

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Working Party No. 3 on Co-operation and Enforcement

ECONOMIC EVIDENCE IN MERGER ANALYSIS

-- Sweden --

15 February 2011

The attached document is submitted to Working Party No. 3 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 15 February 2011.

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1. Sweden is one of few jurisdictions in the European Union where the merger control process is adjudicative rather than administrative. In order to block a merger, the Swedish Competition Authority (SCA) has to sue in the Stockholm City Court, which has a specialized chamber dealing with Competition law. The ruling of the Stockholm City Court can be appealed to the Market Court - the court of final instance in Competition Law cases.

2. Suing in court implies that we must submit our substantive analysis to a full review, where we argue, and in principle are assessed on, each step of the quantitative analysis before the court. In practice however, no recent lawsuit has reached far enough in the court proceedings to actually yield an assessment by the court of the SCA's, or the merging parties', substantive analysis.¹

3. In this note, we will describe the use of quantitative economic methods at the SCA today, using examples from the two last horizontal mergers that were analyzed in the special investigation phase (Phase II)²: *GSK/AstraZeneca* in 2008 and 2009, a concentration involving two brands of over-the-counter painkillers with the same active ingredient, and *Åhléns/DSE* in 2009, a concentration between department store chains that raised competitive concerns in high-end cosmetics retailing. *GSK* was cleared without remedies, while the merging parties in *Åhléns* withdrew after the SCA sued to block the merger.

4. After discussing the methodologies used in these cases, we end by discussing the role of economists and economics in the SCA review process.

1. The use of quantitative methods

1.1 Data collection and consumer surveys

5. The SCA normally initiates its quantitative analysis at the beginning of Phase II, and sometimes even before that point. Early on in the process the SCA schedules a meeting with the merging parties, as well as with third parties, to discuss the available data. These meetings are usually fruitful as all parties have an interest in moving the analysis forward as quickly as possible. After the meetings, the SCA files a formal request for the parties to submit the data deemed useful. The SCA also purchases additional data from data providers when needed.

6. In both *GSK* and *Åhléns*, the SCA commissioned consumer surveys at an early stage in the investigation to supplement the already-obtained data. In *GSK*, an outside expert was used to devise a survey consisting of a series of hypothetical price experiments, while in *Åhléns* the SCA constructed the survey questionnaire, including the price experiments. Before implementing the survey, the SCA invited the parties to comment.

7. In both cases the surveys yielded results that were of consequence to the substantive analysis of the case. One lesson learned however was that questions in this type of survey easily become too hypothetical and complex. In view of the usefulness in merger analysis of having consumer data with

¹ Since the year 2000, out of the 18 mergers analyzed by the SCA in the special investigation phase (Phase II), none of the four mergers that the SCA sued to block in court stayed in court long enough to be assessed on substantive issues; three were revoked (*Svenska Girot, SF/Sandrews* and *Åhléns/DSE*) and one was dismissed (*Assa/Copix*).

² According to the Swedish Competition Act, the Competition Authority has 25 days from notification (Phase I) to decide whether there are no grounds for action, or whether to initiate a special investigation (Phase II). The Competition Authority then has three months to can take legal actions before the Stockholm City Court.

“exogenous variation”, even if it is only hypothetical, we continue searching for refined methods in this field.

1.2 Demand estimation and merger simulation

8. One of the theories of harm in *GSK* was that the merger would imply significant unilateral effects due to the high substitutability between the two merging brands in particular, or within active ingredients in general. To test this theory econometrically the SCA worked with an external expert. Based on scanner data for over-the-counter painkillers, he estimated a demand system for the products using nested logit, which he then used to perform a merger simulation.

9. In *Åhléns*, one theory of harm focused on the low substitutability between high-end cosmetics and mass market cosmetics, implying significant unilateral effects of a retail merger in the high-end segment. To test this theory, we performed nested logit estimations similar to those in *GSK*, using scanner data on cosmetics sales obtained from the parties. This time the estimations were carried out in-house, while the same expert as in *GSK* worked with the SCA in the capacity of an external advisor.

10. The nested logit estimations in *Åhléns* were supplemented by an additional econometric analysis of substitutability between stores, which was based on data on promotional campaigns. In this analysis as well we had the help of an external advisor. In addition, we also performed an analysis of the cross-elasticity between traditional retail and travel retail.

11. In both *GSK* and *Åhléns*, the econometric analyses yielded results that influenced our assessment of the overall case and formed a building block in the overall understanding, which also included fact-finding and other qualitative analysis. But since neither case got to the stage where it was argued in court, we unfortunately do not know how the analysis would be assessed in a full review.

1.3 The use of simpler but more tractable methods

12. Both these horizontal mergers would likely, in retrospect, have lent themselves also to UPP or IPR-style analysis. Such analysis could easily have been performed if we for example had included a second-choice question in our consumer surveys, using the results to calculate simple diversion ratios between the merging painkiller brands in *GSK*, or between the merging cosmetics departments in *Åhléns*.

13. Being able to supplement the results of the econometric methods described above with a simple but tractable result would definitely have strengthened the analysis. It could also have helped us focus the analysis on the central question of a horizontal unilateral effects case, that of the substitutability between the products of the merging parties, while putting less emphasis on other parts of the analysis that principally served to answer the question of market definition.

14. For example, in the analysis of the scanner data on cosmetics sales in *Åhléns*, we had to deal with the many thousands of cosmetics products sold by the retailers. This presented us with various categorization and aggregation problems, as well as having to deal with noisy data from small sales volumes. In comparison, the dimensionality of a UPP analysis would have reduced the problem to that of the consumer’s willingness to substitute going to one store for the other.

2. The role of economists and economics in the process

2.1 The composition of the case team

15. The SCA has made use of structured economic analysis in its merger review since the late 1990s. At that time however, the economic analysis - and the economist conducting it - was not fully integrated in

the case team. An economist could perform a separate piece of analysis by him- or herself, which was later added to the rest of the analysis.

16. In recent years, the case team has become much more organized around the economic analysis. It is now more or less a rule that a Phase II investigation team includes at least one Ph.D. economist working full-time on the case team, and often also a second Ph.D. economist working part-time. In addition, the case team may include one or more case officers specializing in economics, and often also interns who are studying for masters degrees in economics. The full-time economist will often lead the economic analysis, working closely together with the case team manager who oversees the overall team product.

2.2 Theory of harm

17. The outline of a coherent and testable theory of harm is increasingly the explicit main priority for the case team in Phase I and in the early stages of Phase II. The goal is to have a workable hypothesis that can guide both the fact-finding and the design of the econometric analysis.

18. In *Åhléns*, the SCA met early in the process with the merging parties and their economic expert, discussing both data issues as well as potential theories of harm (and non-harm). Their expert submitted a calibrated merger simulation showing near-zero price increases, as well as a longer report on the mitigating effects of vertical control due to “selective distribution”-agreements that are commonplace in high-end cosmetics retailing. The *Åhléns* case team put emphasis on analyzing the effects of this vertical control – and to separate the retail merger’s effect on intra- vs. interbrand competition.

19. In another recent case, *TT/Retriever*, a vertical merger in 2010 involving news service providers, the case team worked extensively in Phase II on evaluating several potential vertical foreclosure theories. The analysis put emphasis on explaining not only whether there would be increasing ability to foreclose, but foremost whether there would be increased incentives to do so. The problem of whether there were incentives to foreclose, often boiled down to whether any exception to the “one monopoly rent”-theory could be identified. Ultimately, the merger did not seem to cause serious competitive concerns and was cleared.

2.3 Outside experts or outside advisors

20. In the early 2000s, the SCA made more frequent use of outside experts for quantitative methods, but also for other parts of the economic analysis. Lately the SCA has relied much more on doing the analysis in-house and instead using outside advisors to guide and advise the economists in their analysis.

21. A principal reason for this change is simply that by assigning the entire analysis to an outside expert, the economists on the case team risk losing track of exactly what the final analysis entails. This makes it difficult and time-consuming to change assumptions, or to extend the analysis if needed on short notice.

22. Relying on outside experts for a portion of the quantitative analysis also makes the final assessment of the case more difficult, since this assessment requires integration of many different kinds of analysis. If the work underlying the commissioned analysis is not fully understood by the economists in the team, it will be much harder for them to help the case team evaluate and integrate the results of that analysis with the many other, often disparate strands of analysis that have been carried out.

23. Another reason for engaging in more extensive analysis in-house is that it helps the SCA’s economists develop their econometrics skills, as well as their general skills in economics, and also helps keep those skills at the SCA by making the merger analysis work more challenging and stimulating.