Analytical Framework Teleconference
What Is Dominance?
Monday, 7 March 2016
Transcript and Speaker Submissions

Teleconference Transcript

Tim Longman: Good morning, or, for many of you, good afternoon, or good evening, depending on where you are in the world. My name is Timothy Longman, and I work for the United States Department of Justice. On behalf of the three co-chairs of the Unilateral Conduct Working Group: the United States Department of Justice, the Turkish Competition Authority, and the United Kingdom Competition of Markets Authority, I welcome you to this teleconference.

This teleconference is the first of two teleconferences associated with the two-year project to explore the analytic framework for evaluating unilateral conduct under competition law. The subject of today's teleconference is perhaps the most basic question in the analytic framework, that is: What is dominance, or equivalently, substantial market power. Addressing this question with me today are: Pablo Ibáñez Colomo, who teaches law at the London School of Economics; Roger Ware, who teaches Economics at Queens University in Canada; and Graeme Woodbridge, who recently became the chief economist at the ACCC in Australia. Each of our speakers contributed a short paper on the subject of this teleconference, as did several others in response to a call for papers last fall. These papers were distributed last week and will be made available on the ICN website. For this call, our speakers will not be presenting their papers. We will assume that you have read the papers in advance and they will be responding to my questions, which were provided to the speakers in advance.

With that, I'd like to begin with some questions directed to the two economists on the panel. I believe that, as stated in the papers, we are all agreed that market power is a matter of degree. Roger, are you aware of any criterion in the economic literature which indicates the point at which a firm's market power becomes substantial?

Roger Ware: Thanks Tim. And thanks for inviting me to be a part of this teleconference. I would say the answer in general is no. In fact, I would say that substantial in reference to market power is really, fundamentally a legal concept not an economic one. When one looks at the simplest possible economic models of oligopoly, let's take a model that we're all familiar with, the Cournot model of oligopoly, what it would predict, of course, is that market power is a monotonic function of the number of firms. As market structure becomes more concentrated, the firms have more market power. But there is no discontinuity; there is no particular level of concentration, or structure, at which the degree of market power suddenly becomes substantial. In

Bertrand models, economists' other favorite model of oligopoly, that is more or less true. It is a little bit more of a complex framework, but, nevertheless, certainly in the Bertrand model of differentiated products, which is a favorite one and has been much analyzed, it's once again true that as the market becomes more concentrated, the degree of market power processed by each firm steadily increases. So I would say there is no threshold. The threshold that one may wish to create as a matter of legal enforcement, not economic theory, is one that really has to be associated with particular practices and has to be based on issues such as the constant benefits of Type 1 and Type 2 errors, which I think we're going to talk about later on. So why don't I leave it there at this point.

Tim Longman: Graeme is there any literature that you would like to mention?

Graeme Woodbridge: I agree with Roger. It's not really an economic concept, but when thinking about this, someone reminded of a quote from a court case in Australia where his Honour made the following comments: "The word 'substantial' has been said to be 'not only susceptible of ambiguity' but to be 'a word calculated to conceal a lack of precision.'" Well, I don't want to be pessimistic about what the terms "substantial" and "substantial market power" mean. But I think that reasonable people may have different views on what it is. It's just not a precise concept without putting it in some sort of context.

Tim Longman: Thanks Graeme. Economics defines market power as a power to exploit customers, for example, as the ability to persistently charge more than the competitive market price. But when competition law uses substantial market power as a screen, Graeme's paper suggest that the relevant question is whether the firm engaging in suspect conduct has the power to produce an exclusionary effect. Graeme could you please explain how you determine whether a firm engaging in a suspect practice has the power to produce an exclusionary effect?

Graeme Woodbridge: Thank you. Before answering this question I would like to note that my comments concern how I think about substantial market power in a unilateral conduct investigation. It's not necessarily how the courts in Australia approach the task nor the ACCC for that matter. With that in mind, when assessing whether a firm has substantial market power, it is helpful to put the issue in the context of the unilateral conduct investigation at hand. The context is the concern that the firm is engaging in conduct that may be anticompetitive. So assessing whether a firm has substantial market power, one can ask whether the firm has sufficient market power to produce an exclusionary effect. To determine whether the firm has sufficient market power to produce the exclusionary effect, you start with the conduct and ask the question: what options are available to those adversely affected by the conduct, or can the parties who are affected by the conduct readily avoid it, or bypass it. Just to give an example, say a vertically integrated firm refuses to supply an upstream input to its rivals operating in a downstream market. A number of relevant questions might be: who else can supply the input and at what cost? Can alternative suppliers of the input expand their production? Can the input be readily imported? What are the barriers to rivals vertically integrating themselves? All these questions go to whether the firm has a substantial degree of market power in the supply of the input, or has the power to produce an exclusionary effect. So that's how I think about that issue.

Tim Longman: Thanks. That's helpful. Roger, is the power to produce an exclusionary affect for a particular practice apt to be closely related to the proportion of the market subject to the practice?

Roger Ware: So that's an interesting question Tim, and I think that's a good example of why one has to be careful in abuse of dominance. I think at one level the answer is an emphatic no. If you consider a market with, let's say, a few producers, a standard kind of imperfectly competitive market, more than two and less than ten, which characterizes many, many, many industries that we tend to get involved with. All of those firms may be engaged in some practice, which means they might all have exclusive dealing arrangements with downstream distributors, for example. 100% of them. So, strictly speaking, the answer to your question, now does that imply any anticompetitive affect? No. In fact, it's much more likely to imply some procompetitive or efficiency effect. Because if there's something—in a reasonably competitive market—there's a practice that all firms are engaged in, it's likely to be an efficient one. So I think in a sense one perhaps has to rephrase this that perhaps one could say something more like, the more dominant is a particular supplier or the more dominant is one supplier, than the more likely it is that certain practices can and will be used for exclusionary purposes. Take something like, for example, all units' discounts. There have been some papers on these recently. This is the classic *Intel* issue of keeping out small firms that are capacity constrained. So that a large dominant firm can have a pricing scheme with its customers, which says if you buy everything from me, I will reduce the price on all units that you buy, but if you don't, you'll pay a higher price for the units that you do buy. So a dominant firm can use a scheme like that, an all units pricing scheme, to exclude capacity constrained rivals. But you should not assume, or one should not infer, that just because a practice is being adopted largely or invariably throughout a market that it is anticompetitive.

Tim Longman: Thanks Roger. So, bringing Pablo into the discussion, Pablo, in competition law, is dominance the power to exclude?

Pablo Ibáñez Colomo: Thanks. So I would say that it is necessary to distinguish between different levels when thinking about the question. So one looks from a legal perspective of how dominance has been defined. Well, there is an element of power to exclude in the definition that was given in the early cases, in particular, in EU competition law. There is an element that refers to the ability to prevent or to hinder affective competition. So then at that very abstract level I could say, at the very least, one could say that courts tend to assume that substantial market power implies that a company has the ability to exclude competition. Coming back to some of the points that have been mentioned already, what we observe in the practice of courts is that very often is that the behavior of a particular company is taken as evidence that the company has substantial market power or enjoys a dominant position. So then from that perspective the power to exclude is taken us a proxy for the substantial market power and the dominant position enjoyed by the company. So in a sense it is an indicator that can be considered among others.

But from a legal perspective, I think, it is important to emphasize, that the power to exclude does not seem to be required to establish dominance. In other words, it could be a useful condition that is not a necessary condition to establish dominance, or for that matter, I would say, at least from a legal perspective, I understand that substantial market power does not require that condition. There have been some cases at the EU level where there was evidence that the firms lacked the power to exclude competition. This factor was considered compatible with a finding of dominance. I'm thinking about *British Airways*. I'm thinking about *Michelin II*. It was made very clear that an authority would not have to show the power to exclude in order to establish dominance. That's the important factor. In the same vein, I would also mention subsequent cases concerning what was already mentioned, loyalty discounts, where one of the defenses tried by the dominant company was that the market structure allowed competitors to operate at a profit, and this factor alone suggested that the company lacked the ability to exclude. This factor was not considered sufficient to exclude the finding of dominance or, for that matter, to establish the absence of an abuse. In answer to this particular question, my sense is that the notion of dominance falls below the threshold or the impression is that the power to exclude sets a bar that is higher than the bar that required that person to establish dominance.

Tim Longman: Thanks. Building on this concept of dominance, I consulted with several dictionaries and all the dictionaries define dominance more as a relative concept than an absolute concept. Pablo is this true in competition law? In particular, can the second largest firm in a market be dominant or can even the smallest firm out of the three firms be dominant?

Pablo Ibáñez Colomo: Again I think there is something that should be distinguished in this regard, and it's an aspect that I did not emphasize sufficiently in the paper, which is the distinction between single dominance and joint dominance. One can have a firm alone is able to enjoy a dominant position and substantial market power, or a situation which several firms simultaneously enjoy a position of dominance. What is clear under EU competition law that a joint dominant position may exist and an abuse of a collective dominance may take place. My understanding of U.S. antitrust is that the issue is much more contentious, and my understanding of the relevant case law is that shared monopoly remains controversial and has not been accepted. The possibility that joint dominance or collective dominance may be established in EU competition law does not mean that the second or third largest firm in a given market may be found alone to hold a dominant position. So from that perspective the notion of dominance, as currently understood, does not comprise the second or the third largest firms when alone exercising their power. I think this is particularly well illustrated when one thinks about the reforms that were introduced at the EU level to system of merger control. The reason why the substantive test in merger control in Europe was changed was precisely to encompass instances in which second or third largest firms in a given market enjoyed a market position that falls below the threshold of dominance. That would be the position at present in that regard. So it is accepted from the perspective of merger control that as significant impediment to effective competition or substantial lessening of competition may take place below the threshold of dominance. But this does not mean that the notion of dominance, as currently understood, comprises the second or the third largest firm of the market. But what is required, as I was saying before, is to establish a position of collective dominance, which is very rare in practice, even though we do have cases in which an abuse of collective dominant position has been established.

Tim Longman: Thanks. Pablo's paper reminds us that the European Court of Justice has defined dominance as the ability to behave "to an appreciable extent independently" of competitors, customers, and consumers. Graeme's paper offers a similar definition. Graeme, how do you use this idea in determining whether a firm has substantial market power?

Graeme Woodbridge: Thanks. I suppose when a firm is engaging in conduct that may involve a use of market power a couple of questions come to my mind. The first question is what will the likely reaction of competitors and customers be to the conduct? The second question is will that reaction be sufficient to make the conduct uncommercial for the firm. In other words, is it the case that the firm has sufficient market power to profitably engage in the conduct? So in a general sense, if a firm increases prices above what might be a competitive level, will sufficient customers take their business elsewhere to make the price increase unprofitable? Or in the case of the example I mentioned before, where a vertically integrated firm refuses the supply an input to a rival, will rivals react by seeking supplies from alternative suppliers? Will the rivals' reaction make the refusal to supply unprofitable? So put simply to answer the question, the reaction or the likely reaction of competitors and customers to the conduct are important in determining whether the firm has substantial market power.

Tim Longman: Ok. Roger, do you have a comment on the same idea from an economic perspective?

Roger Ware: Yes, so I was just going to say that this strikes me as being an example of a concept that's reasonable clear if you pick up any intermediate microeconomics textbook, but can be rendered rather unclear by turning it into the drafting language of some competition statute. And it seems to me that, yes, the prose that you use, the behaving independently of competitors, customers, and consumers, sure it reflects what market power is, but it doesn't really help you very much in identifying it. For that purpose, you still got to go back to your building blocks. You've got to most likely define the market or at least characterize the market in an economic way. And you need to estimate the elasticity of demand and study the conditions of entry. In a sense, for me, those are more precise terms than "behaving independently" because "behaving independently" is so vague that it doesn't really tell us what in economic terms in being described.

Tim Longman: Thanks. Pablo, do the courts put this independence definition to practical use, and if so how?

Pablo Ibáñez Colomo: Thank you. The answer to the question completes very well what Roger has just been saying, because there is this gap between economic theory—what economic theory suggests that it means to enjoy substantial market power—and how this market power is assessed in practice. And one of the questions that I sought to emphasize in the paper relates to the proxies that have been used in the practice of the courts to show this ability to behave independently of customers and competitors. What we observe in the practice of the courts is that questions such as, for instance, the status of the dominance firm as an unavoidable training partner is taken as an indicator of this ability to behave independently of consumers and competitors. I can think of cases like *Intel* that has been mentioned before on loyalty discounts. One of the points that the Commission made, and that was explicitly accepted by the General Court when the case was challenged, is the fact that Intel from the perspective of customers was what we call "a must have brand." We can think of other cases like *British Airways,* where the scale of the company, the number of contracts, made the company an unavoidable trading partner. Along the same lines, one can think of some cases in which the ability to behave independently of competitors and customers comes from the fact that, at least as far as part of the industry is concerned, the company enjoys a statutory monopoly.

One of the cases that comes to mind in this regard is a recent ruling of the European Court of Justice, which is *Post Danmark II*. The point was made explicitly; the status of the company as an unavoidable trading partner came from the fact that, at the time of the decision adopted by the national competition authority, this company enjoyed a statutory monopoly for a large part of the relevant market. In this same vein, we can think of other similar proxies, such as the indispensability of an input, which can stem from the fact that the input in question has the features of a natural monopoly, which make it again an unavoidable trading partner for downstream competitors and therefore affords the possibility to engage in anticompetitive conduct on a lasting basis, back to Graeme's point. Network effects are another basis for inferring market power. So, then, the sense that we develop is that some of these indicators are taken to reinforce the reliability of market shares. In this regard, the *Microsoft* case in Europe is a very good example. The EC General Court was very explicit in mentioning that the findings of the European Commission, related not only to the market shares enjoyed by Microsoft, but by the fact that this market share was reinforced by the presence of network effects. So those would be the indicators that in practice are taken to be indications of the ability to behave in an anticompetitive manner on a lasting basis.

Tim Longman: So talking a bit about market share, the papers submitted by our panelist as reflect the consensus that market share is a highly imperfect indicator of the degree of the firm's market power. I'd like to hear from all our speakers on whether competition law should nevertheless hold that a firm is dominant or possesses substantial market power only if it has a market share above some threshold. If we could hear first from Graeme, then Roger, and then Pablo on that issue. So Graeme.

Graeme Woodbridge: This question is not something that I've given a lot of thought to as it's not something that we do in Australia. In any event, two questions come to mind: What role could such a threshold have? Why might setting such a threshold be valuable? I could think of three reasons. First, a threshold may reduce risk of capturing procompetitive conduct. If a firm with a market share below X% couldn't really engage in exclusionary conduct, then the law shouldn't capture the conduct. So that might be one reason to have a market share threshold. A second reason might be to provide guidance for large firms. Compliance costs of competition law can be significant. There might be value in giving large firms guidance that is their market share is below a certain threshold, then their conduct cannot be captured by competition law, or is unlikely to be. A third reason is to provide a filter for antitrust authorities, who need to use their resources carefully to address the most egregious anticompetitive conduct. A market share threshold might be useful for an antitrust authority in determining which cases to investigate further and which ones to leave. I think all of these objectives are important, but I just question whether a market share threshold is a good answer or a complete answer. A key challenge with market share thresholds is defining the market in the first place. Having been involved in many antitrust investigations, it is clear that reasonable people have different views on the dimensions of market. Market share thresholds are less valuable if there is a dispute about the dimensions of the market itself. Also I wonder whether market share thresholds provide a good filter for investigations by antitrust authorities. Other filters, such as the value of the commerce that's affected by the conduct, might also be as good. I am not saying that market share thresholds are of no value; it is just that one has to be clear of the objectives and the potential pitfalls.

Tim Longman: Thanks. Roger, could you address that same question?

Roger Ware: Yes. So I agree with what Graeme just said. Perhaps I can elaborate a little more in the same area. The point I would make is really a very kind of standard one is legal theory, which is that all enforcement activity is subject to what is sometimes called Type 1 and Type 2 errors, some people prefer the language of false positives and false negatives. That is to say, you can find practices that appear to be anticompetitive and you prosecute them as anticompetitive, but they turn out not to be. That would be the Type 1 error or the false positive. Or you can not prosecute firms that are engaged in anticompetitive practices. That would be the Type 2 or the false negative. All law enforcement—it doesn't matter whether it's competition law or any other kind of law—is concerned with balancing those two possibilities. In the case of competition law, this is an argument that's pretty standard, and I certainly didn't come up with it, there is a case to be made for why one should err on the side of making the false positives pretty small. You want to make it the likelihood of the Type 1 error pretty small, and that means your Type 2 errors may be more common. The reason is because the cost and benefits are asymmetric. If you choose not to prosecute a firm that's engaged in some practice that is anticompetitive, the process of competition will still go on working; the firm will go on doing whatever it was doing engaged in exclusive dealing or tying which was anticompetitive, but the process of competition eventually will erode that firm's market power. Through entry or innovation other technologies will come along, and market power will be eroded. On the other hand, if you do prosecute firms that are engaged in practices that are in fact efficient, then it will have a chilling effect on other firms adopting those pro efficiency practices. I tend to lean towards allowing the criteria of dominance to be fairly large, or the scale of harms to be fairly large, before an investigation commences just on these grounds alone, simply on the cost-benefit analysis of the enforcement of competition law. It's very expensive to investigate and to litigate, so one wants to keep the error probability pretty small for false positives.

Tim Longman: Thanks. Could I address the same question to Pablo?

Pablo Ibáñez Colomo: What Roger was already pointing out, I would say that there's a strong case to be made in competition law to use safe harbors and this is actually a trend that is very marked in Europe. We have seen the trend towards adopting market share thresholds across the board. We do have them in particular for vertical agreements, for horizontal cooperation, even in the context of merger control we have indicators that are best understood as market share threshold. I think there's a wide acknowledgement that legal enforcement entails Type 1 and Type 2 errors and that this is an indicator that is valuable for competition authorities to focus their resources to the most harmful practices. So from that perspective, I think the trend is a very marked one. The only aspect I would add—from the perspective of firms and precisely because many of the practices that are potentially abusive are also widespread—I think it is from the perspective of a legal certainty very useful to have a market share threshold below which firms have the knowledge or have the guarantee that they will not be prosecuted. And this is in particular and this is important in particular in jurisdictions where the threshold of effects, which is an issue to which we'll come back later, is a relatively low one. But from that perspective I believe there is a strong case to be made for introduction of safe harbors.

Tim Longman: Building on that, if competition law must have a minimum market share for dominance or substantial market power, what number would you pick? And very briefly what is your principal rationale for that number? Could we hear first from Pablo, and then Roger and then Graeme? Pablo.

Pablo Ibáñez Colomo: So then the rationale comes back to many of the issues that we have already been discussing: the use of resources would be one factor; the likelihood of making errors is another. What I would add to these issues is that whenever intervention has taken place in markets where the share of the dominant company was below 50%, the cases were very controversial. The cases really drove a change in the enforcement priorities of the European Commission were cases that were at that level. And what these cases indicated (this is not something to be generalized) is that the companies clearly did not have the ability to exclude competition. So that should be one aspect to be emphasized. The second aspect is, if we look at the practice of authorities in Europe after 2005, when the approach to the enforcement of Article 102 and similar provisions were reconsidered, it would seem that authorities were refocusing their efforts towards cases in which the market share of the dominant firm was substantially above 50%. This, to some extent, is an indicator that the threshold, at least from the perspective of enforcement priorities, should be set above 50%. So what we know from a legal perspective at least Europe is that dominance is pursued when the market share of the company is above 50%. So the question is whether, at least from the perspective of enforcement priorities, a higher threshold should be set. And in light of the cases I was discussing, in light of the suggestions that firms with 50% market share most often did not have the ability to exclude competition, my inclination is to say that probably, the dominance threshold should be set at the higher level. Perhaps 65% or 70%, so closer to what is understood could be the threshold of monopoly power in the U.S. This I think is a more appropriate threshold. From a perspective of justification, as I was saying, I think the issues are more or less clear and fairly uncontroversial. That would be my take.

Tim Longman: Thanks Pablo. Roger, do you want to address that same question?

Roger Ware: Yes. Thanks. So I'm going to try and make a case, which is kind of similar to what Pablo said, although perhaps I'm not able to refine it in the way that he did. But I'm going to make case for why 50% is a bit of a magic number. And that is because exclusionary strategies that are anticompetitive are really about preventing an equally efficient competitor or an equally efficient rival from competing for a minimum efficient scale, from being in this market at an efficient scale, or expand in this market to an efficient scale. Now if a dominant firm, the firm that's under our scrutiny, has less than 50% of the market (I wouldn't say it's impossible) but it's unlikely that they're able to do this: that they are actually able to prevent an equally efficient firm from competing or gaining minimum efficient scale. So that's why 50% has an attraction in this regard. Once you get above 50%, then it is possible for a lot of their practices that could be engaged in—exclusive dealing, loyalty discounts, various kinds of price discounting schemes, that could prevent a firm of efficient scale from entering. I'm making a play for 50%, but as I said above that I'm not really able to refine it.

Tim Longman: Thanks Roger. Graeme, do you want to address the same question?

Graeme Woodbridge: I'm quite thankful that you put me last here, Tim, because I'm probably going to avoid the question a bit. At the ACCC, we don't have a threshold for substantial market power. Substantial market power depends on the facts of the matter: what is the conduct, what is the market, and what is the market structure (including barriers to entry). It also depends, as I note in my paper, on the approach taken to market definition, in particular, whether the market captures both the supply-side substitutes and the demand-side substitutes. So maybe the threshold should be a little bit different in those circumstances. So I won't venture with a number.

Tim Longman: Abstracting from any particular criterion for establishing dominance or substantial market power, we will generally refer to the height of the dominance bar. Roger's paper endorses a high dominance bar. Roger, tell what experience leaves you to favor a high dominance bar.

Roger Ware: Tim, in Canada, the enforcement agency, the Competition Bureau, has, in my opinion, been admirably frugal in litigation in the abuse of dominance area. So actually I can't think of a single Canadian case where the market shares were less than 80% or so. Even though I think it's also true that 10-15 years ago the enforcement guidelines for abuse of dominance in Canada actually did mention a share of something less than 50%. I think it was 30%, but they say that don't anymore. I think they've retreated from that now. So as far as cases go, I'm not able to give you a case that I've worked on or a Canadian case I could bring you. I can cite cases which, putting myself at some risk here because I'm pretty sure my fellow panel members know more about these cases than I do, but some of the well-known cases to all of us, the loyalty rebates case in Europe where *British Airways* had a market share that was in the 20% range. And the *Michelin II* case, which is another case involving rebates, again its market share was well below 50%. I'm sure Pablo will correct me if I'm wrong about that. And then I would even go back further to a couple of classic U.S. cases. In *Kodak*, a famous U.S. Supreme Court case, of course was an aftermarket case, so some fancy economic theorizing took place in that case. In the primary market for copy machines, the market share was well below 50%. And then finally in the *Brooke Group* case, which is a very important U.S. predatory pricing case, *Brooke Group* had a market share which was well below 50% as well. And I would argue that all of those cases are cases that probably should not have been brought under my dominance screen of 50%.

Tim Longman: Graeme, going to you, what are the most important factors in your view in setting the dominance bar?

Graeme Woodbridge: I don't think about setting a high bar or a low bar. I think that can give rise to a bit of false precision. I think of substantial market power as being a market power sufficient for the conduct to cause an anticompetitive effect. I struggle with the idea of setting a low bar or a high bar because it gives the impression that one can dial it up or dial it down. I think effort should be directed to identifying the present and future constraints on the firm, and how strong those constraints are and how market participants can react to the conduct. So I suppose the issue for me is understanding the constraints the firm faces and the alternatives available to those affected by conduct, rather than setting a high bar or a low bar.

Tim Longman: Thanks. Pablo, do you want to share your views on these issues?

Pablo Ibáñez Colomo: Yeah, sure. So what I would say from my perspective is that the dominance threshold should be a useful and a reliable one. I was discussing before that we can use different, more or less reliable, proxies to establish dominance, but dominance itself as a concept is a proxy for a situation in which the competitive process is likely to be harmed. So from that perspective, I think we should define the bar in such a way that we minimize the mistakes that conduct leading to efficiency gains is prohibited and we maximize the chances that exclusionary conduct being prohibited. So against that background, and knowing that it should itself become a reliable proxy, I think there is a case to be made for relatively high dominance bar. Some of the other cases that Roger was discussing before I think are useful from that perspective. As the market was defined, I think British Airways market share was in the region of 40%. As the market was defined, in *Michelin II* it was around 50%. But this matters far less than that a close analysis of the two cases gave the impression that the conduct was most probably of a sort with efficiency gains and that, under the procedure of the court, the efficiency gains were not considered in a sufficient manner.

I think it's useful, for instance, to take a look at the work that Massimo Motta did in relation to the *Michelin II* case to understand why the dominance bar should be set at a relatively high level. So looking closely at the different categories of rebates that *Michelin* was applying, these rebates look more like the schemes we see in selective distribution systems than a naked exclusionary conduct. They were powerful reasons suggesting not only that Michelin didn't have the power to exclude competition, but that what it was doing was the routine practices that we have observed in companies that engage in selective distribution as a method to sell each product. Then for us to give an analysis, probably, an indicator that suggested that the dominance bar in this case was set too low is the fact that Michelin itself was selling the products of competitors in its own stores. So then, I guess, from the background I gave on those indicators, it looked like the practices were justified on an efficiency case. So, from that perspective, the conclusion that is inevitably drawn from them is that the bar was probably set at a low level, even though as the market was defined the company was found to hold a share of 50%. I would conclude by saying that we will be safer in terms of minimizing errors if setting relatively high dominance bar.

Tim Longman: Thanks, Pablo. So, hopefully I am accurately characterizing your paper when I say that your paper, Pablo, makes the point that the proper effects threshold depends on the height of the dominance bar. You argue, I believe, that greater evidence of anticompetitive effects should be required the lower that that bar is set. Pablo, if the dominance bar and the effects threshold are inconsistent in your view, both set low, which of the two is more important to raise?

Pablo Ibáñez Colomo: Well, I think this builds nicely on what I have just said and on the fact that, after all, the notion of dominance is a filter for conduct is likely to harm the competitive process. Well, if we bear that aspect in mind, it seems to me that what really matters is to establish anticompetitive effects to the requisite legal standard, and we have to redefine the legal standard. And what really matters is to define a structured rule of reason, a structured approach, to make sure that only conduct that is likely to harm the competitive process is prohibited. From this perspective dominance is a more or less reliable instrument. What I gather from the discussion we've had so far is that it is bound to be an imperfect one. The notion of dominance, or the notion of substantial market power, is not well grounded on economic theory. We bear that in mind. I would say that what really matters is the exclusionary effects. The arguments for why I think that we have already been explored to a large extent. I think one of the key aspects is probably the fact that conduct that has a potential to exclude competition is also conduct that leads to efficiency gains most of the time. The practices that have already been mentioned include refusal to supply, loyalty rebates, or exclusive dealing, and all are practices that are known to lead to efficiently gains, whether it's in the short run or in the long run.

Another argument that from a legal perspective is important, I think, and is clearly in favor of emphasizing the importance of showing that negative effects on competition law has to do with the fact that it makes sense to ensure consistency across competition prohibitions. So we are discussing only the abuse of dominance but we have to bear in mind that practices that are caught under Article 102 may also be considered agreements within a meaning of Article 101, Section 1, or similar prohibitions. Practices like tying may also be examined at some point through the lens of merger control. So one question that might arise in the field of merger control is whether the merchant would have the ability and the incentive to eliminate competition through tying. So we bear in mind that like practices are likely to be examined through the lenses of different provisions, and I think it makes sense to devise a threshold of effects in a uniform manner across the whole of these provisions. I think this is one of the areas where more progress would need to be made. So the impression, at least in Europe, is that the threshold of effects in the context of Article 102 in relation to unilateral practices is set at a relatively lower level. So then the question we have to ask is well, do we have compelling reasons to set a relatively lower threshold of effects for unilateral practices.

Well, probably not. Just to mention one case to illustrate why I think it would make sense to raise the threshold of effects or to put an emphasis on restrictive effects, I would mention *Van den Bergh Foods*, which is a case involving exclusive dealing. And the peculiarity of this case is that it was examined both under Article 102, as a unilateral practice, and under Article 101. What's interesting is that, had this case been examined only under Article 102 as a unilateral practice implemented by a dominant firm, the case and the analysis of effects would have been much shorter; the authority would not have been required to show exclusionary effects from competition at all. But because it was also examined under Article 101, the general court and the commission itself went through a lengthy analysis of effects from that perspective. If you bear in mind that all competition authorities should pursue the same objectives, I think it would make sense to place an emphasis on restrictive effects, and if we look at what is done under merger control and what is done under Article 101 on agreements that may restrict competition, the impression that we have is that, under these provisions, the threshold of effects tends to be higher. That would be my take.

Tim Longman: Thanks. I'd like to hear whether the economists on the panel agree with Pablo, starting with Graeme.

Graeme Woodbridge: I might have misinterpreted this question a little bit, but it implied to me that there might be a trade-off here. That is, if the bar for concluding whether a firm has a substantial degree of market power is set low, then the evidence of anticompetitive effects must be greater in order to balance that out so one doesn't make errors or minimizes the errors. Assessing the likely effects of conduct on competition can also inform the question of whether a firm has substantial market power. For instance, inquiry as to whether the conduct is handicapping the ability of rivals to compete on the merits is likely to incorporate an investigation of whether these rivals can avoid the conduct. The analysis that goes to the effects of conduct on competition and the analysis that goes to assessing whether the firms has substantial market power often involve similar inquiries.

Tim Longman: Thanks, Graeme. Roger, do you want to comment briefly on that?

Roger Ware: Sure. So first, I agree with what both Pablo and Graeme said. I think one point that we all know but that has not been made explicitly enough in this call is that competition enforcement in most of our jurisdictions has really changed from a conduct-based framework to an effects-based framework within our lifetimes, in the last 25 years, rather dramatically. Perhaps the change is biggest in Europe, and Pablo is certainly an expert on that. But it's also true in Canada, and I think to some extent in the United States, too. That is a change that underlies all of our case law. When I was harking back to some of those older cases, of course, I did so perhaps a little disingenuously in a sense that those cases—*British Airways* and so on—were decided when the framework was a conduct-based framework and not an effects-based framework. So I guess I would just advocate that we need to (I am now moving to what Graeme was saying) we need to analyze the competitive effects of an individual practice in a particular context and determine whether or not there is harm to consumers as a result of the practice. And if we do that, then we come back to this question of what's the role of dominance in all of this? And this is a point I made in my paper: why have a dominant screen at all? If we're just going to look at individual effects and analyze them, if we do a competitive analysis of each case, then we get back to the question of just economizing the use of resources in competition analysis. And then we want to do our case selection, and that's where we investigate the most egregious, or likely most egregious, practices first. That's when the dominant screen comes in.

THE NOTION OF DOMINANCE AND SUBSTANTIAL MARKET POWER IN COMPETITION LAW

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Meaning of dominance from a legal and an economic standpoint

There is not a fundamental disagreement around the broad idea behind the legal notion of dominance. It is intuitively understood to reflect an instance in which one or several firms enjoy a substantial degree of market power and thus are able to significantly influence the various parameters of competition. The relevant case law in EU competition law, which dates back to the 70s, is compatible with this understanding of the notion.

In *Hoffmann-La Roche*, the European Court of Justice referred to the ability of a firm '*to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers*',[1] which captures the idea of (substantial) market power particularly well. The position taken by the Court in *Hoffmann-La Roche* is in fact relied upon to define the notion of 'Significant Market Power' within the meaning of EU telecommunications regulation.[2]

The practical difficulties entailed by the application of the concept of dominance to individual cases have also been well identified. Part of the difficulty relates to the fact that market power is known to be a matter of degree. It is therefore not surprising that the threshold of dominance varies across jurisdictions. The divergence in approaches taken in the US and the EU is often emphasised to illustrate this variation.

The second difficulty relates to the fact that competition authorities appear to follow a variety of approaches to establish dominance in practice. An analysis of the practice of the European Commission, for instance, reveals that proxies are often relied upon to infer the existence of a position of significant market power. In this sense, the relative robustness of the proxies, and not so much the idea underlying the notion itself, is what often leads to controversies.

These issues become particularly apparent when thinking about the evolution of enforcement in EU competition law, on which this paper focuses. The European Commission approach to unilateral practices gave rise to significant controversy in the late 1990s and early 2000s. Much of the discussion and the commentary related to the definition of the notion of abuse. However, the cases that led the European Commission to reconsider its approach – *British Airways*[3] and *Michelin II*[4] – were controversial, first and foremost, because it was far from clear that the firms held a dominant position on the relevant markets. By the same token, the single most noticeable difference since the

[1] Case 26/76, *Hoffmann-La Roche & Co. AG v Commission*, EU:C:1979:36, para 38: 'The dominant position thus referred to 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 affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers'.

[2] Pursuant to Article 14(2) of the so-called Framework Directive, '[a]n undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers'.

[3] Case C-95/04 P, *British Airways plc v Commission*, EU:C:2007:166.

[4] Case T-203/01, *Manufacture française des pneumatiques Michelin v Commission*, EU:T:2003:250.

Commission issued its Discussion Paper in 2005 has to do with the fact that the issue of dominance is far less controversial in the new cases it has chosen to pursue. In the past decade, the European Commission has focused its enforcement efforts on incumbent operators controlling bottleneck segments in the network industries and on firms with market shares well above 50%.[5]

This note focuses on the lessons that can be learnt from the re-focus of the enforcement priorities of the European Commission since the mid-2000s. I place an emphasis on two of the questions raised: (i) the considerations in calibrating the height of the dominance bar; and (ii) the relationship between the height of the dominance bar and the standard of proof for an abuse.

The use of proxies and the height of the dominance bar

Market shares are only imperfect indicators of the market power enjoyed by a firm. Past experience provides useful indicators of the instances in which dominance is less likely to exist in spite of the strong position – in terms of market share – of one or more players on the market. Such factors include the following:

- ***Firms' position on neighbouring geographic markets***: In *Michelin II*, the Commission concluded that the relevant geographic market was national in scope. As far as France is concerned, Michelin was found to hold a dominant position. An analysis of the case suggests that the relatively large market share of *Michelin II* was not necessarily a reliable indicator of a dominant position, as it faced strong competition from other major tyre manufacturers. Evidence of the constraints placed by these manufacturers was reflected in the decline of Michelin's market share in France over time.
- ***Market expansion***: In *British Airways*, the market share of the incumbent airline had been in consistent decline for a number of years. This factor suggested, as in *Michelin II*, that British Airways did not have the means to influence the parameters of competition in a significant way. In this sense, the structural indicator considered crucial by the European Commission and the EU courts – that British Airways' share was several times larger than that of its rivals – was not a particularly strong one. The practice was implemented in a market that had been opened to competition relatively recently, and that was in expansion. In the same vein, the European Commission concluded that the acquisition of Skype by Microsoft did not create a dominant position on the market for video calls, even though the market share of the merged entity was above 80%.[6]
- ***Unavoidable trading partner***: A dominant firm may be an unavoidable trading partner, or a 'must stock brand'. It is clear, however, that this is not a precondition for a finding of dominance – or at least not in the EU. On the other hand, this concept has played a fundamental role in EU competition law. In *British Airways*, the European Commission assumed that the incumbent airline was an unavoidable trading partner for travel agencies. This is also true of earlier cases, such as *Michelin I*.[7]
- ***Regulatory barriers to entry***: In some cases, a firm may be an unavoidable trading partner as a result of the regulatory barriers to entry that limit access to the market to rivals, and thus

[5] A firm is presumed to be dominant where it holds a market share of 50% or more. See in this sense, Case C-62/86, *AKZO Chemie BV v Commission*, EU:C:1991:286, para 60.
[6] Commission Decision of 7 October 2011, *Microsoft/Skype*, Case COMP/M.6281.
[7] Case 322/81, *NV Nederlandsche Banden Industrie Michelin v Commission*, EU:C:1983:313.

their ability to challenge the position of the incumbent. This factor was given significant weight by the ECJ in *Post Danmark II*, which, at the time of the facts, was the only operator legally entitled to provide services in the so-called reserved sector.[8]

- ***Bottleneck features***: The ability to influence the parameters of competition is greatly enhanced when the relevant market present bottleneck features. This expression is used to refer to markets that have a tendency towards monopoly.
  - *Natural monopoly:* For instance, the relevant market may have natural monopoly features. In such instances, the dominant position tends to be strengthened by the effects of legacy regulation on the position of the incumbent.
  - *Network monopoly:* Since the 1990s, it is well understood that markets that display network effects sometimes have a tendency towards monopoly.
  - *Intellectual property rights* may also act as a bottleneck in some instances (or strengthen the bottleneck features of some markets).

The relationship between the dominance bar and the standard of effects

The question has been framed as one about a trade-off between the level of dominance and the threshold of effects. I would be more inclined to refer to the need to ensure the *consistency* between the dominance bar and the applicable standard of effects. Where the threshold to establish dominance is low, the law should require cogent and convincing evidence of the likely effects of the practice. Where, conversely, the dominance bar is very high, a lover threshold of effects should suffice.

This question points to an inconsistency that characterises EU competition law. At least for some of the practices, the threshold of effects is very low. Exclusive dealing obligations, or loyalty rebates, are prohibited as abusive irrespective of their likely effects on competition. The ECJ assumes that such practices are *capable* of having exclusionary effects. The capability standard is a notoriously low one. It would be sufficient for a claimant or an authority to show, at most, that the exclusion of rivals is a plausible prospect.[9] The General Court (first-instance court in the EU system) held in *Michelin II* that merely establishing that the object of a practice is anticompetitive is sufficient to establish that it is capable of having exclusionary effects. In *Microsoft*, the same court assumed that the prominence enjoyed by Windows was sufficient to assume that the tying of the operating system and Windows Media Player was sufficient to establish anticompetitive foreclosure to the requisite legal standard.[10]

In the EU, this low threshold of effects is combined with a relatively low dominance bar. In *British Airways*, for instance, the incumbent airline's market share was below 40%. The consequence of the observed inconsistency is that the assumption of anticompetitive effects on which EU competition law rests does not capture the reality of markets to which it applies, and fails to acknowledge that some practices are only likely to have a negative effect on competition in a narrow set of circumstances. For instance, it has already been mentioned above that in *British Airways* and *Michelin II* rivals had been able to thrive and gain market share away from the dominant firms.

[8] Case C-23/14, *Post Danmark A/S v Konkurrencerådet*, EU:C:2015:651.
[9] Plausibility in this context is understood to mean that the exclusion of rivals is not contrary to 'logic and experience'. See in this sense Oliver Budzinski & Arndt Christiansen, 'Simulating the (Unilateral) Effects of Mergers: Implications of the Oracle/PeopleSoft Case', available at http://papers.ssrn.com/.
[10] Case T-201/04, *Microsoft Corp. v Commission*, EU:T:2007:289.

The inconsistency between the dominance bar and the threshold of effects has been criticised as problematic from a legal and from an economic standpoint:

- From a legal standpoint, it creates an asymmetry between the dominant firm and the competition authority (or claimant). The dominant firm is not in a position to put forward evidence of the absence of effects, but the competition authority may rely upon evidence of an anticompetitive effect to conclude to the existence of an abuse (and even of a dominant position). The GC has also controversially stated that the absence of exclusionary effects is not to be concluded from the fact that rivals have been able to thrive. According to the GC (which supported the conclusion drawn by the Commission in this sense), rivals could have gained even more market share in the absence of the practice. Some commentators have taken the view that this position comes very close to a *probatio diabolica*.[11]
- From an economic standpoint, the observed inconsistency may have the result that resources are devoted to challenge practices that are unlikely to have negative effects on competition. Evidence from the case law in the EU suggests that, the lower the dominance bar, the more likely it is that the practice is a means to achieve efficiency gains. Massimo Motta, current Chief Economist at DG Comp, concluded that the practices challenged by the Commission in *Michelin II* were plausibly justified on efficiency grounds. In many respects, the restrictions were found to be similar to the restrictions found in selective distribution agreements.[12]

[11] See in this sense Robert O'Donoghue & Jorge Padilla, *The Law and Economics of Article 102 TFEU* (Hart 2013).
[12] Massimo Motta, 'Michelin II: The Treatment of Rebates' in Bruce Lyons (ed), *Cases in European Competition Policy: The Economic Analysis* (CUP 2009).

ECONOMIC AND LEGAL FRAMEWORK ON THE ABUSE OF DOMINANCE

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1. Is a Dominance Test Needed?

Market power is the ability to influence prevailing prices, output, or other characteristics of the market. Several jurisdictions refer to market power and market dominance as synonymous, e.g., Canada (Competition Bureau 2001; 2012). Other jurisdictions may make a special distinction between the two. In European Union law, for example, for a firm to be labelled as "dominant," it must have enough power to prevent effective competition in the market and to behave, to an appreciable extent, independently of its competitors, customers, and consumers (European Commission 2016). While critical for the implementation of antitrust policy (American Bar Association 2012), the distinction will not be important here. The focus of this paper is the abuse of a dominant position – however defined.

The influence of economic analysis in competition law has steadily increased over the past several decades. Firm practices are judged by their economic effects and statutes are judged by their accuracy in capturing the economic effects of anticompetitive practices. As competition law becomes exclusively effects based, why is a dominance test is needed at all? Several jurisdictions have a unique statutory provision assigned to it, such as the "Abuse of Dominance" provisions in Canada. If the economic effects of a particular practice, e.g., predatory pricing or exclusive dealing, are all that matter for competition law, why confuse the issue by requiring that the government first establish "dominance"?

The answer to this question breaks naturally into two parts. First, although it is often said that "market share is neither necessary nor sufficient for market power," a dominance test serves as a highly cost-effective screening tool. Evaluating abuse of dominance cases is challenging, costly, and subject to Type I and Type II errors.[1] This is a good reason for screening out the vast majority of cases where the respondent firm has little or no market power. Accordingly, the screening function is the reason that most jurisdictions require proof of dominance as a necessary first step before proceeding to an investigation, and possibly a prosecution.

Second, the degree of dominance may, in some cases, be an important input to the economic analysis of competitive effects. This forms the analytical basis behind the legal concept that some practices may be legal, and even pro-competitive, for small firms without market power but illegal and anticompetitive for firms that do possess significant market power.

[1] Type I and Type II errors correspond to finding regular competitive practices infringing and failing to find anticompetitive practices as infringing.

Examples could include exclusive dealing contracts, efficiency enhancing for firms with little market power, exclusionary and anti-competitive for firms with significant market power.

2. Abuse of Dominance in Canadian Antitrust Law

A dominant position, in itself, is not a problem under the Canadian *Competition Act*. The antitrust concern occurs with exclusionary practices by a dominant firm that preserve or enhance its dominant position. Examples include raising rivals' costs and predatory product innovation (Church and Ware 1998). Economic theory indicates these practices move the market away from competitive, efficient market allocations: they lead to losses in social welfare. Research attempting to estimate these welfare losses has shown they are potentially large (Baker 2003). This research motivates the need for antitrust regulation.

The Canadian abuse of dominance provisions are in the *Competition Act* Sections 78 and 79. Section 78 lists examples of potentially anticompetitive practices, such as a vertical price squeeze, vertical foreclosure, or predatory pricing. Section 79 (1) states the following:

> Where, on application by the Commissioner, the Tribunal finds that
> (a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,
> (b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and
> (c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,
> the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

Section 79 is narrower in scope than Section 2 of the *Sherman Act* in the United States. The provisions do not suggest attempted monopolization or conspiracy to monopolize are infringing behaviours. They suggest that liability requires market power, if not monopoly (Church and Ware 1998).

The phrase "one or more persons" implies that the abuse provisions could apply to a situation where market power is exercised *jointly* by a small number of firms, as opposed to a single dominant firm. The coordination required amongst firms for the joint abuse of dominance can lead to free-rider problems. Firms must invest resources or engage in activities in which the returns will be enjoyed by the group (Vatiero 2009). Each firm will have the incentive cheat on an agreement, cut prices, and sell more, however. Moreover, the exclusionary abuse of dominance requires member firms to jointly establish contracts that would otherwise be avoided, i.e., contracts that would be inefficient for contracting members (Iacobucci and Winter 2010).

Because of these coordination problems, the regulation of joint abuse differs slightly from a single firm: it could also include facilitating practices. Facilitating practices may increase the probability that cheating is detected or make it easier for firms to coordinate (Church and Ware 1998).[2] Generally, these practices make the cartel more stable or collusion more likely.

The *2001 Enforcement Guidelines on the Abuse of Dominance Provisions* explicitly lists facilitating practices as anti-competitive acts (Competition Bureau 2001). Although draft guidelines in 2009 suggested facilitating practices were no longer an infringement, the current *2012 Enforcement Guidelines on the Abuse of Dominance Provisions* state that "the Bureau considers that certain acts not specifically directed at competitors could still be considered to have an anticompetitive purpose" (Competition Bureau 2012). These revised guidelines provide scope for finding facilitating practices anti-competitive.

Parallel behaviour across firms may be coordinated without an explicit agreement. The 2001 guidelines required "something more than conscious parallelism must exist before the Bureau can reach a conclusion that firms are participating in some of coordinated activities" (Competition Bureau 2011). The 2009 draft guidelines did not refer to explicit coordination in the assessment of joint dominance; the test was based on firms' actions and market conditions only. The 2012 guidelines effectively return back to the 2001 language: "similar or parallel behaviour, in isolation, is insufficient, on its own, for the Bureau to consider those firms to hold a jointly dominant position; firms may engage in similar practices that are pro-competitive, such as matching price reductions or making similar competitive offers to customers" (Competition Bureau 2012).

3. Challenges

It can be difficult to clearly distinguish behaviour that is anticompetitive from behaviour that is procompetitive. This is an important challenge for antitrust law on the abuse of dominance. Consider discounts and rebates, for example. A dominant firm providing discount or rebate schemes to dealers is likely to sell more, and its rivals less. The same can be said of low pricing,

[2] An example is the case *Atlantic Sugar*, in which Redpath posted prices in its lobby. The competitors relied on this information and historical market shares to maintain parallel pricing behaviour.

however. Despite this, there have been a number of abuse of dominance cases decided against firms offering rebates or discounts since they can produce a foreclosure effect (Vickers 2008). Similarly, while long-term contracts can be used to exclude potential entrants, they are also an efficient way to protect the returns on a specific investment – such as when there is uncertainty in the evolution of the economic environment (Iacobucci and Winter 2010).[3]

This difficulty leads to a trade-off in the design of abuse of dominance law, in particular the height of the dominance bar. A higher dominance bar makes it more difficult to find firm behaviour infringing. For example, the monopoly and monopolization provisions under the Canadian *Combines Investigation Act*, a predecessor to the *Competition Act*, contained high hurdles for prosecution. Therefore prosecutions were infrequent and successful prosecutions virtually non-existent (Church and Ware 1998). While a higher bar permits more anticompetitive firm behaviours, it also permits more procompetitive behaviour. Finding the appropriate level at which to set this bar, to balance these two alternatives, is not easy.

Another example of this trade-off is the regulation of parallel behaviour in joint dominance cases. Iacobucci and Winter (2010) argue the 2009 revision of the Canadian draft guidelines was correct: the bureau should not require evidence of explicit coordination. The bureau appears to have used this interpretation in a consent agreement with Waste Services (CA) Inc. and Waste Management of Canada Corp., requiring both firms to stop including exclusivity terms in their contracts with customers. The consent agreement does not refer to coordinated action – market share and the exclusionary effect of the contracts were sufficient on their own for the bureau to take action. Gudofsky et al. (2010), in contrast, argue the broader net cast by the 2009 revision captured too much firm behaviour, some of which would be procompetitive.

Certain industries are particularly challenging for market definition and market power analysis. Among these are industries with networks, in which the value of a product depends in part on the number and nature of other consumers. It is natural for these industries to tend towards dominance since the utility consumers experience increases with the number of others also consuming the good or service. However, a superior technology or service may have difficulty dislodging the dominant incumbent (American Bar Association 2012).

[3] An example of contracts intended to protect returns on a specific investment are "pay for delay" agreements. For example, a generic pharmaceutical manufacturer will acknowledge the patent of the original manufacturer and agrees not to market its generic drug for an agreed upon time period. As a consideration, the generic manufacturer receives a payment from the original manufacturer.

An important recent example of a market exhibiting network effects is the market for search-based and online advertising. The algorithmic results can improve following an increase in end-user searches (Lianos and Motchenkova 2013). Google is the dominant firm in this market. For example, market shares in the United Kingdom of Google, Yahoo, and Bing are 90.8%, 3.2%, and 3.1%. European Commission announced formal antitrust investigations into Google Inc. in late November 2010. Google is alleged to have violated Article 102 in the Treaty on the Functioning of the European Union (TFEU), prohibition on the abuse of a dominant position, by engaging in anti-competitive activities (van Loon 2012).

The European Commission raised four concerns with Google's business practices related to the abuse of dominance:

1. In search results, Google displays links to its own services differently than it does for competitors.
2. Google may be copying material from competitors and using it as their own without authorization.
3. Agreements with advertisers result in *de facto* exclusivity, requiring them to obtain all or most of their requirements of search advertisements from Google – shutting out competing search providers.
4. There is a risk that Google imposes contractual restrictions on software developers that prevent them from offering tools that allow for the easy transfer of search advertising across platforms.

A single dominant search engine can result in excessive pricing for advertisers, and a reduction in the quality of search results – which harms *both* advertisers and users. Moreover, dominance in the search engine market can affect (harm) competition in upstream markets (Lianos and Motchenkova 2013).

The trade-off involved in choosing the height of the dominance bar plays a fundamental role in abuse of dominance law. Vickers (2008) advances three economics-based tests that could be used to distinguish behaviour that distorts and harms competition from normal competition on the merits: the sacrifice test, the as-efficient competitor test, and the consumer harm tests.[4]

[4] A full discussion and description of each test is outside the scope of the present paper. See Vickers (2008) for a discussion of the pros and cons of each.

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Some issues in assessing dominance or substantial market power in a unilateral conduct investigation

Graeme Woodbridge[1]

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The purpose of this note is to comment on a number of issues relevant to assessing whether a firm is dominant or, in the terminology used in Australia, has a substantial degree of market power.

Many jurisdictions prohibit unilateral conduct by firms with substantial market power that prevent or inhibit competition **(misuse of market power)**. Misuse of market power provisions seek to prevent firms with substantial market power from engaging in conduct that prevents other firms from competing on their merits, while ensuring that large or powerful firms are not prevented or discouraged from engaging in fierce competition themselves.

Australia's misuse of market power provisions are captured in section 46 of the *Competition and Consumer Act* (CCA). Under section 46(1),

> A corporation that has a substantial degree of power in a market shall not take advantage of that power in that or any other market for the purpose of:
>
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
>
> (b) preventing the entry of a person into that or any other market; or
>
> (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

The misuse of market power provisions under Australian competition law includes a purpose test. The inquiry is whether a firm with a substantial degree of market power has taken advantage of that power for the **purpose** of damaging a competitor or preventing or deterring competitive conduct. In some other jurisdictions, the test is an effects test. That is, whether the conduct had the effect of preventing or restricting competition.[2]

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[1] Chief Economist of the Australian Competition and Consumer Commission (ACCC). The views expressed in this paper are not necessarily those of the ACCC.

[2] The recent Harper Review of the CCA has recommended to the Australian Government that the Australian law be changed to include an effects test in section 46. The Review recommended that section 46(1) of the CCA be changed to:
A corporation that has a substantial degree of power in a market shall not engage in conduct if the conduct has the purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market.
See *Competition Policy Review, Final Report*, March 2015.
The Australian Government has not yet announced a decision on this recommendation.

Substantial market power as a threshold

It is well recognised that conduct by firms with substantial market power can, in some circumstances, be exclusionary. Exclusionary conduct is conduct that has the effect of preventing or restricting rivals or potential rivals from competing on their merits.[3]

The potential for unilateral conduct to be exclusionary depends on the degree of market power of the firm that engages in the conduct.

Whether or not a firm has substantial market power is a threshold question in investigations of the possible misuse of market power.

While substantial market power is a threshold question, it is not determinative. If the firm engaging in the conduct has substantial market power it does not mean the conduct is exclusionary. It simply means that further investigation is required.

Over capture or under capture of conduct

Determining whether or not conduct by a firm with substantial market power is exclusionary can be difficult. There is scope for error. If the threshold used for substantial market power is set too high some exclusionary conduct may go undetected. If the threshold used for substantial market power is set too low some benign or pro-competitive conduct may be captured.

Both sources of error may adversely affect the incentives to compete. The risk of capturing pro-competitive conduct by large firms is likely to discourage these firms from engaging in some competitive conduct. The risk of failing to capture exclusionary conduct by firms with substantial market power is likely to discourage rivals from ‘taking on’ these firms. Competitive rivalry can be lessened and consumer welfare reduced.

What is meant by market power?

Market power comes from the lack of competitive constraint. A firm with market power is able to act without significant constraint from competitors, potential competitors and customers. As noted by Professor Brunt:

> “Market power is essentially the power of a firm to “administer” its production and selling policies (for example its prices, its service, its capacity, its techniques) somewhat independently of market pressures: it is the extent to which a firm “can give less and charge more” without its market being undermined by rivals’ incursions.[4]

A range of firm and market characteristics can influence the degree of competitive constraint faced by a firm. These include the:

- firm’s share of the market;
- number and size of other firms in the market;
- height of barriers or impediments to other firms expanding their production;

[3] Under section 45 (contracts arrangements or understandings) and section 47 (exclusive dealing) of the CCA the test is whether the conduct has the purpose, or has or is likely to have the effect, of substantially lessening competition. Section 46 (misuse of market power) is an exception to this. The ACCC is of the view that the substantially lessening competition test is effective in distinguishing exclusionary conduct from pro-competitive or benign conduct.

[4] Maureen Brunt, “Market Definition” Issues in Australian and New Zealand Trade Practices Litigation, *Australian Business Law Review*, Volume 18, No.2, April 1990

- height of barriers or impediments to new firms entering the market (including the speed and scale of entry);
- height of barriers to firms exiting the market;
- countervailing power of customers (in particular whether they can 'sponsor' new entry or the expansion of an existing competitor or establish their own production facilities);
- scope for imports of the product;
- degree of product differentiation; and
- size of the costs faced by customers in changing their supplier of the product.

What is meant by substantial market power?

Arguably, most firms have a degree of market power. Typically, firms have some discretion over their selling and production policies. If they raise their price above the price of their rivals, they will not lose all of their customers. While such action may temporarily increase the profits of the firm, any increase in profits will only persist until its customers and rivals react. In such circumstances market power is small and transitory. It is not substantial.

The term substantial market power is open to interpretation. Arguably, it means large or significant, but this does not assist much in practice.

One approach to assessing whether a firm has **substantia**l market power is to ask the question:

> Is the market power of the firm engaging in the conduct sufficient for the conduct to have an exclusionary effect?

Assessing substantial market power using this approach involves considering a misuse market power provision as a whole. The elements of the provision are not segmented.[5] Under this approach substantial market power is not assessed independently from the likely effect of the conduct on competition.

Should the substantial market power bar be set high or low?

Substantial market power is a high threshold. A key issue for a competition enforcement agency is forming a view on whether this threshold is reached. There are no 'hard and fast' rules. Whether or not a firm has the requisite market power to engage in exclusionary conduct depends on the facts of the case. Setting a rule that applies in all circumstances can lead to errors.

A factor that one may wish to take into consideration is how enduring the firm's market power is likely to be. While the firm may currently have a significant degree of market power, if the market is particularly dynamic and there are strong prospects that changes in the market (such as innovation) may undermine this market power in the near future, one may be less inclined to intervene. While the conduct may have an exclusionary effect in the immediate future, these effects may be short-lived.

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[5] The ACCC considers that the elements of substantial market power, take advantage and purpose in section 46 of the CCA should be dealt with in a holistic way. It appears Courts in Australia have moved away from this approach. See ACCC, *Reinvigorating Australia's Competition Policy, Submission to the Competition Policy Review*, 25 June 2014, page 78.

Should there be a market-share safe harbour for substantial market power?

Providing quantifiable guidance as to what may constitute substantial market power can be of value. It can provide businesses with greater certainty over whether their conduct could be captured by a misuse of market power provision and reduce their compliance costs. This can be particularly valuable during the formative years of competition law where there are few, if any, Court or regulatory decisions to provide guidance.

There are also potential advantages for enforcement agencies. Agencies can use this guidance to 'triage' matters and devote their resources to matters that are likely to cause greater competitive harm.

There are broadly two types of guidance, safe harbours (non-rebuttable presumptions) and rebuttable presumptions. In order for a safe harbour to be effective, the criteria or standard:

- must be easy to measure and verify; and
- must not be set so low to only rule out the most obvious of circumstances.

Determining a standard for substantial market power is difficult. The commonly used indicator of market power is market share. The Australian Competition and Consumer Commission (ACCC) does not provide a safe harbour for substantial market power. The ACCC does however use market shares to provide businesses with guidance when deciding whether to notify the ACCC of a merger. This guidance is not a safe harbour. Merger parties are encouraged to notify the ACCC well in advance of completing a merger where both of the following apply:

- the products of the merger parties are either substitutes or complements;
- the merged firm will have a post-merger market share of greater than 20 per cent in the relevant market/s.[6]

Even so, the ACCC states:

> Mergers that fall outside the notification threshold will rarely require investigation by the ACCC. However, the notification threshold is indicative only.[7]

There are three difficulties in using market shares as safe harbours for substantial market power.

The first is defining the dimensions of the relevant market. Typically, the dimensions of a market are open to debate. Yet these boundaries may determine whether a firm falls within or outside a safe harbour.

Moreover, the dimensions of the market may vary depending on the approach to market definition adopted in a jurisdiction. For example, in Australia, the product dimension of a market is defined to include products that consumers see as close substitutes **(demand-side substitutes)** and products that are produced by firms who can readily switch their efforts to produce the product of interest **(supply-side substitutes)**. In other jurisdictions supply-side substitutes are not included in the market. Rather, the constraints from firms producing these products are incorporated in considering entry into the market. Whether or not a firm has substantial market power should be the same under both approaches. However, the market share threshold for a safe harbour should arguably be lower under the former approach.

[6] Australian Competition and Consumer Commission, *Merger Guidelines*, November 2008, p.9

[7] Australian Competition and Consumer Commission, *Merger Guidelines*, November 2008, p.8

The second difficulty is obtaining the most appropriate data to measure market shares. Sometimes this data can be difficult to obtain and provide different answers. For example, market shares by customer numbers may provide different results to market shares by revenue. Moreover, given the dynamic nature of many markets it is often necessary to measure market shares over a period of time.

The third difficulty is setting the appropriate threshold. Market shares are an imprecise measure of market power. As noted above, a range of other factors influence the degree of constraint faced by a firm. Whether these factors are present or not (and to what degree) will affect an appropriate threshold for a safe harbour. If one takes a conservative approach and assumes that few (if any) of these other factors are present, then a safe harbour threshold may be too low to be particularly useful.

Is there a trade-off between the height of the bar for establishing substantial market power and the standard of proof for the abuse of that market power?

As noted above, whether a firm has a substantial degree of market power is a threshold question. However, it does not determine that the conduct is exclusionary. This requires a rigorous investigation of the effects of the conduct on competition. The degree to which a firm may exceed the threshold does not allow the inquiry into whether the conduct is exclusionary to be less rigorous.