A GUPPI Revolution in the EU?

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The new U.S. Horizontal Merger Guidelines, issued in August 2010, introduce the so-called GUPPI test, the Gross Upward Pricing Pressure Index.
According to the U.S. Guidelines, "[a]dverse unilateral price effects can arise when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm and thereby divert sales to products previously sold by the other merging firm, boosting the profits on the latter products. Taking as given other prices and product offerings, that boost to profits is equal to the value to the merged firm of the sales diverted to those products. The value of sales diverted to a product is equal to the number of units diverted to that product multiplied by the margin between price and incremental cost on that product."

This blog is not a place for formulas, but (borrowing from a CRA article on the issue), the above statement in the U.S. Guidelines can be translated as follows:

GUPPI for Product 1 = diversion ratio from Product1 to Product2 × percentage margin of Product 2 × price ratio of Product 2 to Product 1

The U.S. Guidelines add that "[d]iagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration."

This statement has been the source of prolific commentary and some level of consternation in the U.S. Is this the death of market definition, market shares and concentration ratios? As a reaction, the U.S. authorities are going through great pains to explain that GUPPI certainly does not mean the end of market definition, but that the GUPPI simply presents a possible complementary analysis.

Inevitably, the issue crossed the Atlantic and raises the question whether GUPPIs could be introduced into the EU Merger Regulation, possibly threatening also in the EU the important role played by market definition, market shares and concentration ratios. And here too, Commission officials were quick to confirm that market definition and market shares are alive and well in the EU. But these statements have not been able to appease all worries.

At least as far as the EU is concerned, GUPPI will likely not revolutionise the Commission's review of mergers.

In the first place, the discussion whether GUPPI will replace market definition and market shares may be less important in the EU. The Commission often leaves the issue of market definition open, because regardless of market definition, the notified transaction does not raise any problems. In addition, in some cases, the Commission does not define the market because under any of the possible alternative market definitions, the concentration raises concerns or proposed remedies address the concerns. As an example, see the recent DB/Arriva decision.

Especially in the case of differentiated products, such as for example branded consumer goods, the Commission typically appears to acknowledge the difficulty to adequately define product markets and tends to focus more on the question of closeness of competition. For example, in Kraft/Cadbury, the market definition discussion for chocolate confectionery products is relatively short and superficial and the conclusion is phrased in a very tentative way ("competitive conditions are distinct in the various chocolate confectionery segments"). On the other hand, a detailed analysis of closeness of competition between the parties' products, including through market investigations and a complex merger simulation model, allowed the Commission to conclude that the parties' combined UK share in tablets of 60-70% did not raise major concerns.

And even if the Commission introduces GUPPI, notifying parties will still need to define relevant markets (at least for the purpose of completing the Form CO and identifying whether a concentration results in affected markets) and GUPPI may in some cases even assist the market definition discussion.

"Introducing" GUPPI is probably a misnomer. The Commission has used diversion ratios in measuring closeness of competition in prior cases and the Horizontal Merger Notice discusses closeness of competition in differentiated product markets, which can be measured on the basis of estimates of cross-price elasticity and diversion ratios – see paras 28/29. Whether GUPPI, which is a highly simplified and relatively rough first measure of closeness of competition and possible effects on prices, will replace the more complex merger simulations and models which the Commission has routinely used in recent years, is doubtful.

It should not be forgotten that GUPPI can only be a screen and needs to be complemented with further analysis. GUPPI as such cannot replace a thorough analysis of possible effects of a concentration. For example, it does not take into account efficiencies or the entry or repositioning of (potential or actual) competitors. In addition, by focusing on margins, it almost automatically results in high upwards pricing figures in industries with high fixed/upfront costs and low variable costs (typically resulting in high margins), such as software or pharmaceuticals.

As a conclusion, at least in the EU, GUPPI should not replace either market definition/market shares or a further substantive analysis of the possible effects of a concentration.