ICN Module 4 - Market Power Presented by Terry Calvani and Elizabeth Farina

MR. TERRY CALVANI: Welcome to this, the fourth module in the ICN's introductory curriculum on the fundamentals of competition law. My name is Terry Calvani and I join you from the offices of Freshfields Bruckhaus Deringer in London.

In this module, we'll discuss market power, which is a central concept in both the analysis of unilateral abuse and the assessment of mergers and acquisitions. It can also play an important role in concerted action cases. Accordingly, its importance to competition law generally can not be overestimated.

Well, we have a lot to do and not a lot of time, so let's get under way.

Market power is defined by different courts in different countries in slightly different ways. But, in general, a firm exercises market power when its behavior is not constrained by competition. Market power is most often defined as the ability to price profitably above the competitive level. Indeed, the ability to raise and maintain prices is used as shorthand for the various ways in which market power can be exercised. Thus, a firm exercising market power might not raise its nominal price, but rather eliminate some desired service. Dominance is a high degree of market power, both with respect to the price level and the duration that price can be maintained.

The ICN has published a recommended practice that you might find helpful and which is available on the ICN web site.

Of course, all firms try to price their product so that they can earn a profit. And as a seller, you want to get the best price possible, nothing wrong with that. But it's the responsibility of the competition authority such as your own to ensure that markets remain competitively. After all, competition is a good thing, not only because it ensures efficient allocation of

MR. CALVANI: resources, but also because it provides consumer benefits, including lower prices and better products. Competition alone will generally be capable of disciplining firms that seek to engage in anticompetitive conduct, but which lack market power. Usually customers are able to vote with their feet and to turn to other suppliers in such cases. There markets work effectively and there's no need for competition authorities to intervene.

With market power, however, firms have an opportunity to reap anticompetitive returns. Therefore most competition enforcement agencies devote resources to the investigation of market power and its abuse.

As a case officer, you will likely encounter many assignments where the assessment of market power is a very important task. This module will provide some analytical and investigative tools to assist you with those assignments.

Now that we have a general overview, the next obvious question is how do you determine whether a particular firm has market power? In its survey of unilateral conduct laws, the ICN found that many jurisdictions focus on a firm's appreciable freedom from competitive restraints or its ability to act in ways that a competitively-constrained firm could not.

Let's take a brief look at the laws of two jurisdictions in this regard. Focusing on the EU, the Court of Justice in its 1978 United Brands decision stated that dominance relates to a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers, and ultimately its consumers.

Now some economists have criticized this definition since it seems to suggest that demand curves do not slope downward, but as you know, customers obviously constrain the

MR. CALVANI: pricing of even the strongest monopolist. Perhaps this is why the Court inserted the word "appreciable."

But we're getting off track and this is perhaps too much detail. The point is a dominant firm's conduct is not constrained by competition.

In the United States, for another example, courts have defined substantial market power as the ability to profitably raise prices substantially above the competitive level and to persist in doing so for a significant period of time without erosion by new entry or expansion of incumbents.

That said, these definitions may not help case officers when it comes to the task of actually assessing market power in a particular investigation. As a practical matter, when assessing the existence of market power, it's useful to consider which firms, if any, constrain the ability of the firm at issue to exercise power over price.

Three sources merit our attention. First, one needs to identify the firms that currently operate in the market. Such firms may already constrain anticompetitive conduct.

Now permit me just a short advertisement--for those of you who have not already seen it, I strongly recommend that you view the excellent module regarding the issues surrounding market definition, which is the third in this series, hosted by David Lewis of South Africa and Professor Richard Whish from the UK. See it if you have not already done so.

Well, second, one needs to identify those firms, which would be able to either enter the market or expand their position sufficiently to constrain the ability of the firm or firms from exercising power over price.

And lastly, consider whether buyers constrain seller pricing by virtue of their perceived ability to enter themselves or sponsor new entry.

MR. CALVANI: One very common mistake is to confuse market share with market power. They're not the same thing. And having said that, market share can be a useful tool in your investigation of whether there is market power in a particular case.

But, remember, market shares reflect a static snapshot and they're not necessarily good predictors of the future. For example, you may have a very temporary spike in petrol prices if a hurricane or an earthquake temporarily puts 3 out of 4 competing refineries out of operation for a week. Yet it would be a mistake to characterize the operating firm as dominant based on this episodic event.

There are also markets, for example, where rivalry is such that one firm seems to outdo its competition one season only to be replaced by a competitor the next. The market for children's electronic games was such a market, at least when my kids were growing up. Firm A would be the top dog one season only to completely disappear the next.

So when focusing on market shares, the stability of those shares over time should be observed. Although it would be wrong to assume that a firm with high market shares necessarily has market power, it is nevertheless true that a small market share generally indicates that it is unlikely that a firm would be found to have market power. For this reason, competition authorities might consider using a presumption that firms with small market shares generally do not warrant investigation. Resources for most agencies are, well, let's be honest, they're scarce. Focus your attention on those cases that present a real opportunity for competitive injury.

Well, at this point, we have spent too much time in the office. So let's move across the Irish Sea and look in on the Irish Competition Authority at its Dublin headquarters on Parnell Square.

MR. CALVANI: In this next segment of this module, we'll meet Ms. Carol Boate, a senior official with the Irish Competition Authority who will be meeting with case officers to discuss a complaint the Authority recently received alleging predatory pricing by a manufacturer of carburetor kits for consumer use.

This will be followed by Elizabeth Farina's discussion of the role of entry and expansion when--when, excuse me, evaluating market power. Elizabeth served as president of the Brazilian CADE from 2004 through 2008 and is a professor of economics at the University of Sao Paulo. She is my co-host for this module.

MS. CAROL BOATE: Okay, let's get started. We're here today to look at a complaint from National Carburetor Kits. And, Janet, would you give us a summary of the complaint?

MS. JANET MCCOY: Yeah, National Carburetor Kits is a manufacturer of carburetor kits. They complained that their competitor, Cutting Edge Kits, is engaged in predatory pricing. Essentially they're alleging that Cutting Edge Kits are selling their carburetor kits to consumers at unfairly low prices.

MS. BOATE: Right, do they say what they mean by unfairly low prices?

MS. MCCOY: Yeah, they didn't provide specific data, but they did say that it's not possible that Cutting Edge Kits are selling their carburetor kits to consumers for only EUR 10. They say it's not possible based on their experience to sell carburetor kits for less than EUR 12.

CATHAL HANLEY: And because National needs to sell its kits at at least EUR 12 to break even, this year it has sold 80% fewer kits than last year.

Now carburetor kits are National's main business, so if this continues, they could go out of business altogether. And if that happens, then Cutting Edge can just jack up the price of its kits and consumers will have no choice to pay higher prices.

MS MCCOY: Yeah. And National did supply market share data. And this information comes from the European Automotive Supply Association. And this data shows that Cutting Edge does have a high market share. Now obviously that depends on how you define the market, but looking at the ICN film on market definition, it's quite possible that carburetor kits sold to consumers in Europe is a relevant market.

MS BOATE: Right. I think we should look at this complaint further. We need to remember, though, that National is a competitor of Cutting Edge and so they may have their own strategic reasons for making this complaint to us. For example, it's possible that Cutting Edge are just more efficient or that their input costs are lower than National's. Also we need to think about whether other competitors could enter this industry. Are there high barriers to entry or are there different ways of manufacturing these kits.

MS. FARINA: Our Irish colleague raises an important point regarding entry. As Terry told us earlier, we are not concerned about market share. We are concerned about whether a firm's position in the market is so high that it can set price and output without regard to what competitors do. But if it is easy for someone else to get into the market, the firm can't do that.

That's why it is always important to consider entry and expansion. The Irish case offers a good example. If it is--it's true that Cutting Edge is selling below its cost in order to drive National out of the market, we are not all that worried if it is easy for someone else to come into the market and compete with Cutting Edge. If it is easy to do so, then Cutting Edge won't be able to exercise market power since it will always have to worry about new firms that would come into the market.

QUESTION: Professor Farina, but what about National's complaint about losing sales and potentially being put out of business by Cutting Edge? Should competition agencies be concerned when firms are put out of business?

MS. FARINA: You are right as this analysis won't be much comfort to National, but we have to remember what our job is. We are not here to protect the competitors from each other. There may be lots of reasons why National is having a hard time in competing with Cutting Edge. It may have higher input costs. If it hasn't achieved enough economies of scale, it may be less efficient. Price competition is what we would expect from market rivalry and we have to be very careful to not punish tough competitor for predatory pricing. Our job is to look at the case from the consumer point of view. And in the case of entry, we need to understand how easy it is to get into this market. Then we will turn to an examination of buyer power, which could eliminate market power even if there are significant barriers to entry.

Entry conditions and the capacity of competitors to expand their production are important checks on the ability to exercise market power. Such threats keep market participants on their toes and in danger of losing sales to a new entry.

But it's not always easy for a new firm to enter a market. Obstacles that would prevent a new firm from entering the market are known as entry barriers. One definition that seems to reflect current thought and practice is as follows.

Barriers to entry are structural, institutional, and behavioral conditions that allow established firms to earn economic profits for a significant length of time. There may be more than one barrier. And for that reason the cumulative impact of all barriers in a given market has to be considered in market power assessment.

QUESTION: Given the fact that firms often encounter barriers to entry, how does one determine which firms are likely to enter new markets or expand their businesses into adjacent markets?

MS. FARINA: That's a good question. A number of jurisdictions have addressed entry barriers in the context of merger guidelines. And they are equally useful in new non-merger investigations. The ICN has synthesized the learning of many jurisdictions to develop its recommended practices for merger analysis on entry and expansion. They say that entry is sufficient to forestall the exercise of any incremental market power that a merger would cause if such entry or expansion would be timely, likely, and sufficient in nature, scale, and scope to defeat any price increase resulting from the merger. More generally, ease of entry is deemed a factor that renders the exercise of market power difficult or unlikely.

Let's look at these criteria more closely. First, we look at the likelihood by this we mean that entry is likely to occur if it's profitable for a competitor of the merged entity to expand output and offer potential entrance to enter the market in response to an attempt by the merged entity to profit from the potential reduction in competition brought by the merger such as a post-merger price increase.

QUESTION: So what you're saying here is that it is not just a question of whether it is theoretically possible to enter the market. What we need to know is whether in the real world would someone actually do it?

MS. FARINA: Exactly. Second, we look at timeliness. Entry is timely if it would take place and produce competitive impacts within certain time frame, not just eventually after the merger. The impact of the entrance in the relevant market must be rapid enough that the merger does not significantly harm customers. Two years has been adopted as a useful horizon for

MS. FARINA: antitrust concerns. The appropriate time horizon may vary according to characteristics of the relevant market.

QUESTION: So if it would be profitable to enter, but it would take five years to build a factory and obtain the necessary licenses, does this mean that at some point we just lose confidence that entry would really happen?

MS. FARINA: It's partially that. If entry is too far out on the distant horizon of time, it just becomes too speculative to know what's going to happen in the market. Our crystal ball just isn't that good. But it's also the case that consumers are going to be injured between now and they in truth take place. And there's just a limit to how much injury we're willing to accept.

The third question is sufficiency or the scope of entry. The entry will be deemed sufficient when it allow all sales opportunities to be effectively exploited by potential entrants or smaller rivals. The scope of entry must be large enough in order to constrain the allegedly dominant company to a sufficient extent.

But as the new Horizontal Merger Guidelines adopted by the DOJ and FTC states entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at significant competitive disadvantage.

QUESTION: Okay, so if we look at the Irish case, if the market for carburetor kits is 100,000 units per year, it really is not going to help much if a potential entrant can only produce 500 units per year.

MS. FARINA: Exactly. In order to assess entry conditions, we have to think about what the possible barriers to entry might be. This will differ from market to market, but one way to organize our thinking is to divide them into three broad categories--the structural barriers, institutional barriers, and strategic barriers.

MS. FARINA: The structural barriers are those, which are inherent to the nature of the market. They include things like cost advantages for the incumbents such as the control of important input source, which could make entry unprofitable. Sunk costs such investments in marketing, training, promotional offers, R&D, which cannot be recovered if the firm decides to leave the industry.

By institutional barriers, we mean government regulations that affect entry such as regulations, which limit the number of market participants or impose substantial regulatory approval costs. Intellectual property rights such as patents, trademarks, design, or copyrights are also institutional barriers. Strategic barriers are those that are set up by incumbents that may deter entry such as long-term supply contracts, among others.

Let's return now to join our Irish colleagues in Dublin and see how they work through this problem.

MR. HANLEY: Okay, Janet, putting together the outline of the questions we're going to ask the CEO of Cutting Edge.

MS. MCCOY: Yeah, although I was just looking at Google Maps to get an idea of where Cutting Edge's factory is. And I'm surprised to see how small their factory is, like in comparison to National, it's quite small and surprising considering the amount of, you know, products they manufacture there.

MR. HANLEY: Hm, that's a good point. We must as the CEO about that.

MS. MCCOY: Yeah.

MS. MCCOY: Good morning.

MR. HANLEY: Good afternoon.

MR. CIARAN QUIGLEY: Good morning. How are you?

MS. MCCOY: Good morning, Mr. Quigley. Janet McCoy.

MR. QUIGLEY: Hello, Janet. How are you?

MS. NOREEN MACKEY: I should give you my business card here.

MS. MCCOY: Oh, yes. Here's mine.

MS. MACKEY: Thank you.

MR. QUIGLEY: Thank you. And here's my own.

MR. HANLEY: Okay, good morning, Mr. Quigley. Thank you for taking the time to meet with us today.

MR. QUIGLEY: You're welcome. No problem. We always have time to assist the Irish Competition Authority. As I said earlier on, this is my solicitor, Noreen Mackey.

MS. NOREEN MACKEY: Nice to meet you.

MR. HANLEY: Nice to meet you. Okay, let's get started. Could you give us a bit of background information on your business and the products you manufacture?

MR. QUIGLEY: Sure. We mostly sell carburetor kits to consumers in Ireland. Now as you know, most modern cars don't have carburetors. The carburetor has been replaced by the fuel-injected engine. But nonetheless, there is still is a sizable market for small car parts like the carburetor that we specialize in. And that market is mostly among owners of the older cars, owners who like to maintain and service the cars themselves where they can. And in any event, owners don't like bringing cars to garages anymore because mechanics increasingly are not interested in dealing with cars that they can't plug into a diagnostic computer that tells them what's wrong with the car.

MR. HANLEY: I see. And presumably it'll be a lot more expensive if you did find such a mechanic to do it.

MR. QUIGLEY: Well, exactly. And, in fact, when I founded this company some years ago, I discovered that carburetor kits such as the one that we supply were being sold by companies like National Carburetor Kits Limited, at quite a high price. I did some research and I discovered that it would be relatively easy to source these components from reputable manufacturers in China, import them, and put them into kits here ourselves in Ireland.

So when we created the company, our plan was simply to source the products at a relatively low cost, assemble them in Ireland, and that's the reason why we decided not to manufacture, but rather to assemble and sell.

MR. HANLEY: Okay. We thought you were one of the largest manufacturers of these kits in Ireland.

MR. QUIGLEY: No. As I said, we don't manufacture. It is true that we are one of the biggest sellers of carburetor kits to consumers in Ireland. And--but as I said, our model is simply to source the components for the kit. And I've brought some kits along with me. And we source the kits from manufacturers in China. And we sell them on to our customers.

MR. HANLEY: Okay - - Can I have a look at that please?

MS. MCCOY: So that explains why your factory is quite small then?

MR. QUIGLEY: No. It's a small factory, but it's fit for purpose. And I brought along some plans of our factory, from which you will see that basically our 20 employees sit around their own tables. And on those tables they have what are called Lazy Susans, which is in effect a rotating table. All of the components are on those tables. And for whatever kit that we're manufacturing on that day, our employees simply take the components that the need, components like these, they put them into these boxes. Included are very helpful instructions as to how to replace the components on your carburetor. And we package them and sell them out.

MR. HANLEY: So essentially your employees in Ireland just assemble the kits?

MR. QUIGLEY: That's it. And as I say, our business model is very low cost and we're able to then pass those savings on to our consumers.

MR. HANLEY: That's exactly the point we want to get to. In terms of cost, would you have any figures that you'd be willing to show us?

MS. MACKEY: Just before we hand over anything, we'd like to be assured that these will not be passed on to any third party outside of the Competition Authority and in particular that they will not be given to our competitor, National.

MR. HANLEY: Well, we can assure you that any information you give us today will not be made public and we certainly will not divulge it to your competitors.

MS. MACKEY: Okay, well, that's fine then.

MR. QUIGLEY: And, okay, so there are some spreadsheets on our costs.

MR. HANLEY: Thank you very much. So these are the manufacturing costs on the left. And then down below, this would be more to do with the assembly here in Ireland. Is that correct?

MR. QUIGLEY: Yes. And then the column on the right-hand side you'll see what we actually retail at.

MR. HANLEY: Uh-huh.

MS. MACKEY: Oh, that's great.

MR. HANLEY: But this has been very helpful. Thank you so much for taking the time to meet with us today. And if we require any additional information, we will be in contact.

MR. QUIGLEY: Okay, well, as I said at the start, we're always very happy to help the Irish Competition Authority.

MS. MACKEY: So please let us know if there's anything else we can do to help you.

MR. HANLEY: Okay, thank you very much.

MS. MCCOY: God, that was really interesting. I didn't realize they ran their business that way.

MR. HANLEY: Yeah, no wonder Cutting Edge is able to price its carburetors so low. This is exactly the kind of competition that leads to lower prices for consumers.

MS. MCCOY: Exactly. And there doesn't appear to be any barriers to entry. Anybody could enter the market.

MR. HANLEY: Yeah, that's true.

FEMALE VOICE: Yeah.

MR. CALVANI: This episode from the Irish Competition Authority demonstrates the importance, indeed, the very crucial importance of examining entry conditions in each and every case where market power is at issue. As an aside, I might just mention that the case bears an uncanny resemblance to a case that was actually adjudicated by the United States Federal Trade Commission when I was commissioner back in the 1980s.

Now while this particular fact scenario involved entry conditions, let's not forget that expansion by fringe firms can also impact market power.

At this point, we return to Brazil and my colleague, Elizabeth Farina, who will be discussing buyer power and other aspects of gathering evidence.

MS. FARINA: We have learned so far that market positions and market behaviors of competitors are important to assess market power. The ability of firms to charge high prices also depends on the reaction of buyers, especially if they are large enough to put constraints on their

MS. FARINA: suppliers' strategies. So buyer power is another important constraint to be considered in the analysis of the exercise of dominance or market power.

QUESTION: I thought that we assessed market power by looking at other sellers in the market. What do buyers have to do with the assessment of sellers' market power?

MS. FARINA: Well, a strong buyer can make use of its bargaining power to assimilate the competition among sellers. One buyer is partially integrated and produces itself part of the input it needs. It can switch to internal production. Moreover, the buyer will have information about the cost of production, which can be useful in price negotiations. The buyer's market position tell us something about the extent to which they are likely to constrain the dominant undertaking. However, a high level of concentration of firms on the buyer side of the market is not itself sufficient to disprove the market dominance of a supplier. To effectively constrain market power, it must be profitable for the buyer to award its contracts according to market strategic considerations so as not to become dependent on a dominant supplier. Thus a buyer might be in a position to trigger or sponsor new entry or expansion by another supplier. For instance, through a long-term contract without incurring excessive switching costs.

QUESTION: It sounds like we are looking for evidence that the buyer is able to dictate terms to the seller rather than the other way around. But what exactly are we looking for?

MS. FARINA: Good question. In order to assess if buyer power should be considered as a mitigating effect of dominant positions, we need to analyze several factors. The buyer typically needs to be well-informed about alterative supply. Does the buyer face switching costs, which make the exercise power unprofitable? Powerful buyers may constrain the ability of the seller to raise prices if, for example, they can vertically integrate upstream or sponsor entry or if their conduct undermines coordinated effects. But it only takes us so far to understand the big

MS. FARINA: picture we are trying to see. We also need real evidence that we can use to convince a tribunal or a court or a manager that market power exists. So let us turn to how we would gather this evidence.

Evidence may be either direct or indirect evidence. The basic questions, which the ICN will address in other modules in the series, is to ask yourself who would be in a position to answer this question? This will vary from case to case. But typical evidence we will include internal documents, interviews with customers and competitors, analysis of economic data, and the direct evidence of market outcomes.

Internal documents can be very helpful in order to show how the firm itself views its likely ability to exercise market power. Some of the most useful documents will be the ones that were prepared for the firm's management and directors about the likely impact. Another important group of documents are those that were prepared for the benefit of prospective financiers. If you see documents that say things like after these transactions, we will be able to control the markets or we will eliminate price competition, we should be able to raise our prices by 10%, that will at least tell you that the firm might not consider buyer power to be an important factor. On the other hand, if the documents say things like we will let -- this will let us become more efficient so that we can continue to sell to the major buyer is in the industry, that will tell you a very different story.

Some agencies believe that evidence of profit and price levels are useful for assessing market power. Others are skeptical. High prices or profits alone may have other explanations that have nothing to do with market power. They may represent a return on previous innovation or result from changing demand conditions and thus may be consistent with a competitive

MS. FARINA: market. Any such evidence must be assessed carefully and skeptically and would in any case require very strong econometric analysis.

Interviews with customers could be of a great help to evaluate whether the market has characteristics of dominance or substantial market power. After all, a reasonably-sophisticated customer will know the market it operates in best.

So let's move to the headquarters of the Brazilian Competition Authority in Brazilia. In this next segment, we will meet Commissioner Olavo Chinaglia from CADE, the Brazilian Antitrust Tribunal, who is conducting along with his staff of case handlers a different investigation of a proposed merger between two clinical analysis laboratories. The staff is interviewing a customer of one of the merger firms. Market power is an issue and the interview may provide an indirect evidence of the market power. The case officers are conducting buyer power as a mitigating effect of the post-merger increase in market power.

MR. OLAVO CHINAGLIA: Well Deborah, the purpose of this meeting is to try to assess the effect of this merger between Atlas and LabNet.

MS. DEBORAH CAIXETA: Well, I understand that. We'll see what they have to say.

MR. CHINAGLIA: Okay, well--

MS. CAIXETA: So can I--

MR. CHINAGLIA: You can ask them to come in, please.

MS. CAIXETA: How are you?

MS. LAGO: I'm fine.

MS. CAIXETA: Good morning.

MS. HOFFMAN: Good morning.

MR. CHINAGLIA: Nice to meet you.

FEMALE VOICE: And nice to meet you.

MR. CHINAGLIA: Once again, thank you very much for your time and consideration. The purpose with this meeting is to discuss some of the potential effects of the merger between LabNet Corp. and Atlas Corp., which is, you know, the third and the fourth-biggest labs of clinical analysis in Brazil.

MS. CAIXETA: Indeed, Mr. Chinaglia, and if I may add, as a result of the merger, the companies will become the leader in most of the relevant markets.

MR. CHINAGLIA: Well, this is absolutely correct. Specifically we would like receiving some input on how laboratories interact with their corporate clients such as health insurance companies. For instance, what are the critical factors in the determination of prices and what do they present as advantages to convince their clients to enter into an agreement?

MS. ANDREA HOFFMAN: Perfect, Mr. Chinaglia. Your concerns are perfectly understandable and we are happy to provide you and the competition agency this assistance. I believe we could start with Ms. Lago who has a vast and deep knowledge of these industries.

MS. LAGO: Well, thank you, Andrea. Well, Mr. Chinaglia and Mrs. Caixeta let me start by talking a little bit about the health insurance industry in general and health insurance in corporation in particular.

Health insurance in corporations negotiate their price with the operation in all Brazilian territory. Building on 70 years of experience, we provide a range of products and services to meet our private medical and health plans' needs. Basically we offer two kinds of health plans, individual plans and group plans. In the first one, a consumer who hire us directly to get health plans and medical insurance to them or their employees and the first kind of company or association hire us directly to get to their employees and associates.

MS. CAIXETA: But is there any difference between these individual plans and group plans from the beneficiaries' point of view?

MS. HOFFMAN: Actually, yes Ms. Caixeta, Brazilian law prohibits the imposition of a grace period and a temporary partial coverage in group plans. Thus, the consumer has access to all of the hired service from the beginning of the contract. In contrast, the recipient of the individual or family plan is usually subjected to a waiting period. They can't access certain healthcare services.

The clients of group plans are more attractive for us since they represent greater amount of resources than the individual contractors.

MS. CAIXETA: And what kind of service do your health plans offer?

MS. LAGO: Well, the services are basically divided in two groups, medical/hospital service and support services to diagnostics. The services provided by laboratories are in the latter category. So we offer to our to our clients several types of health plans for in terms of the coverage, county, state, country, available to servicing network, and level of coverage offered into individual home care, et cetera.

Importantly, we needed to obey the mandate of regulatory agents that set a list of mandatory procedures in health insurance. So this requirement is to ensure that the consumer will have under circumstances the minimum necessary to ensure adequate healthcare.

MR. CHINAGLIA: What is your perception about the function of the market of support services for medical diagnostics, which are provided by laboratories?

MS. HOFFMAN: The majority of revenue of the laboratories comes from the contracts with health plans. Patients who undergo diagnostics tests are usually associated with a health plan or are under treatment in public hospitals. Only a small part of them purchase these services

MS. HOFFMAN: in their private capacity. We estimate that over 90% of the customers of laboratories are insured health plans. Those consumers do not pay directly to consultations, examinations, or hospitalizations. The laboratories and hospitals negotiate directly with operators' plans, which is paid by the beneficiary on payment of premium or annuities.

MS. CAIXETA: Mrs. Lago, which factors affect the negotiation between health insurance corporation and the laboratories?

MS. LAGO: Well, the most important factors affecting the negotiation are the coverage will be given to the laboratory service, the price by the laboratory, the existence of alternative laboratories in the region, and viable quality in addition to amount payable, the laboratory also involves negotiation of condition under which these payments will be made payments, terms, clauses and et cetera.

MS. CAIXETA: Mrs. Hoffman, how is this negotiated?

MS. HOFFMAN: Well, normally the insurance companies establish unilaterally the terms and conditions for assistance to the beneficiaries of the health plans. The pricing is based on reference tables. These reference tables were historically created to facilitate the description of many existing procedures, different examinations, consultations, surgeries, and costs, as well as assigning a reference value or a coefficient value commonly called coefficient of fees.

MR. CHINAGLIA: Well, what happens if the laboratory does not accept a suggested price or contract terms that you have set?

MS. LAGO: Well, if we haven't reached an agreement on the price, the laboratory isn't accredited. So, of course, we can bargain the offer in each region. So, for example, we not always accredit all units of the laboratory networks. We can choose not to accredit all service to all units. So but the laboratories are usually interested in doing business because our customer

MS. LAGO: base is quite expansive so our company seeks to accredit all of the laboratories with excellent reputation because we know that this is a draw to for our customers. Often people seek health plan to be able to do routine examinations certainly, less costly than the treatments acute and chronic diseases.

MR. CHINAGLIA: But, well, getting down to the very bottom of this meeting, what is your impression about the merger between LabNet Corp. and Atlas Corp.?

MS. HOFFMAN: Commissioner, although our company is not opposed to the natural movements of the market such as acquisitions and mergers in the industry, we must express our concern over this operation. This is no doubt that this process will lead to a situation of market concentration, extremely detrimental to free competition and to consumers themselves. So it's crucial that CADE monitors closely not only this merger between LabNet Corp. and Atlas Corp., but any transaction of equal relevance in this sector.

Our companies fall within the industry of clinical analysis labs and there is according to our perception a clear movement towards concentration, which must be scrutinized by competition authorities.

MS. CAIXETA: Well Ms. Lago, may this operation affect negatively the activity of your company?

MS. LAGO: Ms. Caixeta, so actually as we are a larger-size health company insurance or health insurance company, as we can easily cope with the market power of the laboratories. So since our business are indefinite my company would prevent laboratories to raise their price to us because we can offer a billing scale in exchange for lower prices. We believe that any market power they acquire with this operation will not affect major health insurance companies. It means that major health insurance company as we are, we can make use of countervailing

MS. LAGO: power to persuade laboratories to reduce their price, in other words, to offset market power by buying power. On the other hand, small business may suffer a negative consequence because they could not use the same technique as the small business are not able to deliver gains in a scale to laboratories. The laboratories can impose them higher prices. So it means that laboratories would have great bargaining power with these small businesses.

MR. CHINAGLIA: You see, Deborah, this is really important. The fact of the matter would be different if the customer may have or may not have countervailing market power. But this is something they'll have to discuss.

Thank you all very much. Your assistance in this matter was really helpful.

MS. LAGO: You're welcome. It's a pleasure cooperating in this case.

MR. CHINAGLIA: Nice to meet you. Thanks again.

MS. LAGO: Thank you, Ms. Caixeta.

MS. FARINA: Interviews with competitors bring important evidence on market power as well. Competitors have a rich understanding of the market and they will usually have thought about how they might react to a transaction that could strengthen another firm could position in the market. However, we have to approach competitors with a measure of caution. They do have incentives to behave strategically when dealing with competition authorities. For example, a competitor may have incentives to overstate facts that would support the existence of market power in the hopes that the competition agency will take action that would disadvantage its competitors. In the Irish case, for example, National may well have come to the antitrust agency not to make sure that competition is fair, but in the hope that the Irish authority will handcuff Cutting Edge in some way. That doesn't mean we don't talk to them, but we have to take those incentives into account.

MS. FARINA: With that in mind, some of the questions we might ask the competitors to assess substantial market power might include the following.

If the merged firm raises its product price between 5% and 10% in a permanent basis, have you enough capacity production to supply the market? How long would be necessary to increase your supply? Is it easy to expand your market share in a situation like that? If the merged firm raises prices between 5% and 10% on a permanent basis, do you think other producers in other regions could deviate their production to attend to the market that suffered the price increase? In the same circumstances, would new firms enter the market? How quickly? In what extent? In your view, would the merger proposal have a negative impact at your business? If any, given an explanation and examples, would the merger proposal limit the ability of suppliers to complete? Would the new entity have the ability to foreclose the market? How?

Would the new entity have the incentive and the ability to refuse to supply an important input? Why? How can it do that? How easy or difficult is the entrance of new suppliers? Questions regarding the history of recent entry can help you very much. Internal documents and information collected with customers and the competitors provide a rich source of knowledge on the market's behavior.

However, as I have mentioned, competitors can act strategically. If you have the ability to analyze it, economic analysis of quantitative information can help to check the views of competitors and customers. Econometric analysis would be an important complementary tool to more qualitative studies. Methods as demand estimation, simulation, analysis of price correlations and concentration can help the decision-maker to better evaluate the likely effect of a merger or the expected effects of a particular conduct.

MS. FARINA: Quantitative economic analysis can be a useful tool, but it's not going to fit every situation. Obviously you have to be able to assess good data. If the data is out of date, biased, or wrong, the analysis will be, too. And you need to have well-trained economists who have the capability of performing the analysis.

How that is done is more than we can accomplish today. But we hope to have a module on that in the future.

With that caution, estimated price elasticities can help the analysts predict which much-- with much greater accuracy whether incentives to raise price after a merger, for example, are substantial or negligible. Demand analysis may enable an economist to infer not only that a set of goods are substitutes, but also to infer what volumes of sales will switch from product X to products Y, even say a specific price increase for product X.

Much of what we've discussed up until now has been about techniques that we might use to predict whether a firm will be able to exercise market power, but sometimes that's not necessary. Proof of actual detrimental effects can confirm the existence of market power and obviate the need for a close examination. The 1986 US FTC v. Indiana Federation of Dentists case is a good example.

MR. CALVANI: Thank you, Elizabeth. Next we return to Washington, DC where we see Hiram Andrews, formerly of the United States Antitrust Modernization Commission and currently an associate at Freshfields entering the headquarters of the US FTC. Hiram will be speaking with David Shonka of the Federal Trade Commission about the Indiana Federation of Dentists case and about the use of direct evidence in assessing market power.

MR. HIRAM ANDREWS: Thank you, Terry. I'm here with David Shonka, the principal deputy general counsel of the Federal Trade Commission. David joined the General Counsel

MR. ANDREWS: office in 1977 and has held numerous positions, including that of acting general counsel. David has tried, briefed, or argued several major cases for the FTC, including the Indiana Federation of Dentists case, which we'll be discussing today and that was litigated in the 1980s.

So, first, thank you for spending time with us today and discussing this case.

MR. DAVID SHONKA: Well, thank you very much. It's an honor actually to be here and to be asked to discuss this case.

MR. ANDREWS: So before we talk about the role of market power in the Federal Trade Commission's case against the Indiana Federation of Dentists, would you mind providing a brief description of what this case was about?

MR. SHONKA: Sure. In the early 1970s, dental health insurers became concerned about the rising costs of dental care. In order to contain that cost, they began to ask that dentists submit copies of dental--existing dental x-rays along with the claim forms. The dentists objected to this, thinking it was an intrusion on the patient/doctor relationship. And in the State of Indiana, there was a trade association of dentists, the Indiana Dental Association. The IDA organized a boycott among the independent dentists, the competing dentists in Indiana.

MR. ANDREWS: And so these were dentists that were actually competing against each other for patients and providing services to patients?

MR. SHONKA: Yes, the trade association, like any trade guild, consisted of doctors who were competitors, otherwise independent. The dental association organized a boycott whereby the dentists, most--nearly all of the dentists in Indiana agreed not to submit the requested x-rays. Now under the American antitrust laws, a boycott among horizontal competitors like that would be illegal. And in 1975, the United States Supreme Court issued a decision in Virginia v.

MR. SHONKA: Goldfarb in which it found for the first time, held for the first time that professionals, doctors and lawyers, are subject to the antitrust laws the same way that every other industry is in this country.

At that point, the IDA became concerned about its liability for violating the antitrust laws and began to cool toward the idea of the boycott. There was, however, a group of dentists in Indiana who were diehards about this and felt that they should persist in the boycott no matter what. And so they organized another group, the Indiana Federation of Dentists, yeah, which continued the boycott in three counties, three areas of the state, and where they were organized, they were--they actually represented most of the dentists.

MR. ANDREWS: So I understand this case ultimately went to the Supreme Court. Could you provie a brief overview of how it actually got there?

MR. SHONKA: Yes. The FTC challenged both the Indiana Federation of Dentists and the dental association. And the IDA promptly settled the case. But IFD continued to litigate. The Commission ultimately found that the IFD had continued a boycott that had started--had begun with--IDA had begun and they continued the boycott and this continuation of boycott was illegal, a violation of the antitrust laws.

The IFD appealed the case to the Seventh Circuit, to one of our courts of appeals. And the Seventh Circuit reversed. It found that the FTC had not proven a market and therefore no market power, of course, and that there was no showing of any anticompetitive effects in the boycott.

Now at this point, the Commission had two choices, appeal or not. It asked the Solicitor General of the United States, who is the gatekeeper of all federal agencies to the Supreme Court, to take the case up for review. He refused for a variety of reasons. And so the Commission went

MR. SHONKA: alone and for the first time in its history the Commission went the Supreme Court, asked them to take it. And they did it.

MR. ANDREWS: So what happened when the case was heard by the Supreme Court?

MR. SHONKA: Well, after briefing and argument, the Court reversed the Seventh Circuit and reinstated the Commission's decision affirming the Commission's finding that there has been an antitrust violation.

MR. ANDREWS: And now how did the Supreme Court deal with the issue of market power if the Court of Appeals, in fact, held that IDF did not have market power?

MR. SHONKA: Well, actually the Court approached this two ways. First of all, it said that what was involved in this case was an agreement among horizontal competitors, competing dentists, that their conduct was inherently likely to cause problems in--with competition because they were withholding a service that other people wanted, namely the dental x-rays, the provision of dental x-rays, and that absent some procompetitive justification, that conduct could be condemned outright without further analysis.

The Court next turned to the Seventh Circuit's market analysis and squarely rejected it. And what it said was that in this record there is ample evidence of anticompetitive effects, that the dental association and the communities where existed where it did business undoubtedly had denied x-rays and had, in fact, imposed a burden by withholding a service that people wanted, the provision of x-rays and given the proven anticompetitive effects that was really enough absent an offsetting procompetitive justification--

MR. ANDREWS: And so they really didn't even have to get into the details of the market power?

MR. SHONKA: Exactly. What the Court said is that given the proven anticompetitive effects, there is no need to get into an elaborate market analysis or an elaborate antitrust analysis or anything else. The effects were proven. They were anticompetitive effects and that was enough. After all, the, and I think that the Court observed that market power and market definition are merely surrogates in any event for anticompetitive effects. And if you have effects, you don't need to prove the other. If you have a market, then you can - - for effects in some cases.

MR. ANDREWS: So has the FTC used the approach outlined in the Supreme Court in the IFD decision? And in what types of cases would the IFD analysis be most appropriate?

MR. SHONKA: The Commission has used the case, the IFD approach, a few times. Most notably I think is probably in the Three Tenors case, which involved an agreement by joint venturers to limit competition beyond the scope of the joint venture.

In terms of where it would be most appropriate, I think probably there are really two situations where this works best. One is, again, as the Supreme Court said where you have an agreement among horizontal competitors who are engaged in conduct that is inherently problematic and where they offer no procompetitive justification. Under the IFD decision, that conduct might be condemned outright.

The other situation probably is where you may have conduct that is questionable, but the anticompetitive effects are clear, where they're manifest. And then in that case, there's probably no reason to get into market power and the details of market definition and so on unless, of course, the party has posed a procompetitive efficiencies that would offset any anticompetitive harm.

And I think those two situations are probably best-suited for this type of a case.

MR. ANDREWS: So I guess my last question is were there any lessons, other lessons learned from this case in how the FTC proved its case?

MR. SHONKA: Yes, there are two takeaways I think, two principal big-picture takeaways.

The first is that antitrust analysis is about effects. It's not about market definition. It's not about analysis of market power. It's not econometrics and cost elasticities and all of the details that go into defining a market. It's about effects. And if you prove effects, anticompetitive effects, you've basically proven an antitrust case. That's the first thing I think that comes away from this.

And the second thing is is the Court has recognized that there is a mode of analysis between categorical condemnations that exist under the per se rule and the hopelessly complicated and detailed and exhausting analysis that so often characterized the full blown rule of reason, that there is a middle ground, that there is if you will a continuum or an approach between the two, a middle ground for deciding antitrust cases.

And in the end, when you think about it, there are earlier cases. There are many earlier cases that said much what IFD says. There's NCAA, which recognizes that some, you know, agreements can be condemned and you--in accordance with that case in the twinkling of an eye.

There are some cases that can be readily condemned. There is the professional engineers, which also recognized that not all justifications and that there has to be solid economic justifications to support an antitrust violation to offset anticompetitive harm. And then there's Goldfarb, which, of course, recognized that the professions are subject to the antitrust laws just as any other profession is.

MR. SHONKA: You know, what IFD did was bring all of these together in one place and reinforce those principles.

MR. ANDREWS: Great. Well, thank you so much for your time today and your insightful thoughts.

MR. CALVANI: Thank you, David and Hiram. Next we travel back to Brazil where we'll hear more about presumptions and safe harbors relating to market power from Elizabeth Farina and Fabiana Tito. Fabiana is a senior economist at Tendencias Consultoria Integrata in Brazil.

MS. TITO: You, and Professor Calvani have shown that market share is not enough to prove market power. However, many jurisdictions adopt market share as a presumption of market power and dominance in merger case, as a safe harbor in case. Why is that? When I worked for the economic department at the Secretariat of Economic Law in Brazil, you used to discuss the usefulness of the market share as a presumption of market power as provided by the Brazilian competition law. The 20% market share threshold is one of the criteria to mandatory notification of mergers to the Brazilian competition system and it is a presumption of market power for anticompetitive investigations and decisions as well.

MS. FARINA: You raise an important issue. Though market share does have a direct correspondence to market power, it can inform a decision-maker as to whether a given case is more likely to raise competitive issues, thus leading the inquiry in the right direction. Therefore the limited resources of the Competition Authority will be saved. The provision of safer harbors based on previously-established market shares brings some predictability to the parties, though one must still define the market properly. But most importantly, the exercise of market power absent of some significant market share is unlikely. The benefits of safe harbors have to be

MS. FARINA: weighted against their risks, in particular potential overemphasis on market shares and thus potential enforcement errors.

Say, for example, ICN recommended practices on assessment of dominance in determining an appropriate market share threshold for use as an indicator of dominance or substantial market power. The benefits such as increased enforcement efficiency and legal certainty, especially for businesses, should be weighted against the risks, including the potential for overemphasizing market shares and thus potential enforcement errors.

MS. TITO: So we should avoid our irrefutable presumption of market power based on the market share?

MS. FARINA: That's right. It's important to bear in mind that the higher market shares are not necessarily proof of substantial market power.

As we mentioned before, any presumed correlation between high shares and market power will depend on how competitors or customers can react when a firm restricts output, the reasons why the firm maintained its high market shares, and whether there are any other conditions that limit the firm's ability to profitably raise prices.

These factors may ultimately become more relevant than market shares in establishing substantial market power. High market share alone should therefore not be conclusive proof that a firm has substantial market power.

MR. CALVANI: Thank you, Elizabeth. In this module, we have sought to examine how a case officer might go about looking at whether a firm or firms has market power. We noted its use in virtually all kinds of competition law cases with particular importance in merger investigations and also in cases with allegations of abuse of dominance.

MR. CALVANI: Very briefly, we explored some operational definitions. Then we discussed three sources that might constrain the exercise of power over price, firstly, current market participants, secondly, entry and/or expansion, and lastly, buyer power.

We learned that while market share may be a useful tool in your investigation, it's not the same thing as market power. We also explored sources of information that are useful when confronted with a real case. And lastly, we considered when direct evidence can provide a shortcut to our analysis.

I want to thank my co-host, Elizabeth Farina, for agreeing to join me in this endeavor, and to extend our joint appreciation to our colleagues at the Irish Competition Authority in Dublin, CADE in Brazil, and the Federal Trade Commission in Washington, DC, and to thank you, ladies and gentlemen, for joining us today. We hope it's been helpful.