LATHAM & WATKINS LLP

DOMINANCE

EU Competition Law
College of Europe
12 July 2013

Howard Rosenblatt

Latham & Watkins, LLP

Brussels

Overarching principles

- **What is dominance?**
- Dominance is “a position of economic strength” which enables a firm to “prevent effective competition” in the market because it can “behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers.” *United Brands*, (1978) ECR 207.
- For the dominant firm: “decisions are largely insensitive to the actions and reactions of competition, customers and, ultimately, consumers.” EC Guidance on Article 83, para. 10.
- Dominant firms are “capable of profitably increasing prices above the competitive level for a significant period of time.” *Intel* (2009)

Overarching principles

DOMINANCE MEANS HAVING SIGNIFICANT **MARKET POWER**

Overarching principles

- Market power underlies almost every aspect of competition law
  - **Price fixing:** The elimination of price competition … to share market power
  - **Market allocations:** Agreements not to compete for customers or geographies … to share market power
  - **Non-cartel agreements** among competitors: Assess whether arrangement reduces competition … by creating market power
  - **Vertical agreements**: The main issue is foreclosure to maintain market power upstream or downstream. Or protecting even intra-brand competition when the firm has market power. (Plus integrating the European Union.)

Overarching principles

- Market power underlies almost every aspect of competition law
  - **Merger control:** Assess whether the merger will give the combined firm unilateral market power, or allow the remaining firms to exercise it collectively (“collective dominance”)
  - **Abuse of dominance:**
    - Exclusionary abuses - assess whether unilateral conduct maintains or strengthens market power
    - Exploitative abuses – dominance is one (of several) prerequisites

Market position, a first step

- Market shares are a “useful first indication” of market power, but the Commission “will interpret market shares in the light of the relevant market conditions.” EC Guidance on Article 82, para. 13.
- First, define the market
  - Relevant market definition goes hand-in-hand with dominance because it assesses over what products and customers might it be possible to exercise market power under the right set of facts
  - Hence the “narrow markets principle”

Market position, a first step

- **Product market**: Against what products do the firm's products compete?
- Demand side analysis: what products are sufficiently "interchangeable" with each other for customers?
- Supply side analysis: does the firm compete against flexible capacity?
- Hypothetical monopolist and SNIP test: Small non-transitory increase in price
- Difference between the EU and US: supply substitution not used to define product market in the US but rather to identify participants and calculate shares (to exclude capacity that would not swing). Rarely changes outcome.

Market position, a first step

- **Geographic market:** Against what locations does the firm compete?
- Demand side: From where could (and would) customers within the relevant jurisdiction obtain products? ‘
- Supply side: From where could (and would) suppliers import products into the relevant jurisdiction.
- SNIP test applies. A predictive test, but current imports are strong evidence.
- Meaning of “world market” – sources of potential supply may be global, but competitive effects are assessed for the location subject to the authority’s jurisdiction.

Market position, a first step

- **"Price discrimination" market**
  - Are there a set of customers for whom fewer products compete?
  - Can these customers be identified?
  - Can these customers be charged a higher price?
  - Can these customers protect themselves through arbitrage?

Market position, a first step

- Measuring market shares
  - Calculating the denominator: total market size
  - Value vs. volume: value might show greater strength for higher end products (but lower priced products can still be a strong constraint).
  - Sales vs. capacity: capacity often makes more sense when product market includes supply substitution or the geographic market includes potential imports. Or when there are players with small sales but large excess capacity.

Market position, a first step

- Initial indications based on market shares
  - Presumptions? Comforting but can result in false positives (or negatives)
  - Indications? Yes.
  - Safe harbors? Helpful at the extremes - while the situation lasts.

Market position, a first step

"The Commission's experience suggests that dominance is not likely if the undertaking's market share is below 40% in the relevant market. However, there may be specific cases below that threshold where competitors are not in a position to constrain effectively the conduct of a dominant undertaking, for example where they face serious capacity limitations." EC Guidance on Article 82, para. 14

Market position, a first step

“Experience suggests that the higher the market share and the longer the period of time over which it is held, the more likely the period of time over which it is held, the more likely it is that it constitutes an important preliminary indication of the existence of a dominant position….

However, as a general rule, the Commission will not come to a final conclusion as to whether or not a case would be pursued without examining all the factors which may be sufficient to constrain the bahaviour of the undertaking.” EC Guidance on Article 82, para. 15.

Beyond the market shares - Expansion

- Expansion by smaller firms can be a competitive constraint
  - Are they capable?
  - Are they credible?
  - Are there substantial switching costs, delays?
    - Qualification processes
    - Investments by incumbents
  - Evidence
    - What do customers think?
    - What do the smaller firms think?
    - What does the allegedly dominant firm think?
    - What is the history of expansion?

Beyond the market shares - Entry

- Potential entry can be a competitive constraint
  - Could a firm enter in response to attempts to exercise market power by the incumbent? Would it?
  - Barriers:
    - Sunk costs
    - Know-how
    - Brand name or other credibility variables
    - Minimum viable scale
    - Small or shrinking markets

Beyond the market shares - Entry

- Potential entry can be a competitive constraint
  - Evidence
    - Past entry
    - Identification of actual prospective companies
    - Evidence of perceptions of allegedly dominant firm
  - Distinguishing supply-side substitution, and does it matter

Beyond the market shares – Bidding markets

- Bidding markets
  - Issue is whether adequate competition exists at the bidding stage
  - A large share can reflect merely the size of contracts subject to competition
  - Shares may not say much about market power when the competition actually occurs
  - Or…high, sustained shares might suggest an advantage in winning contracts

Beyond the market shares – Bidding markets

- Bidding markets
  - Evidence:
    - How many bidders?
    - Concessions by the winner?
    - Unpredictable winner?
    - Competitive behavior (service, innovation, margins, pricing trends, etc.)?

Beyond the market shares – Power Buyers

- Power buyers
  - Large, sophisticated buyers might be able to protect themselves
  - But a strategy must be available:
    - Vertical integration
    - Sponsor expansion
    - Sponsor entry
    - Retaliation tactics
  - And they must know dominant behavior is happening

Beyond the market shares - Aftermarkets

- Aftermarkets
  - Situation:
    - Aftermarket parts are a must-have for owners of the original equipment. They are “locked in.”
    - The original equipment manufacturer has 100% share of a market to supply those parts.
    - Can the original equipment manufacturer exercise market power?

Beyond the market shares - Aftermarkets

- Aftermarkets
  - It depends
    - Manufacturer could not exercise market power on spare parts (the “secondary market”) if the consequence is losing original equipment sales (the “primary market”).
    - To what extent to original equipment buyers look at life-cycle costs when making their decision?
    - To what extent is there competition at the original equipment level?

Beyond the market shares – Two-sided markets

- “Two sided” markets
  - Two sets of customers come from two sides of the market, usually upstream and downstream
  - Examples:
    - Newspapers
    - Payment cards
  - One side of the market may look highly concentrated, but the other side may impose a competitive constraint

Beyond the market shares – Innovation Markets

- Innovation markets
  - Market for development and technological improvements
  - How a firm can be “dominant” in innovation
  - How much innovation is enough?

Beyond the market shares - Evidence

- Examples of evidence of dominance
  - Company views, and documents
  - Customer views
  - Competitor views
  - “Natural experiments”
    - Comparing margins in markets that appear more competitive
    - Comparing margins before and after recent entry (or exits)

A word on monopsony power

- Monopsony power
  - The situation: A powerful buyer who can drive prices <u>below</u> competitive levels
  - Why this is a concern – lower prices, but ultimately reduced output downstream
  - Relevant factors
    - Share of purchases (but see Toys-R-Us at 20%)
    - Potential entry or expansion at the buyer level
    - Ability of sellers to protect themselves, i.e., repositioning

Questions?

Thank you

Howard Rosenblatt
Latham & Watkins, LLP
Brussels, Belgium
howard.rosenblatt@lw.com
+32.2.788.6219