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ECONOMIC ANALYSIS IN MERGER INVESTIGATIONS – Contribution from Latvia

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More documentation related to this discussion can be found at: oe.cd/mergerinv.

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Economic Analysis in Merger Investigations

- Contribution from Latvia –

1. This paper briefly explains the role of economists in merger investigations at The Competition Council of Latvia (The CC) as well as recent experience in the use of economic analysis.

1. What proportion of your merger review cases involve economists, and how does your authority determine whether to involve economists (for example, are economists only involved in in-depth reviews, or in cases where a remedy or prohibition may be required)?

2. In phase I (simplified) mergers that do not require in-depth analysis, economists are usually not involved in the assessment, as this type of case does not require in-depth economic analysis. On the other hand, mergers, where an in-depth analysis will be carried out (regardless of whether a merger prohibition or remedies potentially will be implemented), economists usually are involved at an early stage (prenotification phase) of the merger. At the same time, the degree of involvement in each case may vary, depending on the complexity and the possibility to implement economic methods (availability of data, available time and resources etc.) as well as the case handlers background (lawyer or economist). For example, there may be cases where economists only provide advisory support to case handler.

2. How does your authority structure its economic expertise? For example, is it primarily concentrated in a single team lead by a chief economist, or is it integrated in each case handler team?

3. The CC has a separate Economic Analysis Unit who provides methodological support during case investigations, as well as implements in-depth analysis of market processes during sector inquiries. Economic Analysis Unit consists of three economists, one of whom is a chief economist, who manages Economic Analysis Unit.

4. Depending on the complexity of the case, The CC can organize merger investigation in two different ways. As a result, there may be situations where economists can be integrated into a case handler team:

- When cases are handled by case handlers, the economist usually provides support by carrying out specific and independent analysis. The chief economist supervises the work of economists and, if necessary, gives instructions on investigation (methods to be used, data to be collected, etc.)
- If *project team* is formed, economist is integrated in the case team. As a result, the team manager (usually senior expert) has more freedom to decide how and to what extent to involve the economist. If necessary, team manager can also seek advice from chief economist regarding the possible work of economist. However, the mayor difference is that the team manager ultimately has a final word regarding possible analysis to evaluate the merger.

3. At what stage of a merger review are economists involved (e.g. making an initial decision on in-depth review, preparing information requests, negotiating remedies)?

5. Economists usually are involved at an early stage in mergers, who are more likely to enter phase II (in-depth investigation). In such cases, economists usually are involved in the whole process, including in the process of identify candidate theories of harm and sources and types of evidence needed (information requests) and designing and negotiating remedies. Also, there is an ongoing trend for economists to get involved in court proceedings if The CC's merger decision is appealed. Courts more actively appoint outside economic experts to scrutinize The CC's economic assessment and its conclusions.

6. Economists also at the early stage try to identify the types of data that may be available to determine what economic analysis would be helpful to evaluate the merger.

4. What types of quantitative analysis has your authority employed in merger reviews? What criteria does your authority use to select techniques?

7. In general, what types of quantitative analysis are worth pursuing depends on potential theory of harm, what data is available, how easy it is for firms to produce the data, and how difficult and time consuming it will be to analyze it. The CC has used the following quantitative methods in its practice:

- **Consumer surveys.** Given the limited resources The CC rarely use consumer surveys to define the markets or analyses competition. However, in 2018 The CC analyzed merger in the grocery retail market where consumer survey was conducted to determine closest substitutes (diversion ratios) to the merger parties. The data was collected in cooperation with research company (external experts), which carried out a survey of consumers at acquired party's grocery store.
- **Consumer switching analysis.** In 2020 The CC analyzed a merger in coffee equipment rental market where it was possible to collect data from the clients about their coffee equipment rental choice. In this market costumers were businesses who provide coffee service to consumers (coffee shops, restaurants, *to-go* grocery stores etc.). The CC analyzed in what scale do customers switch from competitor to another to determine the closeness of competition between the merging parties.
- **Natural experiments.** In past cases The CC has analyzed the effect of exit-entry event in the grocery retail market to define the possible relevant product market and to determine what extent smaller shops constrain grocery hypermarkets. For example, in 2016 Prisma grocery hypermarket brand closed one of its stores who was in shopping mall. In turn, another competitor (Rimi Latvia) concluded long-term contract and planned to enter these premises that according to The Latvian Competition Law is regarded asset takeover if thresholds are met. Meanwhile, while the evaluation process of asset takeover by Rimi Latvia was in process, operator of the shopping mall concluded short-term agreement with another grocery retailer to open a small convenience store in the same place. As a result, The CC was able to analyze the consumer response to these changes in local market and determine whether smaller shops located nearby in the particular case would be effective substitute to hypermarket.
- **Vertical arithmetic.** In 2019 The CC analyzed a merger between telecommunications provider Bite Latvia (which also provides wholesale TV services in the Latvia and has a dominant position in this market) and second largest

pay-TV operator in Latvia - Baltcom - who operates in downstream market. To evaluate the risk of input foreclosure, The CC analyzed the ability and incentive of the merged firm to raise rivals' costs (also known as vertical arithmetic). However, existing remedies on Bite's distribution of TV content dating back to The CC's 2017 decision require that Bite offer its content to all market participants on non-discriminatory terms. As a result, even though there was a risk of input foreclosure The CC did not need to oppose the merger or implement any remedies.

8. The CC has not used any advanced quantitative techniques like demand estimation or merger simulation.

5. Does your authority have any experience with the use of surveys in merger review cases? What best practices and challenges have you identified with respect to survey evidence?

9. Like mentioned before, The CC has previously commissioned one consumer survey as a part of merger investigation. However so far consumer survey evidence has not been submitted by the merging parties themselves.

10. Even though The CC has not had extensive experience in organizing and conducting consumer surveys, The CC can describe challenges that has come across in one consumer survey that was commissioned by the CC in 2018.

11. Firstly, The CC would advise to invite professionals (research agencies) to assist in conducting the consumer survey. The choice of research agency is a key decision affecting the survey quality. The assistance of the experts would help the competition authority formulate questions that accurately measure the opinions and behaviors of consumers and lead to better survey results overall.

12. Secondly, The CC has come across few challenges (things to keep in mind) regarding consumer surveys:

- **Stated vs revealed preferences.** Care should be taken when evaluating survey questions that capture individuals stated preferences (for example, "what would you have done instead if you had known that this store would be closed?"). There can be difference between stated and revealed preferences. The consumer can say one thing about how much they value something, but it may be very different from their actual behavior. When planning the survey, the competition authority, if possible, should prefer survey design that are about choices that individuals *have actually made* not about what individuals *would do*. The strong point of this type of survey is that it provides competition authority with the real choices made by consumers. Nevertheless, stated preferences surveys can provide a valuable information about the choice's consumers make when presented with hypothetical situations. However, the design of a stated preferences survey is more complicated and requires experienced interviewers who can explain the choice context to the consumer.
- **Question design.** The CC experience has shown that consumer survey questions in merger review requires attention to specific details to obtain reliable and valid information. Even minor wording imperfections can lower the overall value of the questions and survey. Questions should never be worded in a way that'll sway the consumer to one side of the argument (usually a question is leading if it includes non-neutral wording and pushes respondents to answer according to the survey creators plan).

- **Transparency.** The CC in its practice did not give merging parties possibility to comment on a draft questionnaire. As a result, there is a dispute in court regarding the question design and wording. The merging parties has raised few objections to the survey which possibly was avoidable if the parties had a chance to comment survey in the draft process. So the competition authorities should keep in mind that transparency regarding consumer survey can solve some of the problems early in the process and they should consider the possibility to give merging parties the ability to comment questionnaire (for example Competition and Markets Authority in UK usually give parties 24 hours to comment on a draft questionnaire for any survey that it intends to commission as part of a phase 2 merger inquiry).

6. What is your authority's view of the optimal approach to quantitative analysis? For example, how does your authority decide whether to use new or complex techniques that may be difficult to explain to decision-makers and courts?

13. The CC approach is to use well accepted economic analysis methods which has been successfully implement in other jurisdictions (mainly by the European Commission). As described before The CC usually considers a various aspects (time, data, theory of harm) when making a decision about what quantitative analysis to conduct. Once The CC starts to determine the potential theories of harm, economists begin to determine what analysis would be helpful to evaluate identified theories of harm and what data must be collected. As the case and economic analyses progresses, economists and case team might eliminate some theories of harm because preliminary results show that are no competition problems. Also, if necessary additional information might be gathered and economic analysis used to test the more credible theories of harm.

14. The CC may consider how hard it would be to explain the method, for example, to court, but ultimately this aspect does not play a deciding role. Generally, whatever quantitative analysis is used in a merger investigation, The CC investigation team (and economists) seeks to describe it as clearly as possible and, if necessary, provides simplified examples to illustrate the basic economic concepts. Decision makers at The CC (the board) usually fully understand the economic methods used because economists in detail describe the basic concept of particular quantitative method, practical implementation of the method and how much weight to attach to this evidence. However, The CC has not used any advanced quantitative techniques which would be much harder to explain to non-economists.

15. The CC has had different experience in courts. At times, courts may not understand even simple economic aspects of the issue, as a result of which they may appoint independent experts (economists) to carry out the assessment for them. For example, in 2018, The CC prohibited a merger in the grocery convenience store market, which was appealed. During the court proceedings, in order to gain a deeper understanding of the economic aspects of the case, the court appointed three independent economists to carry out the assessment.

7. Does your authority involve economists in the analysis of qualitative evidence? If so, how, and what are the main issues they consider?

16. Yes. In mergers, where an in-depth analysis will be carried out, economists not only provide quantitative analysis but also assist in evaluating qualitative evidence. Economists usually focus on evidence regarding market definition and competitive assessment (for

example, evidence of customer switching, transport costs, brand loyalty etc.) but also on evidence that are relevant to quantitative analysis used in current case (for example do determine whether the qualitative and quantitative evidence point in the same direction).

17. Also, by analyzing qualitative evidence, economists often provide case handlers the conceptual framework to assess merger effects. Economists in the early stage of the case can eliminate theories of harm that do not require further investigation or where to focus the bulk of the resources. In many cases, it is possible to eliminate all potential theories of harm using qualitative evidence without quantitative analysis. So, it is important to fully involve the economists in the merger process to allocate limited resources in analyzing various aspects of the case and theories of harm more thoughtfully.

8. Does your authority make use of external economic experts? What factors does your authority weigh when making the decision whether to use external expertise, and how do you select external experts?

18. Given the limited resources, The CC has no history of resorting to the services of outside economists in the merger analysis. However occasionally The CC does use external research companies (usually are selected by simplified tendering (procurement) process to make the most use of public financial resources) to conduct consumer surveys or ask for expert opinion that can provide more technical knowledge of market/ product that must be analyzed in merger case.