Konkurransetilsynet
Norwegian Competition Authority

European Commission
Comptetition Directorate-General
1049 Brussels
Belgium

Our ref. 2002/1169 *Date:* April 2 2003

■ Comments on the draft Commission Notice - on the appraisal of horizontal mergers under the Council Regulation on the control of concentrations between undertakings

Dear Sir or Madam,

The Norwegian Competition Authority (NCA) refers to the draft Commission Notice (the Notice) on the appraisal of horizontal mergers, and the invitation to interested parties to submit their view on the Notice. The NCA also refers to the meeting of the governmental experts of the Member States on the 12th of November 2002, and our letter of the 15th of November 2002, where we expressed our comments to section VII of the Notice concerning failing firm.

The NCA considers that the finalised Notice will be a helpful tool. In general we are of the opinion that the Notice is well written, informative, and contains the main components that should be taken into consideration when analysing the economic effects of a merger. The focus on mergers in oligopolistic markets is important. We also welcome the Commission's increased focus on buyer power, efficiency gains and failing firm defence in the merger analysis.

In the following, the NCA would like to draw the Commission's attention to certain points, mainly regarding calculation of market concentration indices, that might be taken into account when finalising the Notice.

Concentration measures
Concentration measures might both over-estimate and under-estimate the extent of market power. As indicated in chapters IV to VII of the Notice, calculation of market concentration should only be the first step in the assessment of the competitiveness of markets. We would like to emphasise that competition may be weak even when ordinary concentration indexes are relatively low. In such cases it might be useful to adjust the concentration measures, as suggested in the following.

Cross-ownership

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When calculating the Herfindahl-Hirschman Index (HHI) each undertaking is treated as an independent unit. This way of calculating the HHI could be misleading in the case of cross-ownership. An undertaking with no cross-ownership interest will, when deciding for example what quantity to offer, only take its own profit into account. In the case of cross ownership the undertaking's objective will be different. In particular, it will focus both on it's own profit and on the profit of the undertakings where it has ownership interests. Although, more aggressive behaviour may increase own profit, it reduces the value of the cross-ownership interests. It is therefore in the undertaking's interest to compete less aggressively. The HHI - not adjusted for cross-ownership - may therefore overestimate the competitive pressure.

Capacity constraints
In industries where capacity constraints are important, the unadjusted HHI may be a misleading measure of market power. Suppose for instance that the only two unconstrained undertakings (undertakings that do not utilize their capacity completely) in the market merge. The post merger unit may then reduce its output without having to fear the output response of competitors. The unadjusted HHI will in such cases overestimate the competitive pressure in the market. On the other hand, suppose two capacity-constrained undertakings have incentives to continue to supply the market with their total capacity also after the merger. If this is the case, the unadjusted HHI will increase although the merger will have no effect on the market equilibrium.

Adjusting the HHI for capacity constraints may be relevant for example in the electricity generation markets. For a more complete discussion of HHI and capacity constraints, see for example Darryl Biggar (2002).[1]

Market concentration and change in market concentration
In paragraph 20, dealing with undertakings with a paramount position, it seems that only the level of concentration is of importance, but not the change in the level of concentration. This is in contrast to paragraph 27 (non-collusive oligopolies) where "A merger is likely to raise serious doubts…when it leads to an aggregate HHI of [2000] or more and an increase in HHI of [150] or more". This may (wrongfully) be taken as an indication that the Commission will not put weight on the change in concentration when the merged undertaking is in a paramount position.

Other comments
The Notice discusses different countervailing effects on the otherwise anticompetitive outcome of a merger. The NCA would like to point to consumers' external substitution possibilities as another countervailing effect that might deserve some discussion. The scope of increasing a price in the relevant market will depend on the size of the elasticity of demand facing a "hypothetical monopolist" i.e. the market elasticity, which in turn will depend on external substitution possibilities.

Although focusing on different aspects of the merger analysis, there is a close connection between paragraphs 21 and 81. It appears that without any explanatory comments on the relationship between paragraphs 21 and 81, the dissimilarity in the structure and content of those two paragraphs might be misleading to the reader.

Paragraph 36 discusses the degree of substitution between two merging undertakings' products and the degree of substitution between these and the remaining rivals' products, as well as the influence on the post-merger price increase. It appears that the geographical dimension might also be mentioned explicitly in this discussion.

[1] Darryl Biggar (2002), *Market power in electricity generation markets*, OECD, Working Party No. 2 on competition and Regulation.