COUNTERVAILING BUYER POWER IN EU ANTITRUST ANALYSIS

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Presentation at Bergen Center for Competition Law and Economics, BECCLE, October 17, 2012.

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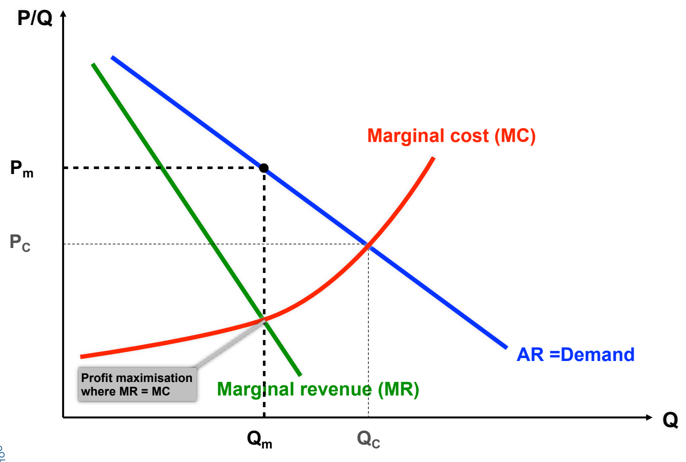
Outline today

- **What is buyer power and when does it become countervailing?**
  - **Theoretical underpinning and likely economic effects**
- **How is it used in EU/EEA antitrust analysis?**
  - **Article 101 TFEU**
    - *Buyer power in relation to restrictive agreements both pro and contra*
  - **Article 102 TFEU**
    - *Countervailing buyer power as an instrument to curb abusive behaviour*
  - **ECMR**
    - *Countervailing buyer power as a defence against concerns related to the SIEC-test*
- **Policy implications**

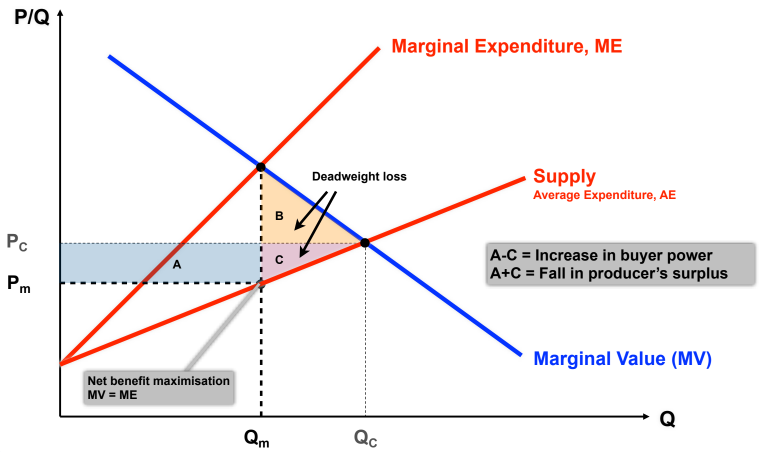
Let's start in theory…

- **Antitrust is about controlling market behaviour**
- **A need to have a legally acceptable, economically reasonable and administrative workable rule**
- **Integrate economic analysis in antitrust enforcement analysis**
  - **Leading up to a clear binding result**
    - *Abuse of dominance, anti-competitive agreement, yes/no to concentration*

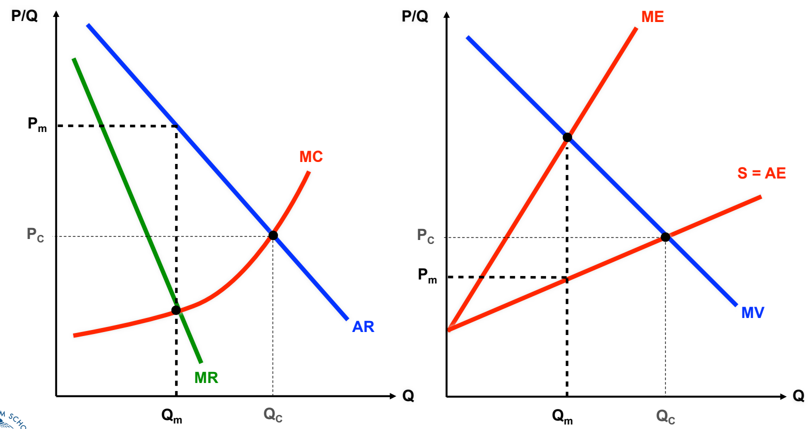
MONOPOLY POWER



MONOPSONY



MONOPOLY AND MONOPSONY



BILATERIAL MONOPOLY

- A rare phenomenon in reality
  - More likely to have oligopolistic settings
- Likely outcome in terms of price and quantity is difficult to predict
  - Depending on a large array of factors
- General textbook principle
  - Monopoly power and monopsony power tend to counteract each other
  - Tension to drive prices closer to marginal cost (monopsony) and closer to marginal value (monopoly)

THE CONCEPT OF COUNTERVAILING POWER

- ”The fact that a seller enjoys a measure of monopoly power, and is reaping a measure of monopoly return as a result, means that there is an inducement to those firms from whom he buys or those to whom he sells to develop the power with which they can defend themselves against exploitation. It means also that there is a reward for them, in the form of a share of the gains of the opponent’s market power, if they are able to do so. In this way the existence of market power creates an incentive to the organization of another position of power that neutralizes it.”
  - John Kenneth Galbraith (1952, 1954)
    - But: Can positive welfare effects be presumed to be endogenous to the creation of countervailing buying power?

BUYER POWER ON THE NEGATIVE SIDE…

- A dominant buyer may create deadweight losses on a market to the detriment of smaller sellers (and ultimately to consumers)
  - General inefficiency
    - *Same type - albeit analogous - concerns as for monopolies*
  - Predatory overpricing to oust rival buyers (exclusionary)
  - Insufficient low prices (exploitative)
    - *Mirror image of excessive prices with appurtenant massive practical problems to draw the line for illegality*
  - Monopsony power can be just as bad as monopoly
    - *Although unclear about the end effects for consumers if the monopsonist is an intermediary*
  - Are they really each other’s mirror images?

BENEFITS OF BUYER POWER

- Lowering input cost resulting in lower consumer prices
  - If downstream competition is not affected adversely
- Better conditions of supply
  - Higher efficiency in supply chains
  - Intensified competition between suppliers
  - Higher potential for increased competition downstream
  - Increased innovation and better conditions for investments
- Good for consumers
  - If benefits are passed on to final consumers
- Bargaining power can result
  - May exist even at quite low market shares

DRAWBACKS OF BUYER POWER

- Cartel in disguise
  - cf. Spanish raw tobacco-case
- Tacit co-ordination / collusion possibility
- Rivalry amongst downstream firms may deteriorate
- Adverse effects on (some) rivals
- Waterbed effect - higher prices for rivals
  - Theoretically weak argument?
  - Does it harm consumers?
- Are we dealing with benign or malicious bargaining?

PRACTICAL PROBLEMS WITH BUYER POWER

- Although buyer power may off-set selling power this is normally rarely a sufficient constraint
  - Monopolies do (sometimes) interact directly with end-users
  - Powerful buyers are usually professional buyers and are sometimes end-users
    - *But normally for intermediary products / raw-materials*
  - Factor markets; bargaining power may exist
    - *Enabling buyer to negotiate low prices due to large and infrequent purchases whilst playing off sellers against one another*
    - *What will happen with the resulting benefit?*

WHAT IS THE BENCHMARK?

- What do we endeavour to accomplish with competition law?
- How does one measure harm to competition?
  - What is effective competition?
    - *Essentially important on oligopoly markets*
- What are the objectives of antitrust?
  - Welfare concerns
    - *Which welfare - total welfare or consumer welfare*
    - *Important to decide on which*
  - Competition as such
    - *preservation of competitive process v. efficiency*
  - Single market imperative
    - *Can produce results on a collision course with economic efficiency*

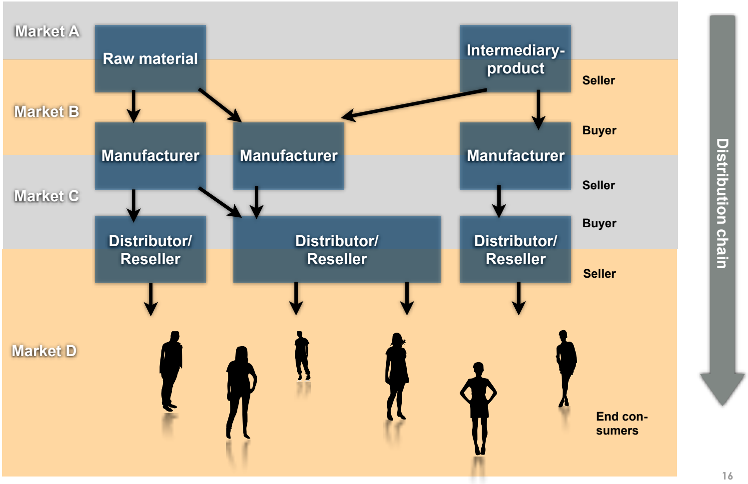
ARTICLE 102 TFEU

- At least in theory, countervailing buyer power may off-set effects of abusive behaviour
  - Case: ICI (2010), T-66/01, ICI, ECR [2010], page II-2631
    - *ICI stated that its four largest customers represented about 50% of its sales.*
      - No details regarding the respective share of each of those four customers
      - Merely an unsupported assertion that those customers, in particular glass producers, had 'countervailing purchasing power'
    - *Tribunal: Accordingly, even if the Commission ought to have taken the countervailing power of customers into account, the applicant had not shown that its customers were able to counterbalance its market power*
  - May, however, result in circular reasoning
    - *If buyer power is that strong on the market - how can the undertaking be considered to be dominant in the first place?*

ARTICLE 101 TFEU

- Commission notice on horizontal agreements
- Negative side
  - Buying power of the parties to a joint purchasing arrangement could be used to foreclose competing purchasers by limiting their access to efficient suppliers.
    - *Buying power may, under certain circumstances, cause restrictive effects on competition*
    - *Anti-competitive buying power is likely to arise if a joint purchasing arrangement accounts for a sufficiently large proportion of the total volume of a purchasing market so that access to the market may be foreclosed to competing purchasers*
    - *A high degree of buying power may indirectly affect the output, quality and variety of products on the selling market*
- Positive side
  - In general, however, joint purchasing arrangements are less likely to give rise to competition concerns when the parties do not have market power on the selling market or markets
    - *If, however, competing purchasers co-operate who are not active on the same relevant selling market (e.g., retailers which are active in different geographic markets and cannot be regarded as potential competitors), the joint purchasing arrangement is unlikely to have restrictive effects on competition unless the parties have a position in the purchasing markets that is likely to be used to harm the competitive position of other players in their respective selling markets*

ARTICLE 101 TFEU



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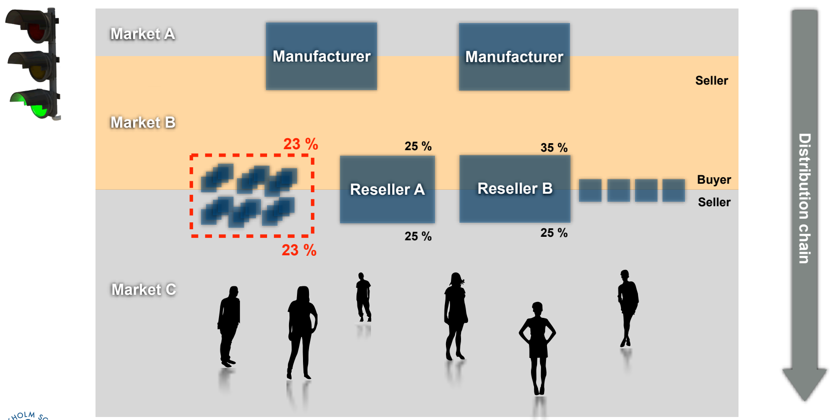

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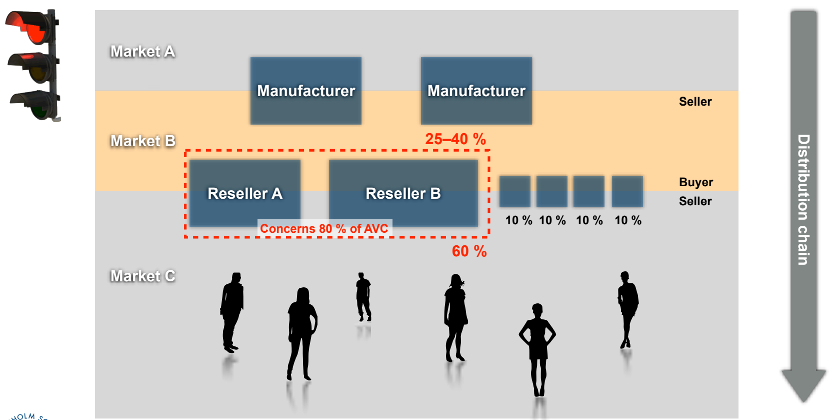

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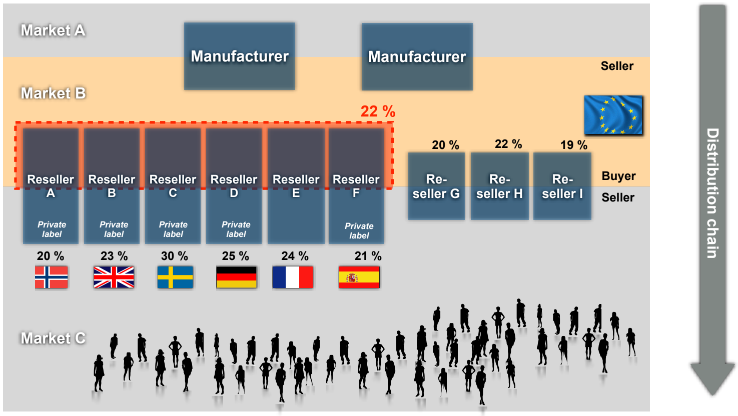

European Union flag by YanniKouts

ECMR - DOMINANCE CONCERNS

- **GE / Honeywell**
  - Commission: Lack or weakness of commercial or competitive constraints
    - *No <u>countervailing buyer power</u> from Boeing or Airbus*
      - A large number of airlines depend on GE because it is the incumbent supplier in their fleet + demand from airlines which are the engines' end users is dispersed since no single company accounted for more than 5% of purchases
      - GE has a considerable influence on airframe manufacturers through their customers as a result of its share of the installed base of those customers' fleets. Possibility for GECAS to 'seed' demand for aircraft powered by GE's engines in airlines and that GE Capital and GECAS have even influenced their choice of engine directly (undisputed)
  - GE's criticisms
    - *In the AlliedSignal/Honeywell decision, the Commission held that Boeing and Airbus had strong buyer power and that in both that decision and the EADS decision it held that airlines had significant buyer power.*
    - *Neither Boeing nor Airbus opposed the merger*
  - Court's finding
    - *The Commission had not made an error of fact or a manifest error of assessment in finding that the degree of commercial constraint exerted by Boeing, Airbus and other airlines on the applicant was not such as to undermine the Commission's conclusion that the applicant had a dominant position (!)*

ECMR CASE LAW - DOMINANCE CONCERNS

- **Case COMP/M.2097 — SCA/Metsä Tissue**
  - One important issue; do customers have countervailing buyer power?
    - *Retail market: ICA ≈ 40 %, Dagab AB ≈ 30 %, Coop ≈ 15 % and Bergendahl < 5 %*
  - Arguments against concentration
    - *Buyer power can only be exercised effectively if the buyer has an adequate choice of alternative suppliers. Limited choice; parties would have around [80-90]* % of current sales in the markets for toilet tissue and kitchen towels and the brands with the strongest brand recognition in Sweden.*
    - *Easy to price discriminate between different customers as tissue products are delivered to the customers. No arbitrage, since tissue products have high transport costs relative to total costs and customers need just-in-time delivery, often several times per week.*
      - Even if the largest customers would be able to exercise some countervailing buyer power this would not protect smaller customers, and the new entity would still be able to raise prices above the pre-merger level.
  - Arguments in favour of concentration
    - *A buyer would need to switch away only a small share of its purchases to "punish" a large supplier and that such smaller volumes could be handled by an alternative supplier.*

ECMR CASE LAW - DOMINANCE CONCERNS

- Case COMP/M.2097 — SCA/Metsä Tissue
  - Arguments in favour of concentration (cont.)
    - *Current over-capacity in the market means that suppliers need as much volume as possible passing through their mills to be profitable*
      - However: Commission noted that for branded products switching volumes between suppliers can only be a credible threat if other comparable brands are available. Not the case in Sweden. Also, even if other, comparable brands were available, competitors would need to have sufficient spare capacity for a threat of switching volumes to be credible. In Sweden the relative size of the merging parties and their competitors is such that only very limited switching could occur
    - *International retailers, or members of international retailing associations, may choose to retaliate against SCA by taking action in other geographical markets*
      - However: very few international retailers present in the Nordic region. The international retailing associations do not at present engage in detailed cross-border price negotiations for tissue products
    - *SCA also claims that retailers could threaten to take action against other SCA products such as baby diapers or feminine protection products*
      - Such a threat would, however, not seem credible as SCA also has very strong positions and well-known brands in these areas.
        - » For example, SCA states in the notification that it had in 1999 in Sweden a market share of [60-70]* % in adult incontinence care, [40-50]* % in feminine protection products and [50-60]* % in baby diapers
  - Conclusion
    - *"buyer power" as may exist would not prevent the creation of a lasting dominant position as a result of the merger*

ECMR CASE LAW - GENERAL EFFECTS

- Case No IV/M.1225 - Enso/Stora
  - The merger will result in a market structure with one large and two smaller suppliers facing one large and two smaller buyers. This is a rather exceptional market structure. On balance, … the buyers in these rather special market circumstances have sufficient countervailing buyer power to remove the possibility of the parties´ exercising market power
- Case No IV/M.938 - Guinness/Grand Metropolitan
  - Such power could come from the trade and in particular the various trade intermediaries that are, in large part, the immediate customers of the spirits suppliers. … trade channels comprise wholesalers supplying on-trade and off-trade outlets, and retailers, including supermarkets, hypermarkets and cash and carry chains. … The major wholesalers buy from importers and sell to small retailers and on-trade outlets …. As a result of its investigation, the Commission concluded that wholesalers would not be able to exercise countervailing power
- Case IV/M.1313 - Danish Crown/Vestjyske Slagterier
  - Large supermarket chains have more buyer power than the small supermarket chains. However, … the buyer side has [not] sufficient buyer power to remove the dominant position … Danish supermarkets are dependent on supplies of fresh Danish pork, which is a "must stock item" for a Danish supermarket, whereas the slaughterhouses have the possibility to export. The abattoirs are not, therefore, nearly as dependent on the Danish supermarkets as those supermarkets are on them
- Case COMP/M.2139 — Bombardier/ADtranz
  - Although Deutsche Bahn Regio AG is the biggest customer for regional trains in Germany which has countervailing buyer power, there are several privately owned smaller operators of regional trains. The privatisation process is likely to continue. While some of these smaller regional train operating companies belong to the French company Connex (Vivendi), a group active across Europe, a majority does not. Therefore, the demand side is much more fragmented than in the market for high speed or intercity trains, and does not enjoy the same degree of buyer power. The risk of market dominance by the Parties cannot therefore be ruled out

ECMR CASE LAW - NO POWER

- Ryanair / Aer Lingus
  - The 'fragmented customers' of Ryanair and Aer Lingus did not have any 'countervailing buyer power' and only limited or no possibilities of switching suppliers
    - *Case T-342/07, Ryanair Holdings plc v European Commission, ECR [2010], page II-3457.*

ECMR - THE ROLE OF CONSUMERS

- Airtours / First Choice
  - Commission on consumers:
    - *It is wrong to claim that in a consumer products market such as the package holiday market consumers have any significant countervailing buyer power*
  - Court's finding
    - *Appropriate to emphasise that the fact that consumers do not have significant buyer power because they act in isolation must not be confused with the question of whether they would be able to react to a price rise brought about by the large tour operators restricting capacity put onto the market to an anti-competitive level.*
    - *Consumers make comparisons before purchasing a holiday and are sensitive to relatively small differences in the prices of similar holidays*
    - *The Commission underestimated the role that might be played by UK consumers, who were in a position to try to obtain better prices from small tour operators*
      - Case T-342/99, Airtours plc v Commission of the European Communities, ECR [2002], page II-02585.

EU HORIZONTAL MERGER GUIDELINES (I)

- Defence against possible anti-competitive effects
- Key elements of the defence
  - Bargaining strength that the buyer has vis-à-vis the seller in commercial negotiations
    - *Origin: As a result of its*
      - Size,
      - Commercial significance to the seller
      - Ability to switch to alternative suppliers

EU HORIZONTAL MERGER GUIDELINES (II)

- Key Elements (cont.)
  - If the supplier decides to increase prices / deteriorate quality or delivery conditions
    - *Credibly threaten to resort to alternative sources of supply within a reasonable timeframe*
      - Switch to other suppliers
      - Bearing in mind possible lock-in effects / switching costs
      - Credibly threaten to vertically integrate upstream
      - Sponsor upstream expansion or entry
        - » Placing large orders with potential entrants
    - *Large and 'sophisticated' customers more likely to possess power than fragmented smaller firms*
      - Cf. concentration levels
    - Refusal to buy / delaying purchases (withhold demand)

EU Horizontal Merger Guidelines (III)

- **Key elements (cont.)**
  - **Incentives of buyers important to analyse**
    - Free riding problem when sponsoring low cost entry (competitors can benefit too)
  - **Sufficiently off-setting adverse effects**
    - Effects must benefit all segments of customers
    - Buyer power must exist both before and after the merger
      - *An upstream merger may reduce that power in removing credible alternatives*

ECMR case law - standard of proof

- **Case COMP/M.4071 – Apollo/Akzo Nobel, IAR**
  » Case T-282/06, Sun Chemical Group BV, Siegwerk Druckfarben AG and Flint Group Germany GmbH v Commission of the European Communities, ECR [2007], page II-02149
  - **Commissions view on customers to merged entity**
    - *Could exercise countervailing buyer power owing to their size, in-house production of certain rosin resins, vertical integration in the production of rosin resins of others and the dependence of rosin resin producers for their sales on two or three large customers*
  - **Challenged by customers due to error in assessment, held:**
    - *Not sufficient to show that demand in the market is concentrated or that customers source from a number of suppliers.*
    - *Focus on the ability of buyers to take action to undermine any attempt by suppliers to increase prices.*
    - *Incumbent upon the Commission to conduct a more 'sophisticated' analysis*
      - extending to the structure and other dynamics of the industry
      - the precise strategies that buyers could undertake to curb price increases post-merger

ECMR - standard of proof

- **Case COMP/M.4071 – Apollo/Akzo Nobel, IAR**
  - **Court's findings**
    - *Commission's decision did in fact address the following relevant issues*
      - Customers operated their own in-house production which allowed them to discipline their suppliers to a certain extent
      - Possibility for customers to source their supplies from other large and small suppliers which had significant excess capacity and were able to produce the whole range of rosin resins
      - Demand was concentrated on a very limited number of large customers, which conferred on them considerable negotiating power
      - The existence of the credible threat of vertical integration was highlighted, which also allowed those customers to discipline their suppliers
    - *Considerations corresponded, in essence, to the relevant factors for assessing countervailing buyer power stated in the Guidelines.*
      - Commission underlined the suppliers' high level of dependence on a few large customers.
    - *It is not necessary, in order to discourage anti-competitive conduct on the part of the merged entity, for such customers to withdraw entirely from the supplier in question*
      - The possibility for the applicants to transfer a substantial part of their requirements to other suppliers may be regarded as a sufficient threat of losses for the merged entity to be capable of deterring it from pursuing such a strategy
    - *Whilst the facts in Enso/Stora may have required, due to an exceptional market structure, sophisticated analyses of the industry structure and strategies that buyers could undertake to curb price increases post-merger, this did not apply in Apollo/Akzo Nobel, IAR*

Do Horizontal mergers create buyer power?

- General methodological approach
  - Finance literature: Event studies
    - *Indirect approach – evaluate stock price reactions or merging firms, rivals, suppliers to M&A announcements*
    - *Results*
      - Weak evidence for finding market power; Eckbo, Stillman (1983)
      - Motivated by efficiency rather than market power; Eckbo, Wier (1985)
      - Improvement in production efficiencies, but also preliminary evidence for increased buyer power; Thomas (2004), Shahrur (2005)
  - I/O-literature: Effect on product prices
    - *Direct approach, industry specific studies (limitation)*
    - *Results*
      - Increase in airfares on routes operated by merging firms; Borenstein (1990), Kim, Singal (1993)
      - Lower deposit rates; Prager, Hannan (1998)
      - Increased power in an industry; Akhavein, Berger, Humphrey (1997), Barton, Sherman (1984)

Evidence for buyer power?

- Presumption of buyers acting as agents for consumers or increasing their selling power?
  - Likely that increased concentration may permit increase intermediate prices, leading to higher final prices an lower social welfare.
    - *Dobson & Waterson (1997)*
- General effect of down-stream mergers
  - Dependent suppliers face declined selling prices and adverse change in cash flow – especially those with high entry barriers
    - *Data: SDC, 1984-2003*
- Consolidation downstream / upstream
  - Is buyer power triggered by upstream supplier mergers or exogenous to the upstream merger?
  - Sequencing problem
    - *Evidence for upstream response – not vice versa*
    - *Consolidation travels backwards*
  - Horizontal mergers do create buyer power and impact the performance of dependent buyers
    - *Bhattacharya, Nain (2011)*

Relevant measure of power

- When and how should it be an antitrust concern?
  - Benefit consumers or enhancing total welfare
    - *Relevance of distributional effects*
- The textbook view (not buyer power)
  - Strategically withholding demand, lower market clearing prices, benefiting all customers
  - Reduction in total welfare, detrimental to consumers
  - Could result in coalescing power instead of countervailing power
  - Suitable for standardised goods
- The bargaining view (buyer power)
  - Prices set through bilateral negotiations – individual discounts
  - Outcome dependent on the buyer's and seller's outside option
    - *In-/ decreasing the outside options, bargaining position*
    - *How do you calculate the next best option in reality?*
  - Lower purchasing cost without withholding demand
  - Pass-on to consumers may/may not be possible depending on inter alia bargaining over per-unit purchasing prices
    - *Inderst, Shaffer (2005)*

Relevant measure of Power

- What is bargaining power?
  - Size could be a proxy, but in reality the countervailing power does not always originate from size (absolute or relative)
  - Should be related to what is needed to offset consumer harm resulting from selling power
  - "Gatekeeper" function
  - Ability to achieve individual discounts without reducing overall volume
    - *Doyle, Inderst (2007)*

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Countervailing Buyer Power

- Conditions for sufficient constraint
  - Size and ability to substitute or create alternative sources of supply
    - *Ability to substitute is dependent on the buyer's level of knowledge and degree of sophistication*
- Does buyer power also benefit other buyers?
  - If collusion amongst suppliers is made difficult, typically; yes
  - Often not profitable to collude for smaller contracts = buyer power benefits the powerful buyer's competitors
  - Differences in sophistication, way of introducing new sources of supply may/may not lead to benefits for others
  - Concentration levels and degree of competition amongst buyers matter

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Conditions for qualifying as defence

- Should result in higher consumer surplus and higher total welfare
  - Not only in the short run…
    - *Interaction between seller and buyer through bargaining,*
    - *In order to get lower per-unit prices*
    - *Pass-on of gains to consumers*
      - Gains must be greater than effects of buyer's powers downstream
  - … but also in the long run
    - *No significant adverse effects of shifting profits downstream*
    - *Long term competition affects product development, R&D, innovation*
    - *Long-term shift in balance may affect investment incentives*
    - *Little attention in the guidelines, much more difficult to analyse ex ante; however indispensable*

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POLICY IMPLICATIONS

- **Article 101 TFEU**
  - May generate both positive and negative effects
  - Depending on market shares at all levels and degree of downstream competition
- **Article 102 TFEU**
  - Less important, although likely to reduce effects of dominants firms' behaviour
- **ECMR**
  - Ambiguity on actual effects, although possible to generate positive effects for consumers
  - Definitely room for a case-by-case defence, although complex and necessary to show benefits for consumers