactions from his competitors, whom he can readily identify. An (unidentified) number of suppliers constitute an oligopoly to the extent that they realize they have a strategic interdependence among themselves. From this perspective, most economic sectors in Europe present a (more or less tight) oligopolistic structure of supply, be it telecommunications, media, chemicals, pharmaceuticals, vehicle manufacturing, computers and computer software, air transport, etc...

Oligopolies are nevertheless perfectly compatible with active competition and a competitive market outcome. It is only when a small group of suppliers accounts for a large

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² DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, 2005, available at <http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf>

³ *Airtours/ First Choice*, Commission Decision of 22/09/99, Case IV/ M 1524, OJ L93, 13/04/2000, p 1.

share of output in markets with certain characteristics⁴ that competition authorities, and in particular the Commission, may consider raising concerns. Thus the starting point to answer our question would appear to be a very simple one. It is not, however.

III. OLIGOPOLIES UNDER THE MERGER REGULATION PRE-GUIDELINES

The initial assessment of concentrations under the Merger Regulation relied on a concept of oligopoly inspired in the economic model of collusion in stable, mature, and transparent markets. When concentration is high in these types of markets, barriers to entry are significant and customers enjoy limited or no countervailing power. In this situation the Commission regards the members of oligopoly as being in a collective dominant position, provided that there are overall symmetric conditions among them. The logic underlying this combination of factors stems from the tension between the objective interests of the members of an oligopoly to collude in order to attain collectively monopoly profits, (or profits as close to that level as possible) and the individual interest of each member of the oligopoly to cheat and deviate from the collusive behavior in order to maximize its own individual profits.

In this context, market transparency is crucial for the oligopolists to achieve a collusive outcome, since it allows for the identification of deviations from the collusive behavior and thus allows to members to deter such deviations with a credible threat of retaliation.

Economic theory shows that both collusive and competitive equilibria can be obtained by an oligopoly, depending on a number of factors. Whereas the notions of collective dominance or joint dominant positions are legal terms that are strange to economic analysis, there is, however, a clear equivalence between an oligopoly where a collusive equilibrium is sustainable and a collective dominant position.

In fact, when establishing a collective dominant position, the Commission analyzes most of the factors that facilitate collusion in economic terms, such as the level of supply concentration, the stability and symmetry of market shares, the degree of similarity of cost structures, stable demand, low level of technological innovation, and transparency. The particular combination of these characteristics in a market with an oligopolistic supply may render the collusive equilibrium credible and sustainable. In other words, each member of the oligopoly will find a collusive or accommodating strategy more profitable in the long run than deviation.

Although this analytical approach was initially well-founded, its implementation in actual cases quickly degenerated into a static analysis of the presence/absence of factors typical of markets prone to collusion, instead of a dynamic analysis of how competition works in the relevant markets and of the likely effects of the merger. The climax of this (unfounded) approach is to be found in the *Airtours/First Choice* decision where, for unexplained reasons (and which are probably unexplainable), the Commission focused on a theoretical analysis of

⁴ For a concise presentation of these characteristics, see, for instance, Sigrid Stroux, *Is EC oligopoly Control outgrowing its infancy?*, WORLD COMPETITION, Vol. 23 (March 2000).

rationale incentives, and even dismissed the requirements of key features for collusion to be possible and sustainable.

A. The Scope of Collective Dominance after Airtours/First Choice

The *Airtours* decision expanded the traditional approach in at least two directions. Firstly, it covered situations where the oligopolists were more than just two players. In *Airtours/First Choice*, the Commission, for the first time, forbid a merger on oligopolistic grounds where there were three members of the oligopoly. In its previous decisions, the Commission had forbidden concentrations or (imposed conditions) only in situations of duopoly.

Airtours/First Choice also extended the application of collective dominant positions to a set of situations that may be very different from the kind of markets described above.

1. Incentives and Rational Behavior

This extension is partly explained by the overriding concern of the Commission with the issue of the incentives for members of the oligopoly to avoid competition among themselves. This concern with incentives constitutes, in my view, the most prominent feature of the decision in the *Airtours/First Choice* case.

This concern is clearly and explicitly expressed at paragraph 54 of the decision where the Commission stated that "it is sufficient that the merger makes it rational for the oligopolists, in adapting themselves to market conditions, to act, individually, in ways that substantially reduce competition between them (...)."

Such a strong emphasis on the notion of "rational" behavior in response to incentives leads the Commission: (i) to even exclude the necessity of a retaliatory mechanism to find collective dominance,⁵ and (ii) to find that transparency plays a very secondary role relative to the notions of incentives and rational behavior, i.e. the objective interest of the oligopolists. Consequently, the Commission plays down the need to indentify a precise punishment mechanism.⁶

Airtours/First Choice vastly enlarged the application scope of the theory of collective dominance. It is indeed difficult to conceive of a situation where the members of an oligopoly would not have an objective incentive to constraint capacity down to the level of optimal production by a monopolist. The overall profits of the oligopoly, in the context of no effective competition by fringe firms and no potential entry, will necessarily be higher if they constrain capacity than if they do not. The rational incentive in the form of higher profits will generally be there. As it has been put, the dismissal of the need for a retaliatory mechanism relative to the importance of incentives "(...) misses the crucial point: firms will always find it rational to

⁵ The decision states that "(...) whereas here, there are strong incentives to reduce competitive action, coercion may be unnecessary."

⁶ Boris Etter considers that the Commission explicitly denies the necessity of a punishment mechanism, and qualifies the decision as an "earthquake" in the EC approach to collective dominance. Boris Etter, *The assessment of Mergers in the EC under the Concept of Collective Dominance: An Analysis of the Recent Decisions and Judgements – An Economic Approach*, WORLD COMPETITION, Vol. 23, (September 2000).

choose collusive actions (whether on prices, quantities or capacities) only if they anticipate that a punishment awaits them if they do not do so.”⁷

The main condition that distinguishes a competitive oligopoly from a dominant one is precisely whether market conditions make the collusive behavior not so much rational, but possible and sustainable.

If there are incentives to collude, whether on capacity or directly on prices, there are equally incentives to deviate. A very clear formulation of this idea is to be found in the OCDE paper resulting from the roundtable on oligopolies held in 1999. One of the two main conclusions of the roundtable was indeed that, "There is a considerable gap between the desire to engage in co-ordinated interaction and the ability to do so successfully. It can be difficult to reach mutually acceptable terms of co-operation, and to ensure that firms do not deviate from them.”⁸

Because the *Air Tours* decision was annulled by the Court, and subsequent cases were also lost in Court, the Commission engaged in a thorough review of its economic analysis of mergers. It subsequently published guidelines on the assessment of horizontal mergers where its treatment of coordinated effects seems to be better founded.

III. OLIGOPOLIES UNDER THE MERGER REGULATION POST *GUIDELINES ON HORIZONTAL MERGERS*

The approach taken in the guidelines constituted, at the time, a dramatic departure of the analysis the Commission had been carrying regarding the notion of collective dominance. The analysis is now focused on the anticompetitive effects of the merger at stake; not so much on the description of a market against a legal concept (collective dominance). With regard to collusion, the central point is now whether the merger may change the nature of competition in such a way that firms that previously were not coordinating their behavior are now significantly more likely to coordinate and raise prices or otherwise harm effective competition. A merger may also make coordination easier, more stable, or more effective for firms which were coordinating prior to the merger (coordinated effects).

A merger in a concentrated market may significantly impede effective competition through the creation or the strengthening of a collective dominant position, because it increases the likelihood that firms are able to coordinate their behavior and raise prices, even without entering into an agreement or resorting to a concerted practice within the meaning of Article 81 of the Treaty. A merger may also make coordination easier, more stable, or more effective for firms that were already coordinating before the merger either by making the coordination more robust or by permitting firms to coordinate on even higher prices.

The Commission considers that this coordination is more likely to emerge in markets where it is relatively simple to reach a common understanding on the terms of coordination. In

⁷ Massimo Motta, *EC Merger Policy and the Airtours Case*, EUR. COMPETITION L. REV., (April 2000).

⁸ Oligopoly, DAF/FEICLP (99) 25, Competition Policy Roundtables, No. 25.

addition, three conditions are necessary for coordination to be sustainable. First, the coordinating firms must be able to monitor to a sufficient degree whether the terms of coordination are being adhered to. Second, discipline requires that there is some form of credible deterrent mechanism that can be activated if deviation is detected. Third, the reactions of outsiders, such as current and future competitors not participating in the coordination, as well as customers, should not be able to jeopardize the results expected from the coordination.

Thus, key features of collusive equilibrium (market transparency and deterrence/punishment mechanisms) have been reintroduced into the analysis, in line with the criticisms of the Court of First Instance in *Airtours/Firstchoice*.

Recent prohibitions and second phase decisions under the merger regulation have dealt mostly with vertical cases. There is, however, one interesting decision post guidelines dealing with coordinated effects. It is the decision to impose conditions (asset divestitures) in the concentration between T-Mobile and Tele.ring in Austria.⁹ The case concerned a symmetric duopoly, in which one of the members of the duopoly acquired a (historically) aggressive competitor who had incentives to price aggressively against the two market leaders so as to expand its relatively smaller subscriber base.

The case was analyzed as a unilateral effects case and, in all probability, it would have been handled as a collective dominance situation under the pre-guidelines dominance test. The Commission did, in fact, evoke in its decision the possibility of handling the case as a coordinated effects case, although in light of the commitments submitted by the parties, it did not consider it necessary to further analyze the issue. So it may be argued that the SLC test may have had a formal impact on the way the case was analyzed (unilateral effects versus previous collective dominance test), but it is to be doubted that the change of test had any material impact on the final outcome.

Another case post guidelines where the Commission followed a similar approach concerned the paper industry.¹⁰ After establishing unilateral effects, the Commission evoked the possibility that there may have already been tacit coordination in the relevant market, in view of the remarkably close alignment of carbonless paper capacity reductions with the declining demand trend.

According to the responses to the Commission's market investigation, suppliers were fairly well aware of the prices obtained by each other; among other reasons due to the importance of price lists. According to most respondents to the market investigation, rival suppliers of carbonless paper did not try to undercut each other's prices. The market investigation also suggested that there was considerable transparency regarding the capacity of the carbonless paper producers. This could have made co-ordination of plant closures possible in order to maintain prices at higher levels than would prevail otherwise. Through the proposed transaction, the number of significant players on the market for carbonless paper will be reduced from five to four. Several respondents to the market investigation have pointed

⁹ Case COMP/M.3916 - T-Mobile Austria/Tele.ring

¹⁰ Case No COMP/M.4513 - Arjowiggins/ M-real Zanders Reflex

towards the proven history of cartelization in this particular market, which took place when the number of suppliers was much higher (144), while expressing their concern for coordination on the EEA market for carbonless paper.

Thus, evidence of tacit collusion pre-merger and transparency on prices and capacity are enough to hint at coordinated effects. Nevertheless, since the undertakings submitted by the parties were considered sufficient, the Commission did not carry its analysis further.

IV. CONCLUSION

The Commission long hesitated before dealing with collective dominance under the merger regulation (the first case where the Commission objected to a merger on grounds of collective dominance was Nestlé: Perrier). Collective dominance was then approached in terms of factors facilitating collusion and factors hindering collusion, in the context of an analysis of the competitive forces at work in the relevant market.

A clear misunderstanding of the concept of economic incentives within an oligopolistic supply led the Commission to vastly extend the legal concept of collective dominance, ignoring the fact that oligopolies may lead to a competitive equilibrium, and strongly discounting any factor hindering the possibility of a sustainable collusive outcome. The Court of First Instance corrected this deviation, and the Commission's guidelines set things back on track.

The general approach of the guidelines to the treatment of oligopolies under competition law is economically sound. However, we have little guidance as to how oligopolies will be handled in actual cases. So far, it seems the Commission has tried to avoid the issue, and given that most markets present an oligopolistic structure of supply, one would have expected to see many more cases where coordinated effects are at the forefront of the assessment.