MARKET POWER

Carmen Estevan De Quesada
Prof. Commercial Law (University of Valencia)
President of the Valencian Antitrust Commission

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Overview

- 1. Defining concepts: “market power” and “dominant position”
- 2. Relevance: special reference to art. 102 TFEU cases
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- 4. Structural criteria to assess dominance
  - Market structure
  - Undertaking’s structure and characteristics
- 5. The limited relevance of the behavioural criteria in the assessment of dominance

1. Defining concepts: “dominant position” and “market power”

- **Market power**: Economic concept
- Classic definition: “ability profitably to set price above marginal cost” (W Landes and R Posner, “Market Power in Antitrust Cases” (1981) 94 Harvard Law Review 937) → “Lerner index”:

$$L_i = \frac{p_i - c_i}{p_i} = \frac{1}{\eta_i}$$

- The Lerner index equates the profit-maximising margin of price *(pi)* over marginal cost (*ci)* for firm (*i)* to the inverse of the own-price elasticity of demand (η*i)* for its product
  - Price elasticity of demand: responsiveness of quantity sold (Q) to changes in price (P) →

$$E_d = \frac{\% \Delta Q_d}{\% \Delta P}$$

(if η <1 demand is inelastic, e.g. gasoline)

  - The elasticity *(ηi)* for a firm facing effective competition will be high, so the profit-maximising margin will be small, but not for a firm with market power
- Essence of market power: power profitably to maintain price above cost (which is directly related to the power to exclude competition → price-elasticity of demand)

1. Defining concepts: "dominant position" and "market power"

- **Market power**: Economic concept (cont.)

- The elasticity of a firm (i) relates to that of the industry (market):

  - $\eta i = \dfrac{\eta + (1-s)\sigma}{s}$

  - where *(η)* is the industry elasticity of demand, *(s)* is the market share of the firm and *(σ)* is the elasticity of supply of the competitors (i.e. the proportional increase in their output in response to an increase in the market price set by the firm)

- Therefore, the "Lerner index" is: $L_i = \dfrac{p_i - c_i}{p_i} = \dfrac{s}{\eta + (1-s)\sigma}$

- This shows the importance of market shares [(s) for the firm, and (1-s) for the rest of the industry] in the assessment of market power, BUT also that of other factors such as the demand elasticity of the industry (η) and the supply elasticity of the competitors *(σ)*

1. Defining concepts: "dominant position" and "market power"

- **BUT COURTS ARE NOT ECONOMISTS → Dominant position**: Legal concept of EU Competition Law

- Art. 102 TFEU: "Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States. (…)

- Art. 2.2 and 2.3 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (EC Merger Regulation):
  - 2.2. "A concentration which would not significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared compatible with the common market."
  - 2.3. "A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market."

1. Defining concepts: "dominant position" and "market power"

- **Dominant position** (cont.) → Jurisprudence concept:

- First reference:
  - Case 27/76 United Brands Company and United Brands Continentaal BV v Commission of the European Communities (1978 ECR 207), §65: "The dominant position referred to in article 86 relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, its customers and, ultimately, consumers"

- Becomes settled case-law:
  - Case T–210/01, General Electric v Commission of the European Communities, § 114: "by virtue of settled case-law, a dominant position exists where the undertaking concerned is in a position of economic strength which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, its customers and, ultimately, consumers"

1. Defining concepts: “dominant position” and “market power”

- **Dominant position** (cont.):

- Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (2009/C 45/02), pt. 10:
  - “Dominance has been defined under Community law as a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on a relevant market, by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers”

- Two main elements in this definition:
  - to prevent effective competition in the relevant market (this is more a consequence)
  - power to behave independently of the actions of the rest of participants in the market: this is the clue, in line with what economist call “market power” → power profitably to maintain price above cost

1. Defining concepts: "dominant position" and "market power"

- Commission's Guidance, pt. 10-11: **legal concept of dominance is based on economic concept of market power**
  - Pt. 10: "This notion of independence is related to the degree of competitive constraint exerted on the undertaking in question. Dominance entails that these competitive constraints are not sufficiently effective and hence that the undertaking in question enjoys substantial market power over a period of time. This means that the undertaking's decisions are largely insensitive to the actions and reactions of competitors, customers and, ultimately, consumers".
  - Pt. 11: "The Commission considers that an undertaking which is capable of profitably increasing prices above the competitive level for a significant period of time does not face sufficiently effective competitive constraints and can thus generally be regarded as dominant"

- **BUT dominance is not assessed with mathematical formulas but with other criteria** (see pts. 3 and 4 of this presentation)

2. Relevance: special reference to art. 102 TFEU cases

- **Dominant position** is a legal concept used in EU merger control and Art. 102 TFEU cases

- For national courts, special relevance of Art. 102 TFEU cases:
  - Art. 102 TFEU: "Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States. (…)

- Michelin I (1983 ECR 3461), §57: "special responsibility" of dominant undertakings
  - "A finding that an undertaking has a dominant position is not in itself a recrimination but simply means that, irrespective of the reasons for which it has such a dominant position, the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition on the common market" (see also EC Guidance pt. 9).

3. Approaches: ECJ Case Law vs. Commission's Guidance

- **Case Law:** Dominant position defined mainly by
  - market shares: e.g. General Electric §§ 115, 122 (analysis §§ 124-181)
  - other factors: e.g. General Electric §§ 122, 123
    - § 123: applicant's vertical integration (analysis §§ 182-242) and competition in the market –including also buyer power– (analysis §§ 243-280)
    - certain reference to behavioural criteria (GE § 190 "strategic behaviour")

3. Approaches: ECJ Case Law vs. Commission's Guidance

- **Commission's Guidance**: pt. 12
  - "The assessment of dominance will take into account the competitive structure of the market, and in particular the following factors:
    - constraints imposed by the existing supplies from, and the position on the market of, actual competitors (the market position of the dominant undertaking and its competitors),
    - constraints imposed by the credible threat of future expansion by actual competitors or entry by potential competitors (expansion and entry),
    - constraints imposed by the bargaining strength of the undertaking's customers (countervailing buyer power)"
  - Importance of certain behavioural criteria
    - market dynamics (pt. 13)
    - factors that constrain the behaviour of the undertaking (pt. 15)

3. Approaches: ECJ Case Law vs. Commission's Guidance

- **CONCLUSION:** both ECJ and EC take similar approaches, that can be summarised as follows
- Structural criteria to assess dominance
  - Market structure
    - Market shares
    - Potential competition (expansion and entry)
    - Countervailing buyer power
  - Undertaking's structure and characteristics
- Also some behavioural criteria (depending on the case, to refine the structural analysis)
- IMPORTANT: "In general, a dominant position derives from a combination of several factors which, taken separately, are not necessarily determinative" (EC Guidance pt. 10 = settled case Law)

4. Structural criteria to assess dominance

- **1) Market structure:**
- A) Market shares:
    - concept: % of sales in the relevant market made by one undertaking
        - practical problems to measure it: e.g. GE §§127-147 ("single entity")
    - large market shares are indicative of dominance: GE §115 (ref. to ECJ case law)
    - importance of stability over time: GE §150, EC Guidance pt.15
- A1) Market share of the undertaking whose conduct is analysed: the higher it is, the more likely a dominant position is found (EC Guidance pt. 15)
    - EC criteria: dominance is not likely below 40% (EC Guidance pt. 14)
    - ECJ practice:
        - above 75% high likelihood of dominance ("super-dominance" around 90%: e.g. Google)
        - below 75% study with complementary criteria (the lower, the more additional criteria needed to prove dominance)
        - above 50% slight presumption of dominance: GE §115

4. Structural criteria to assess dominance

- **1) Market structure (cont.):**

- A2) Market shares of competitors: The difference with market shares of competitors is very important, since this impacts on whether they can constraint the behaviour of the undertaking

- existence of certain degree of competition (i.e. the existence of other competitors) does not preclude dominance (GE §184) → dominance ≠ monopoly (GE §249)

- a relevant point is whether competitors exert competitive constraints (GE § 270)

4. Structural criteria to assess dominance

- **1) Market structure (cont.)**
- B) Potential competition: EC Guidance pt. 16
- two aspects: expansion (by actual competitors) and entry (by potential competitors) → both aspects may constraint the dominant undertaking's behaviour
- to be considered as such, expansion and/or entry must be
  - likely: barriers to expansion/entry, reactions of dominant firm, eventual failure
  - timely: sufficiently swift
  - sufficient: sufficient magnitude (e.g. not only in some market niche)
- Importance of Barriers to expansion/entry: conditions for expansion/entering (in) the relevant market
  - the lower the barriers, the easier to expand/enter → the "weaker" is the eventual dominance (as measured previously by market shares)

4. Structural criteria to assess dominance

- Barriers to expansion/entry can be of a very different nature (EC Guidance pt. 17)
  - legal barriers, such as tariffs or quotas,
  - economies of scale and scope,
  - privileged access to essential inputs or natural resources, important technologies
  - an established distribution and sales network
  - costs and other impediments, for instance resulting from network effects, faced by customers in switching to a new supplier
  - Also created by dominant undertaking: e.g. significant investments which entrants or competitors would have to match, or where it has concluded long-term contracts with its customers that have appreciable foreclosing effects

4. Structural criteria to assess dominance

- Case Law: Examples of barriers accepted by ECJ
  - Legal barriers: administrative authorisation, IP rights (e.g. a patent)…
  - Financial barriers: necessary cost to start an economic activity
  - Economies of scale: cost advantage that arises with increased output of a product
  - Economies of scope: decrease in the average total cost of production as a result of increasing the number of different goods produced
  - Opportunity costs: benefit that a person could have received, but gave up, to take another course of action (alternative given up when a decision is made)
  - Difficulties to access raw materials
  - Consumer preferences (consumer loyalty)

4. Structural criteria to assess dominance

- **1) Market structure (cont.)**
- C) Countervailing buyer power: Competitive pressure can come also from buyers
- Factors (EC Guidance, pt. 18):
  - customers' size
  - their commercial significance for the dominant undertaking,
  - their ability to switch quickly to competing suppliers, to promote new entry or to vertically integrate, and to credibly threaten to do so
- Countervailing power must be of a sufficient magnitude (in order to preclude dominance) → it is not "if if it only ensures that a particular or limited segment of customers is shielded from the market power of the dominant undertaking"
- Case GE §§274-279: demand by airlines is dispersed (§275) and GE has influence on airframe manufacturers, via its subsidiaries (§276)

4. Structural criteria to assess dominance

- **2) Undertaking´s structure and characteristics:**
- Not *per se* factors of dominance (GE § 185) → used to complete the analysis done with market structure criteria
- Typical factors
  - vertical integration: GE § 189 → § 196 GECAS (group GE) is the largest aircraft buyer in the market; impact on dominance §§ 196-198, and especially § 200 ("foreclosure of one of the possible routes by which the applicant's competitors could compete with it")
  - financial strength: GE § 201
  - technical superiority
  - Pre/post sales services

5. The limited relevance of the behavioural criteria in the assessment of dominance

- Undertaking´s behaviour in the relevant market:
  - This is not a structural criteria
  - Must be carefully used, especially in Art. 102 TFUE cases, so not to mistake it with the analysis of the abusive conduct
  - How? If the undertaking has acted independently in the market, this may indicate it has market power (e.g. having its own price policy without caring about competitors prices)
  - E.g. Case GE
    - §§ 213-214: reference to independent behaviour (winning a contract with a lower quality engine that its competitors)
    - § 216: indicative of not healthy competition (market power of 1 of the players, here GE)

THANK YOU!

carmen.estevan@uv.es