MARKET POWER IN EU ANTITRUST LAW

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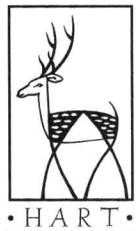

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The notion of market power is central to antitrust law. Under EU law, antitrust rules refer to appreciable restrictions on competition (Article 101(1) Treaty on the Functioning of the European Union (TFEU), ex Article 81(1) EC Treaty), the elimination of competition for a substantial part of the market (Article 101(3) TFEU, ex Article 81(3) EC), dominant positions (Article 10(2) TFEU, ex Article 82 EC), and substantial impediments to effective competition, in particular by creating or reinforcing a dominant position (Article 2 of the EU Merger Regulation). At first sight, only the concept of dominant position relates to market power, but it is the aim of this book to demonstrate that the other concepts are also directly linked to the notion of market power. This is done by reference to the case law of the EU Courts and the precedents of the European Commission. The author goes on to argue that for very good reasons (clarity and enforceability, amongst others) the rules should be interpreted in this way.

Beginning with market definition, the book reviews the different rules and the different degrees of market power they incorporate. Thus it analyses the notion of 'appreciable restriction of competition' to find a moderate market power obtained by agreement among competitors to be the benchmark for the application of Article 101 TFEU (ex Article 81 EC). It moves on to the concept of dominance under Article 102 TFEU (ex Article 82 EC), which is equivalent to substantial (or significant) market power, and then focuses on the old and new tests for EU merger control. Finally, it addresses the idea of elimination of competition in respect of a substantial part of the market (Article 101(3) TFEU, ex Article 81(3)(b) EC), in which the last two types of market power (Article 102 TFEU, ex Article 82 EC and EU Merger Regulation) converge. To exemplify this, an in-depth study of the notion of collective dominance is conducted.

The book concludes that a paradigm of market power exists under the EU antitrust rules which both fits with past practice and provides a useful framework of analysis for the general application of the rules by administrative and even more importantly judicial authorities in Member States, under conditions of legal certainty.

PREFACE

Competition law disciplines the conduct of undertakings in the market, but not conduct pure and simple; it does so on the basis of the conduct's potential effects on the market – that is, as long as the conduct is 'significant for the market'.

As Regulation 330/2010 shows us, the market power of undertakings that *buy* or *sell* products and services makes it possible to distinguish precisely the 'economic' and – as a result – legally significant from the insignificant; the harmful from the innocuous; the innocuous from the beneficial. For this reason, the central concern and the cornerstone of the antitrust and merger control rules is the creation or strengthening of market power (US Department of Justice & Federal Trade Commission (2006); Vickers (2006)). This is reflected by the fact that references to market power by the European Courts, Commission decisions and soft law have increased in recent years, from none in 1983 to 150 in 2006 (Lianos [2009] 60).

According to paragraph 8 of the European Commission's Guidelines on Horizontal Mergers of 2004, effective competition has different advantages for consumers. For this reason the Commission protects it, inter alia, through merger control, preventing 'mergers that would be likely to deprive customers of these benefits by significantly increasing the market power of firms. By "increased market power" is meant the ability of one or more firms to profitably increase prices, reduce output, choice or quality of goods and services, diminish innovation, or otherwise influence parameters of competition.'

At paragraph 25 of the European Commission's Guidelines on Article 101(3) of the Treaty on the Functioning of the European Union (TFEU) of 2004, we find that '[m]arket power is the ability to maintain prices above competitive levels for a significant period of time or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a significant period of time'.

Paragraph 97 of the Commission's Guidelines on Vertical Restraints of 2010 provides that '[m]arket power is the ability to maintain prices above competitive levels or to maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a not insignificant period of time'; while paragraph 98 states that it is within the power of an undertaking to fix a 'higher price of its product', which is effectively the same thing.

Finally, paragraph 39 of the Guidelines on Horizontal Cooperation Agreements of 2011 provides that '[m]arket power is the ability to profitably maintain prices above competitive levels for a period of time or to profitably maintain output in terms of product quantities, product quality and variety or innovation below competitive levels for a period of time'; while paragraph 38 states that 'it is when competitive constraints are insufficient to maintain prices, output, innovation, and product quality and variety at competitive levels that undertakings have market power within the meaning of Article 101(1)', which amounts to the same thing.

In general, it is assumed that, first, market power is a question of degree (variable according to the circumstances), and secondly, a small degree of market power is very common (it

would only be absent in markets with perfect competition) and does not necessitate the intervention of the competition authorities.

The economic and legal significance of the substantial elimination of effective competition (Article 101(3)(b) TFEU), the abuse of a dominant position (Article 102 TFEU) and the significant impediment of effective competition, in particular by the creation or strengthening of a dominant position (Regulation 139/2004 on the control of concentrations), is quite patent. However, the economic and legal importance of agreements between undertakings that restrict competition (eg Article 101(1) TFEU) is more difficult to pin down. In fact, it depends on who is making the assessment.

Thus, a global authority would consider what happens in a single region of the world to be irrelevant; a continental authority views what happens in a single country as irrelevant, particularly a small one; a national authority has no interest in what happens in a single region, particularly a small one; and so on, down through regional, provincial and municipal authorities. Ultimately, we all see as important that which affects each one of us. At what point should antitrust law intervene? Does it help that different authorities must apply the rules depending on the proximity to the individual interests of those affected by restrictive agreements and abuses of market power? Why, with the same conduct (eg price-fixing), is the interest different depending on whether a cartel fixes the prices of essential foodstuffs in an entire country or the four local shops left in my area do it?

At the end of the day, the question is whether the conduct as such, regardless of its ability to affect the market, should be pursued (regardless of who pursues it) or whether a specific quantitative limit must be established in order to apply the rules, and if so, at what level. But the filter will always be market power, ie the ability of conduct to alter market conditions in a sufficiently significant manner.

This is the essential difference between the competition (antitrust) rules and those relating to unfair competition, which embody, on the one hand, the public (collective) interest, and, on the other, private (individual) interests. The public interest is in the market; the private interest is in the definition of the conduct as unfair and in the availability of actions to enable those affected to defend their interests in the courts (which, by the way, also has the indirect effect of influencing the prevalent conditions in the market).

Given the relevance of market power in competition law, two fundamental questions arise: first, how is it assessed? Does the assessment depend on the rule being applied? As regards 'how', the assessment of market power must take place on a case-by-case basis, even with respect to block exemptions (in this case, a general rather than a specific situation will be analysed). With respect to whether the method of assessing varies according to the provision applied, this book will look at how the market power of undertakings has been examined in applying the different rules and will conclude that there are no major differences, except perhaps the specific *ex ante* perspective of merger control.

The foregoing may appear to be an obvious statement that is not worth being proven, and perhaps this is the case; the problem is that in my view – as will be seen below – it is also obvious that there are only two relevant levels of market power in European competition law, and due to this fact I have decided to examine both questions in great detail.

And so we come to the second crucial question: what is the relevant market power for the rules to be applied? Is it always the same, or are there different relevant thresholds, depending on which rule is applied? From the outset, it should be noted that there is not a single relevant degree or level of market power. So how many degrees or levels are there? Two, three, four? Even more? Here it will be concluded, as noted above, that there are only

two relevant levels of market power. This conclusion, which is based mainly on a reading of the relevant texts and systematic reasoning, also has a solid basis in competition policy: effectiveness in the application of the rules and the need for legal certainty lead us to rule out other possible levels, as will later be seen, after reviewing how the different relevant concepts of market power have been applied in relation to each provision. This analysis will, first, allow certain differences to be observed and highlight the need for greater consistency, and, secondly, show how, historically, market power has been evaluated, fundamentally on the basis of market share, potential competition, the countervailing power of demand, and so on.

Nowadays, market power is assessed using very blunt tools. The starting point is to define the market in which such power is evaluated and the goal is to figure out, directly or indirectly, the power of the undertaking(s) being examined. The direct assessment is carried out by reference to market shares exclusively when these may reasonably be considered to represent the share of market power that corresponds to the undertaking(s) in question, which occurs – rarely – when we can reasonably define an 'all or nothing' market where that which is excluded clearly does not exert competitive pressure on that which is included.

The indirect assessment is carried out using certain techniques that allow us to qualify the importance of market share either because of the inaccuracy of the market share to determine market power (because the market in question cannot be defined using 'bright lines' (Schmalensee [2011]), as 'all or nothing', 'in or out', '0/1', without qualifications) or because the intrinsic nature of the market limits the importance of market share (for example, because entry into the market is easy and quick for other companies). However, is it possible to dream about a truly direct assessment of market power, a type of infallible thermometer that tells us the exact position of the undertaking being investigated?

Sigmund Freud, the much vilified father of psychoanalysis, said that many of the ailments that he treated on the couch in his practice in Vienna for years with modest results would be treatable with drugs, once enough was known about the biochemical mechanisms that alter our psyche. At the present time it cannot be said that science has advanced sufficiently to make Freud's prophecy come true, although the same idea could easily be applied to the assessment of market power: perhaps in the future the competition authorities will easily reach the conclusion that one or more undertakings have substantial market power, using entirely reliable econometric techniques, which, logically, will make their task much easier. The economists of the US Department of Justice and the Federal Trade Commission are constantly striving to find this panacea, but the closest they have come so far is the 'Upward Pricing Pressure' (UPP) to which they refer in their new Horizontal Merger Guidelines 2010.

This cosy utopia does not, however, appear to be just around the corner, so I fear that we will all have to continue to observe our patients on the couches of our consulting rooms; in other words, we must continue to define markets and assess market power using less revolutionary procedures that are, nevertheless, tangible, despite their undoubted faults.

In order to examine relevant market power in the application of the competition rules, I consider it both useful and necessary to study collective dominant positions, from all their different perspectives, like some illustrious predecessors (eg Petit [2007]). Useful, because the fact they are a 'meeting point' of the different rules allows us to make comparisons and draw parallels that help clarify matters; necessary, because this is a particularly problematic market structure in competition law.

After this, and directly related to oligopolies, the two theoretical gaps in EU antitrust law will be examined, namely the inability of (i) the dominant position test (specifically, the merger control test under the former merger control regulation) to prevent so-called 'unilateral effects' in oligopolistic markets; and (ii) Articles 101 and 102 TFEU to put an end to tacit coordination.

It is often said that the 'substantial lessening of competition' (SLC) test and its twin brother, the substantial impediment to effective competition' (SIEC) test, are better than the traditional test for determining a dominant position, since they focus on the effects of a concentration in the market and on the reduction of competition between undertakings rather than on structural questions such as the market shares of the parties to the merger and the dominant position thresholds. It is claimed that the substantive assessment focuses fundamentally on whether prices will rise, as if the dominant position test did not do precisely this. In fact, the problem is, always, exceeding a given market power threshold (or elimination of a competition threshold, which, in practical terms, amounts to the same thing) since only then can there be negative effects on prices. Accordingly, however much we may want to distinguish between one test or another, ultimately we will always be referring to the same thing, not just in practice but also in legal and economic terms.

The alleged difference between the dominant position test and the SLC/SIEC test is that the former contains a 'blind spot' or gap that makes it impossible to prohibit concentrations capable of producing unilateral price rises in oligopolistic markets that are not 'tacitly collusive', in the most commonly used economic jargon, or 'tacitly coordinated' in the legal terminology employed by the European Commission. But no such gap exists.

The 'non-collusive' or 'non-coordinated' oligopoly produces competitive results, in principle. The effect of a concentration on this type of market – as on any market – is to alter the pre-existing equilibrium and, by definition (except, perhaps, in very special cases), reduce – a little or a lot – competition. This being the case, where do we place the relevant threshold of intervention? At a price rise of 5–10 per cent, so as to define the market through the hypothetical monopolist test? At a lower price rise?

If the threshold of prohibition is set at a market power level that allows undertakings to increase prices by 5–10 per cent, then we are talking about an individual and instantaneous (one-shot) dominant position of each and every one of the members of the oligopoly (their jump to a new equilibrium at a price that is quite significantly higher must be understood in these terms).

If we are referring to a lower increase, what figure should we use? What is the reference criterion? 1 per cent more? 2 per cent more? What should the percentage figure below 5 per cent be? The problem is that we do not know; as a result, it is better to fix it at the level of the 'hypothetical monopolist' and equate the threshold of intervention to that of the dominant position (again, although we are dealing with momentary individual dominant positions). Thus, if a dominant position is defined as enjoying 'substantial market power' – ie sufficient to make prices rise by between 5 and 10 per cent – then there is no gap and the dominant position test covers all 'unilateral effects' without any problem.

However, if the 'unilateral effects' that trigger the prohibition of a concentration are produced, supposedly, below these thresholds (price increases of 5–10 per cent) and the new and more flexible SLC/SIEC test allows this, then we will have sacrificed business freedom in exchange for very limited anti-competitive effects in the market, the avoidance of which will not offset the damage done to the undertakings concerned.

In short, we are dealing with the old debate between business freedom on the one hand and the control of economic power on the other. The weighing up of both, but legal certainty too, suggest the need for a restrained interpretation of the test used in merger control, whatever this is. In this regard, the old dominant position test raised fewer question marks, although the new test, if correctly interpreted, should not lead to very different results from its predecessor.

Competition authorities may wish to intervene, to benefit consumers and market fluidity, below the reasonable threshold of 'substantial market power', dominant position or the SLC/SIEC, but they should not do this. It is not acceptable to stretch the tolerance of the test or to try out new 'theories of harm' to protect ourselves from business concentration. We are much better protected through legal certainty. Thus, once again the SLC/SIEC test cannot and must not lead to different results, and the European Commission's intervention will only be justified if we have an SLC/SIEC, 'substantial [significant] market power', or an individual or collective dominant position (or unilateral or non-coordinated effects, or coordinated effects) in the form of price increases of 5–10 per cent.

As regards the second alleged 'gap', which would prevent using *ex post* Articles 101 and 102 TFEU to put an end to tacit coordination in non-competitive oligopolies, this has been closed, for better or for worse, by the European Court of Justice (ECJ) in *CEWAL* (2000) and by the General Court (GC) in *Gencor* (1999), *Piau* (2005) and *Impala* (2006) by applying Article 102. Thus, this latter provision may be used to tackle abuses of an oligopolistic dominant position, obviating the need to stretch the meaning of 'agreement' or 'concerted practice' under Article 101.

Another issue dealt with in this book is whether ephemeral 'substantial [significant] market power' is irrelevant in competition terms. In my view, it is not, based on a reading of the relevant texts and also for logical reasons. In this regard, a distinction must be made between (i) the duration of a high market share, which, when ephemeral, may indicate that one or more undertakings are not in a dominant position (Article 102 TFEU), or do not significantly impede effective competition (Regulation 139/2004 on the control of concentrations), or do not eliminate competition in respect of a substantial part of the market (Article 101(3)(b) TFEU) – three things that, in my view, amount to the same thing; and (ii) the lasting nature of market power, which although it is ephemeral, if it is held or obtained, may create competition problems. *Ex post*, I do not consider that substantial but short-lived market power is always irrelevant for competition law purposes if it is used in an anti-competitive manner for whatever time it is held. At most, a lengthy duration will allow us to prove more convincingly the existence of market power. However, it is illogical to make the existence of market power conditional upon its being of a lasting nature. *Ex ante*, in merger control and with respect to an individual or collective dominant position, the lasting nature of potential 'unilateral' or 'coordinated' effects will only be of significance in determining whether there are reasons to intervene, because a possible non-lasting dominant position may effectively not justify the authorities intervening to prohibit a concentration.

This book also evidences the conquest of competition law by economists. Perhaps there should be no complaints about this, given that jurists have been unable to advocate their views more forcibly, yet this conquest has had very dubious results as far as legal certainty is concerned. The criticism of the vilified per se infringements and the reliance, on the one hand, on a relativising analysis based on effects, in all fields, and, on the other, on 'efficiencies' to justify any prima facie anti-competitive conduct has undermined and reduced even

further the legal content of competition law, bringing it closer to economic divination. A 'more economic approach', yes please; exaggerations, no thanks.

More specifically, as regards 'efficiencies' in European law, their rise to fame in recent years is a particularly good illustration of the shift just referred to.

The model (since it already existed) of 'European efficiencies' is Article 101(3) TFEU, which was on the fringes – rather than part of the core – of the substantive test of the repealed Regulation 4064/89. No attention was paid to it until much later (and only then of a limited nature), during the heat of the debate prior to the adoption of Regulation 139/2004. Until then, the conditions imported from that provision were of no practical use, except for the condition of the non-elimination of effective competition – the only one of relevance, in fact, in the form of the old and new substantive test (dominant position/SLC or SIEC).

The term in question was imported from the US to the EU in the field of merger control and first colonised Article 101(3) TFEU, a provision which dates back to 1957 and which, until the publication of the Guidelines on its application, had never been considered to contain any reference to efficiencies. Later, thanks to the architectural creativity of the European Commission, and unless the ECJ as planning authority corrects this, a prefabricated room has been added to the edifice known as Article 102 TFEU. Thus, imitating another well-known but different edifice – Article 101 TFEU – the European Commission has attached a strange 'paragraph 3' to Article 102 via 'soft-soft law' (a Guidance Paper, not even Guidelines). Going beyond the traditional 'objective justification', the new 'Article 102(3)' makes it possible for the Commission to give its blessing to 'efficient abuses' through the expeditious method of analysing the exception in a manner that theoretically takes place prior to the determination of the existence of an abuse, in exactly the same way as occurs in merger control. This is so because only if, logically speaking, the cart (the four conditions of 'Article 102(3)') is put before the horse (the existence, or otherwise, of abuse) can the Article 101 approach be used (in a distorted manner) with Article 102 TFEU.

Thus, the European Commission uses the term 'efficiencies' to refer to quite different legal realities according to whether we are dealing with Article 101 TFEU, merger control or Article 102 TFEU, confusing everyone in the process.

Talking of confusion, the use of the term 'pro-competitive' to refer to that which is economically or technically advantageous in European competition law (see, inter alia, the recent example of the Guidelines on Horizontal Cooperation of 2011 and, in the literature, Faull & Nikpay (2007) paras 3.398ff) has also helped to spread the use of imprecise terminology, which neither jurists nor economists are comfortable with. Thus, while in merger control it is acceptable to refer to an anti-competitive/pro-competitive dichotomy (with neutral in the middle) in the field of Article 101(3) TFEU, the typical use of these two adjectives is incorrect. In merger control, given the limited material scope of the substantive test, significant impediments to effective competition (SIEC) are not permitted, nor are good dominant positions, since if a concentration is authorised on the basis of its 'efficiencies' this is because the latter prevent an SIEC or a dominant position from arising. In other words, the efficiencies make a concentration genuinely pro-competitive or at least neutral. By contrast, under Article 101(3) TFEU, it is clear that there are 'good' restrictions on competition, which nonetheless are still restrictions, despite being economically or technically 'efficient'. In this case, ultimately what is weighed up is not anti-competitive effects on the one hand and pro-competitive effects on the other (this could be examined under Article 101(1) TFEU), but rather anti-competitive effects (which are presumed to be negative) and

effects that are positive in economic or technical terms. Finally, Article 102 TFEU appears in this respect to be closer to merger control or Article 101(1) TFEU than to Article 101(3) TFEU, in the sense that the existence of efficiencies can only lead to the conclusion that there is no abuse but never that there can be *good* abuse, ie abuse whose negative features for competition are offset by other positive features.

At the same time, largely without the help of economists, European competition law has become less systematic as a result of various actions of the Institutions that have blurred the meaning and the position of the rules, specifically as far as the market power of undertakings is concerned. The Commission's decision in *P&I Clubs II* (1999) and the judgment of the GC in *TACA* (2002); the greater flexibility in practice – upwards or downwards – of the merger control test under Regulation 139/2004; the judgment of the GC in *Piau* (2005); the above-mentioned universal application of 'efficiencies' and the backdoor introduction – via soft law that, in theory, only binds the European Commission – of a highly creative and already mentioned 'paragraph 3' – letter b) included – under Article 102 TFEU (Discussion Paper (2005) and Guidance Paper (2009) of the Commission): these have all caused confusion by blurring the basic systematic differences between the rules relating to market power; reduced the level of legal certainty as regards the correct interpretation of the rules; and made it difficult for the uninitiated (including, no less, the judges in the ordinary courts and undertakings themselves) to know where they stand.

The aim of this book is to try to straighten out the current muddle and suggest some practical solutions to make the rules easier to understand and apply, without making them either less strict than they are and without requiring the person called upon to interpret them (ultimately, a judge) to become an expert economist. The task is an arduous one, and the reader will judge whether my arguments are convincing and my goal has been achieved.

Madrid, 1 July 2011

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