

Countervailing Buyer Power

Lars Henriksson

Professor of Law, LL.D., M.Sc., BA & Econ



*54·43. $\vdash : \alpha, \beta \in 1 . \supset : \alpha \cap \beta = \Lambda . \equiv . \alpha \cup \beta \in 2$

Dem.

$\vdash . *54·26 . \supset \vdash : \alpha = \iota'x . \beta = \iota'y . \supset : \alpha \cup \beta \in 2 . \equiv . x \neq y .$

[*51·231]

$\equiv . \iota'x \cap \iota'y = \Lambda .$

[*13·12]

$\equiv . \alpha \cap \beta = \Lambda \quad (1)$

$\vdash . (1) . *11·11·35 . \supset$

$\vdash : (\exists x, y) . \alpha = \iota'x . \beta = \iota'y . \supset : \alpha \cup \beta \in 2 . \equiv . \alpha \cap \beta = \Lambda \quad (2)$

$\vdash . (2) . *11·54 . *52·1 . \supset \vdash . \text{Prop}$

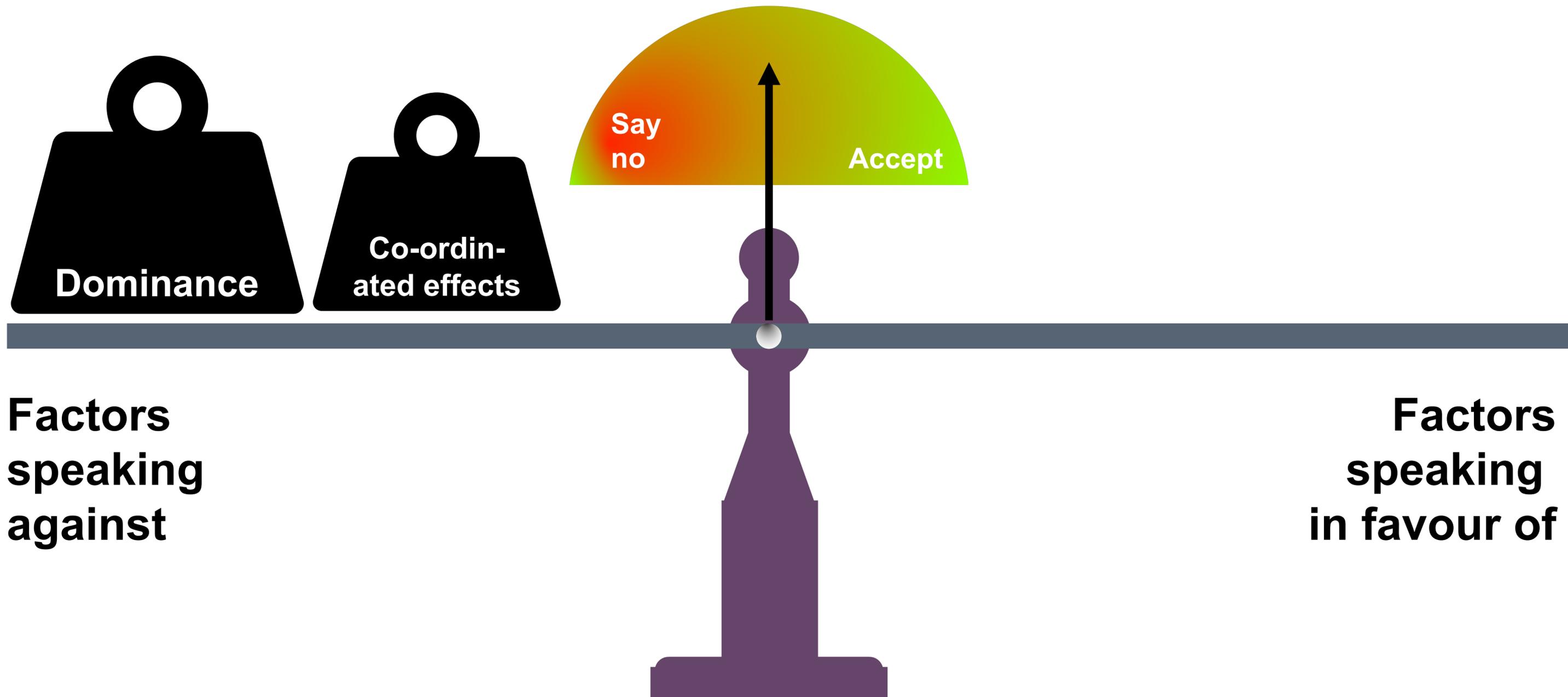
From this proposition it will follow, when arithmetical addition has been defined, that $1 + 1 = 2$.

Concentrations and counterweights

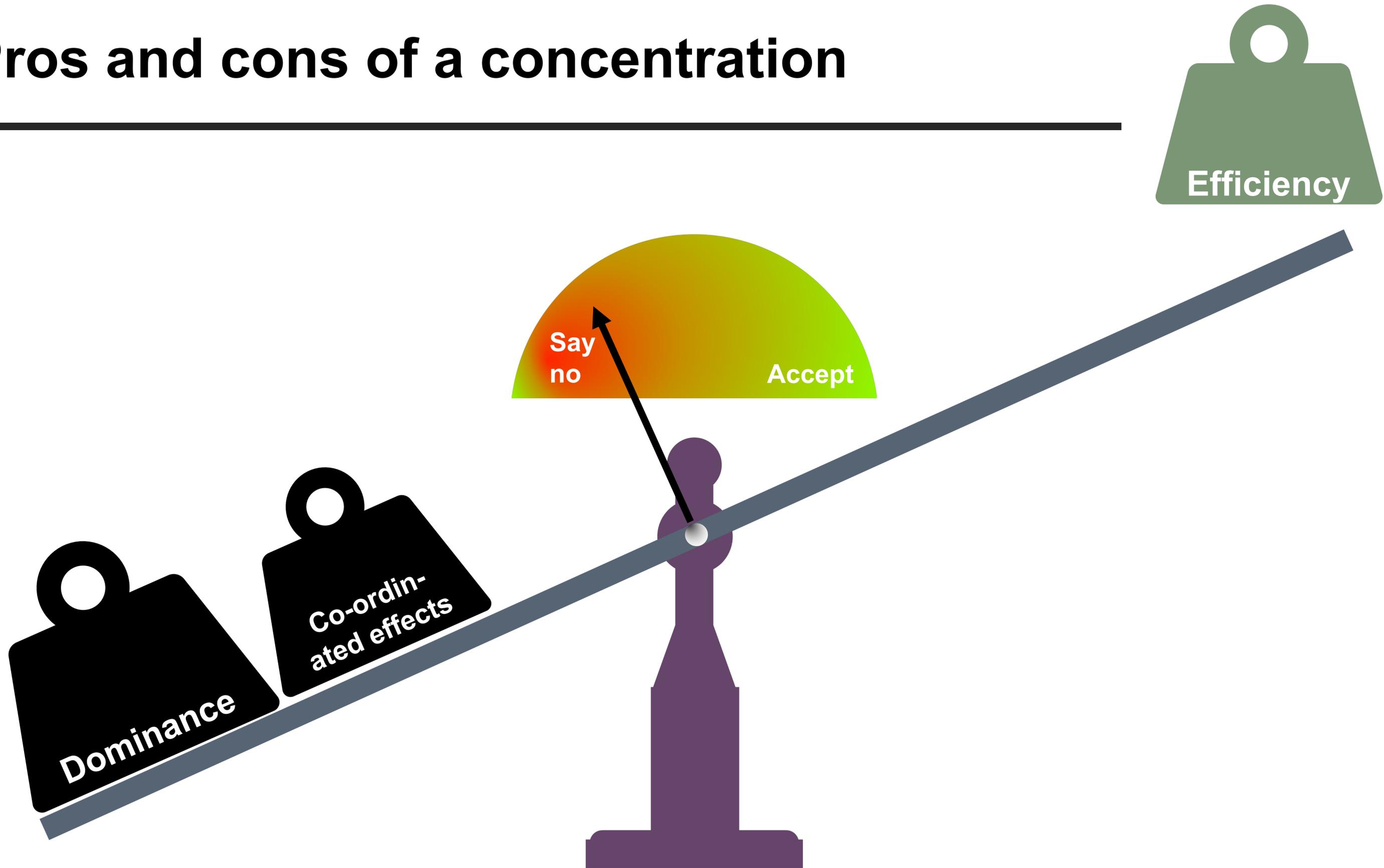
- **How shall countervailing buyer power be assessed within the ambit of concentrations?**
- **Who shall make references?**
 - Ex officio?
 - Undertakings, to some extent Commission/NCAs
- **What to analyse?**
 - What is buyer power?
 - How and when does it arise?
 - What casual links exist?
 - "Never mistake correlation for causality..."
 - Cf Dreber, Johannesson m.fl. (2015, 2018)
 - **What effects does it bring about?**
 - Presumptions possible?



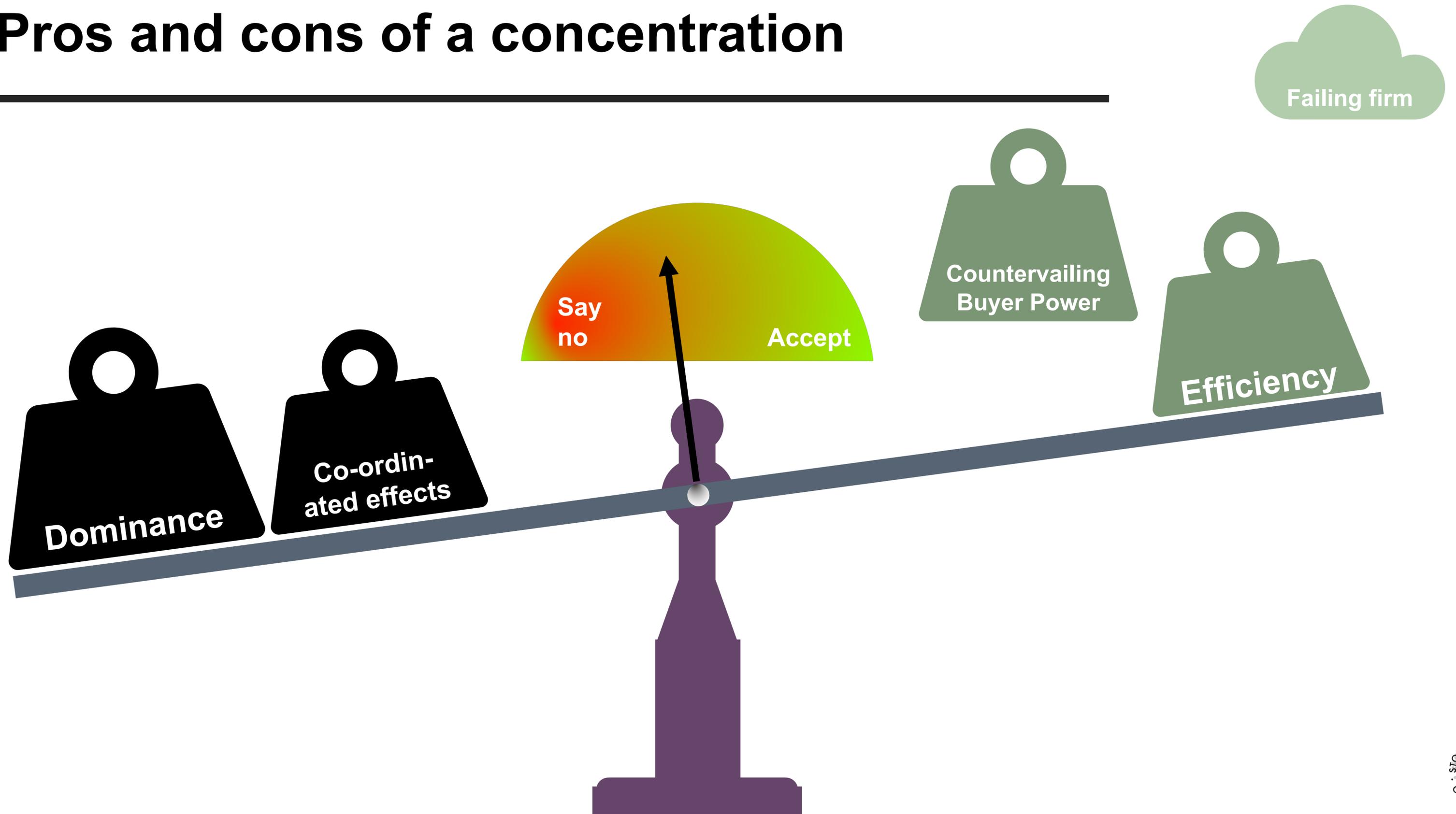
Pros and cons of a concentration



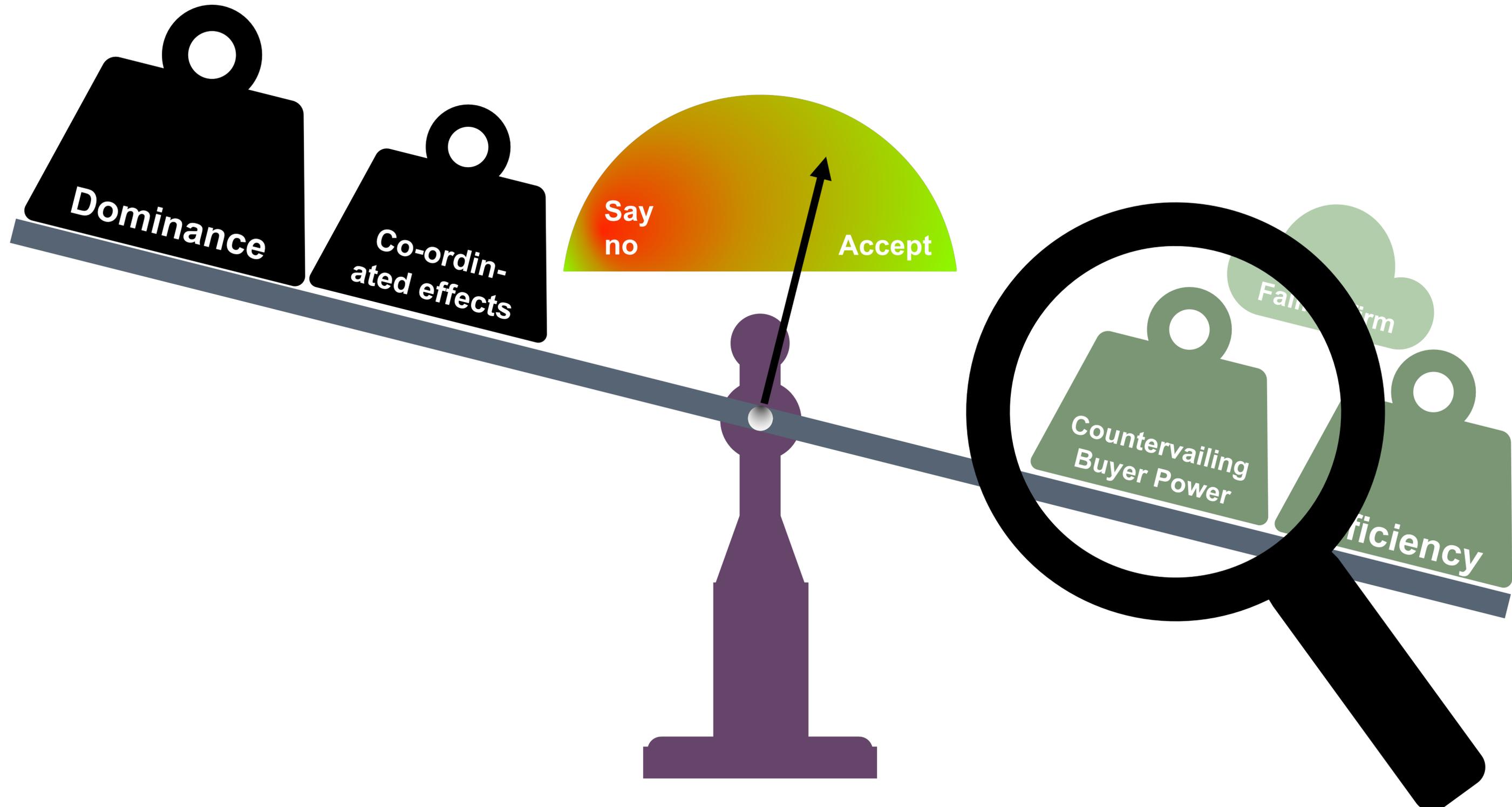
Pros and cons of a concentration



Pros and cons of a concentration



Pros and cons of a concentration



What do we know today?

- **Legal dogmatics**

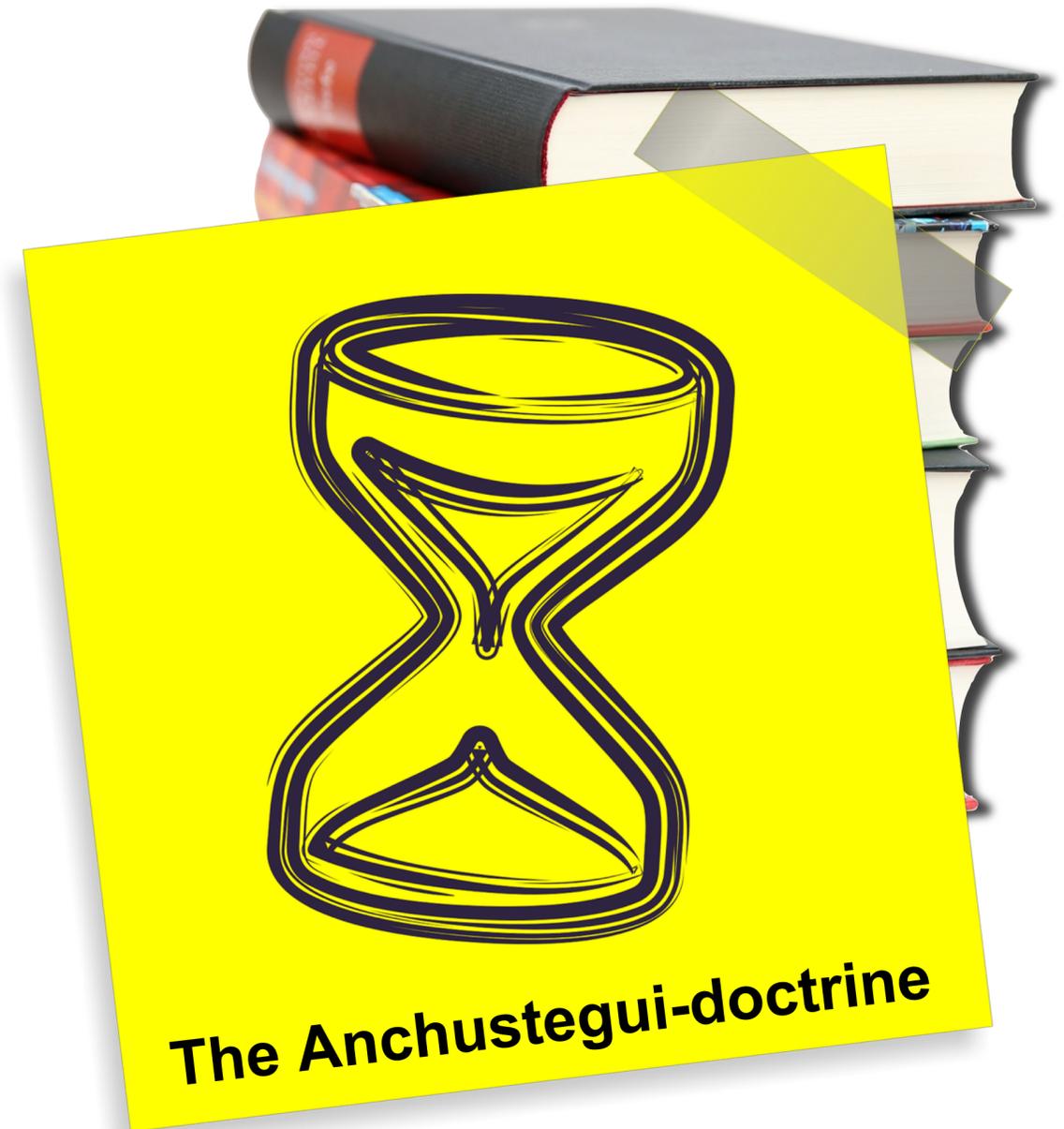
- **State of law is (still) rather unclear regarding substantive and procedural rules**
 - Relatively few clear cut cases, frequent in decisional practice, although unclear on actual weight
- **Considerable broader approach necessary!**
 - 2016 (Anchustegui) + works by Ezrachi, Colitti, Gorecki et. al.

- **I/O research and econometric studies**

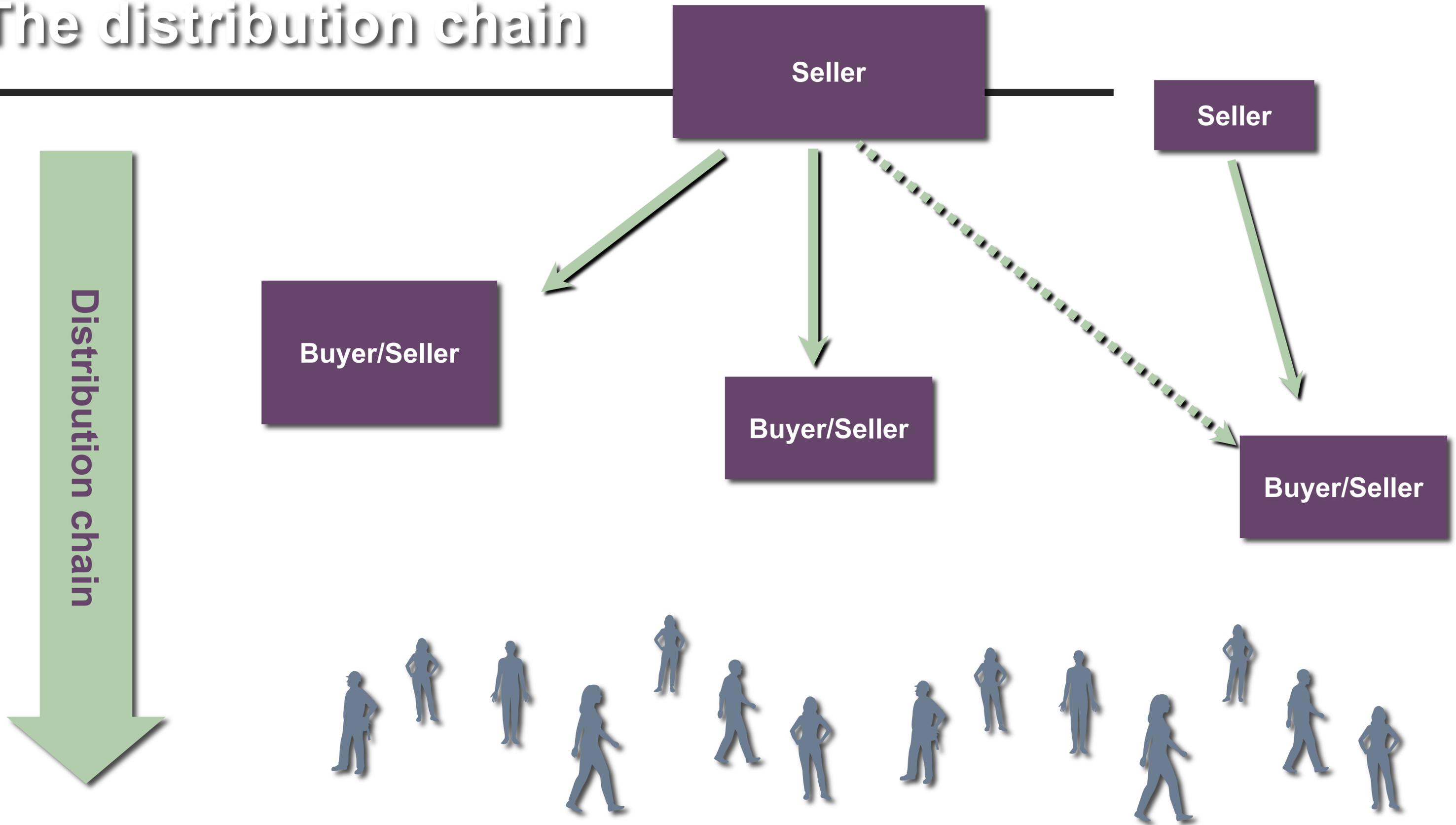
- **Well established research and policy recommendations and it DOES matter**
 - Many researchers since Galbraith; Inderst, Chen, Snyder and others
- **Good knowledge about effects of buyer power today - even in general terms**

- **Financial economic research**

- **New findings regarding causal links and longitudinal effects**
 - Bhattacharyya, Nain, Ahern et al.



The distribution chain



Which benchmark(s) is/are preferred?

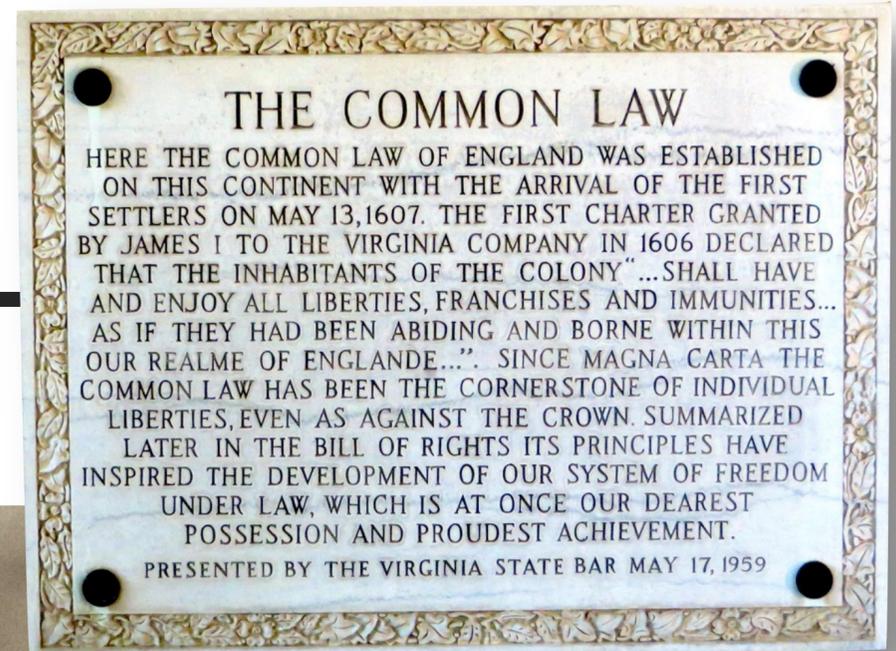
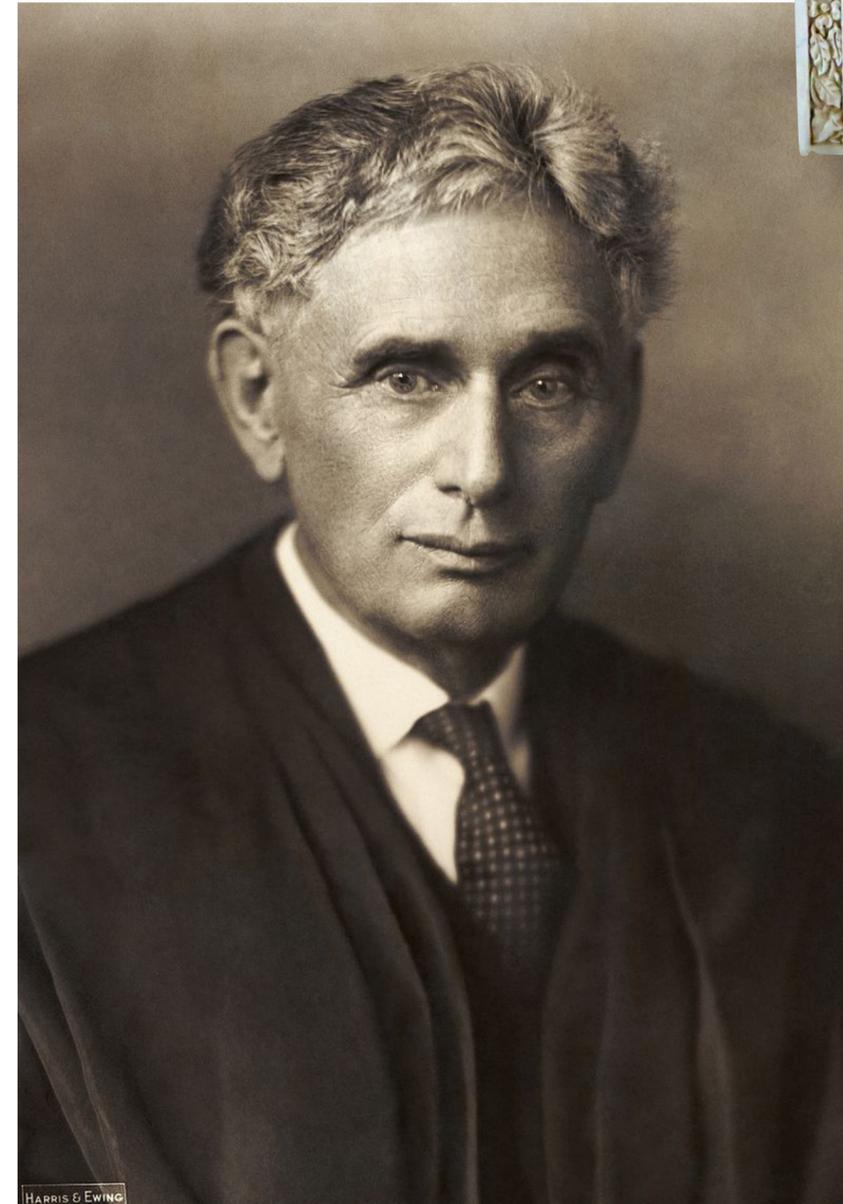
- **The outcome of the analysis is dependent on what we want to achieve with competition law / antitrust!**
- **Which welfare standard do we employ?**
 - Short och long term economic efficiency?
 - Only consumer welfare or total welfare?
 - How to handle fairness considerations
 - What is meant by 'undistorted competition'?
 - Cf. discussion on fairness and exploitative abuse
 - Cf. the ordoliberal inheritance!



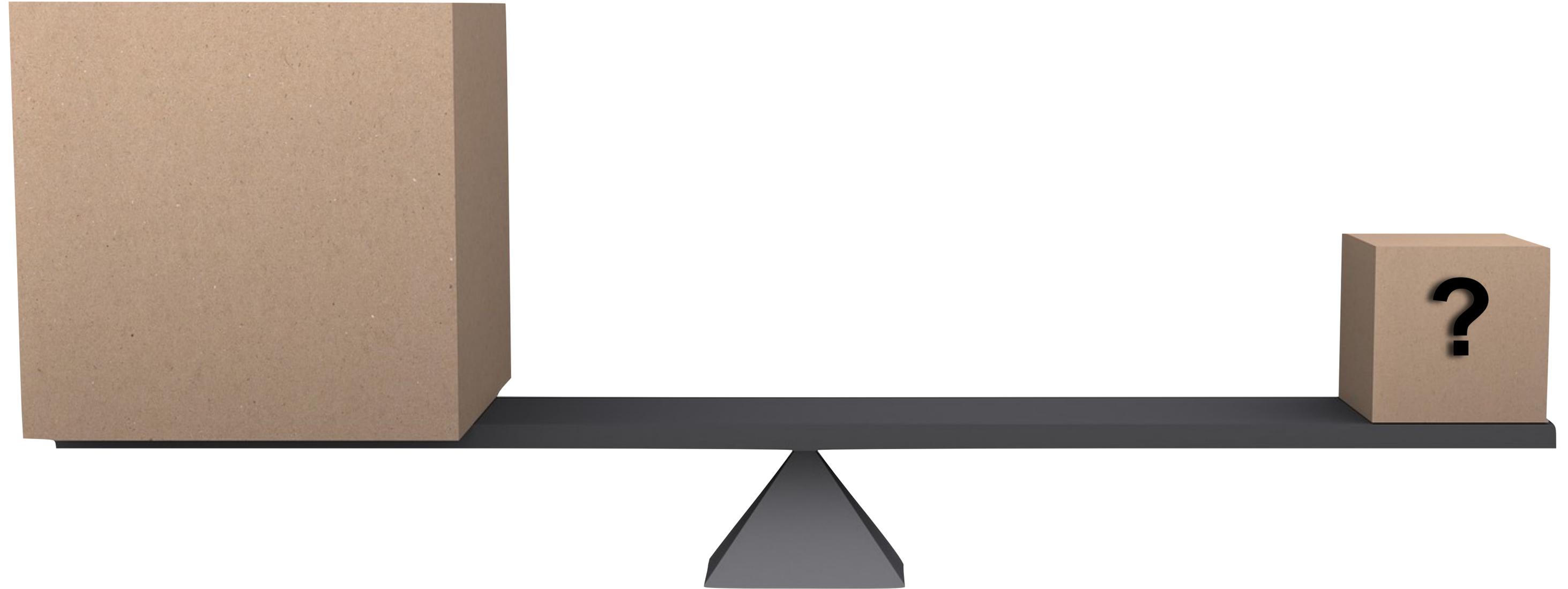


Common law v Civil Law

- **Predictability!**
- ***”... in most matters it is more important that the applicable rule of law be settled than that it be settled right”***
 - **Burnet v. Coronado Oil & Gas Co., 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting)**









Be very careful!



- **Type 1 errors**

- Error credulitas, false positives, excessive enforcement

- **Type 2 errors**

- False negatives, excessive scepticism

	Accept Null hypothesis (H_0)	Reject Null hypothesis (H_0)
Null hypothesis (H_0) is true	Correct! <i>True negative</i>	Type 1 error  <i>False positive</i>
Alternative hypothesis (H_1) is true	Type 2 error  <i>False negative</i>	Correct! <i>Ture positive</i>

Did you here me: Be very careful!!!



- **Type 3 errors – incompetence**

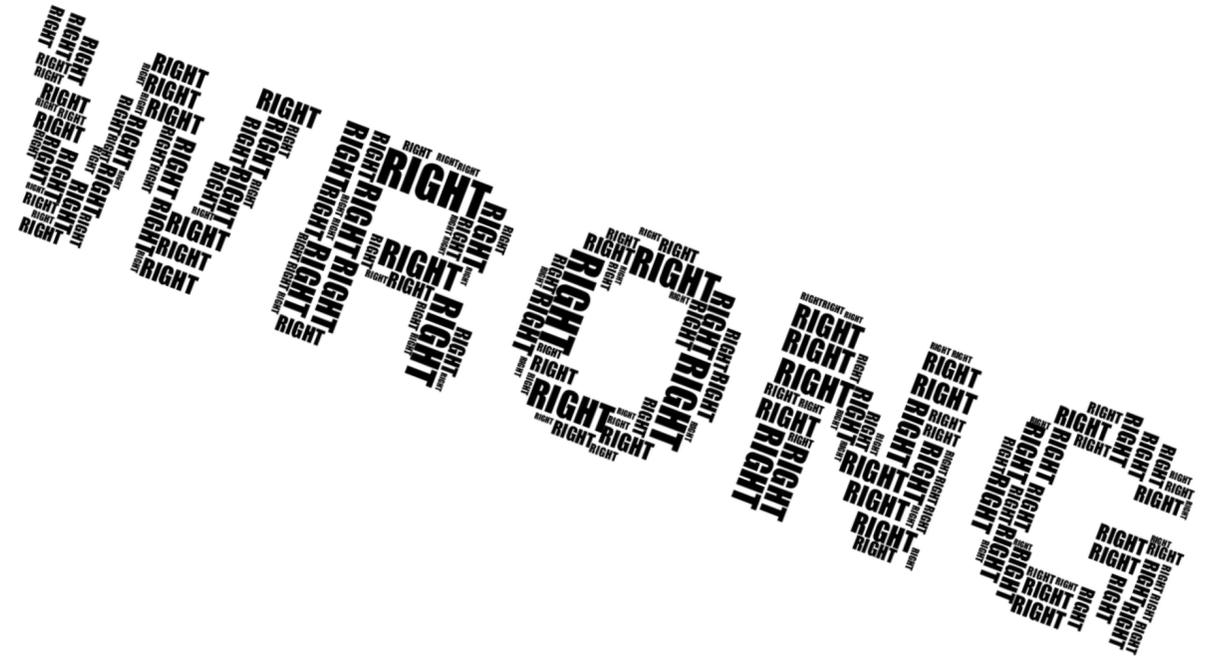
- **System theory: Asking wrong questions and using wrong null hypothesis**

- Correctly rejecting the null hypothesis for wrong reasons
- "...the error committed by giving the right answer to the wrong problem" (Kimball, 1957)
- "It is better to solve the right problem the wrong way than to solve the wrong problem the right way" (Hamming)

- **Type 4 errors – correct reasoning, wrong solution**

- **Incorrect interpretation of a correctly rejected hypothesis**

- Ex: Correct diagnosis of a physician and prescribing the wrong medicine (Marascuilo and Levin, 1970)
- Solve the right problem too late (Raiffa, 1969)

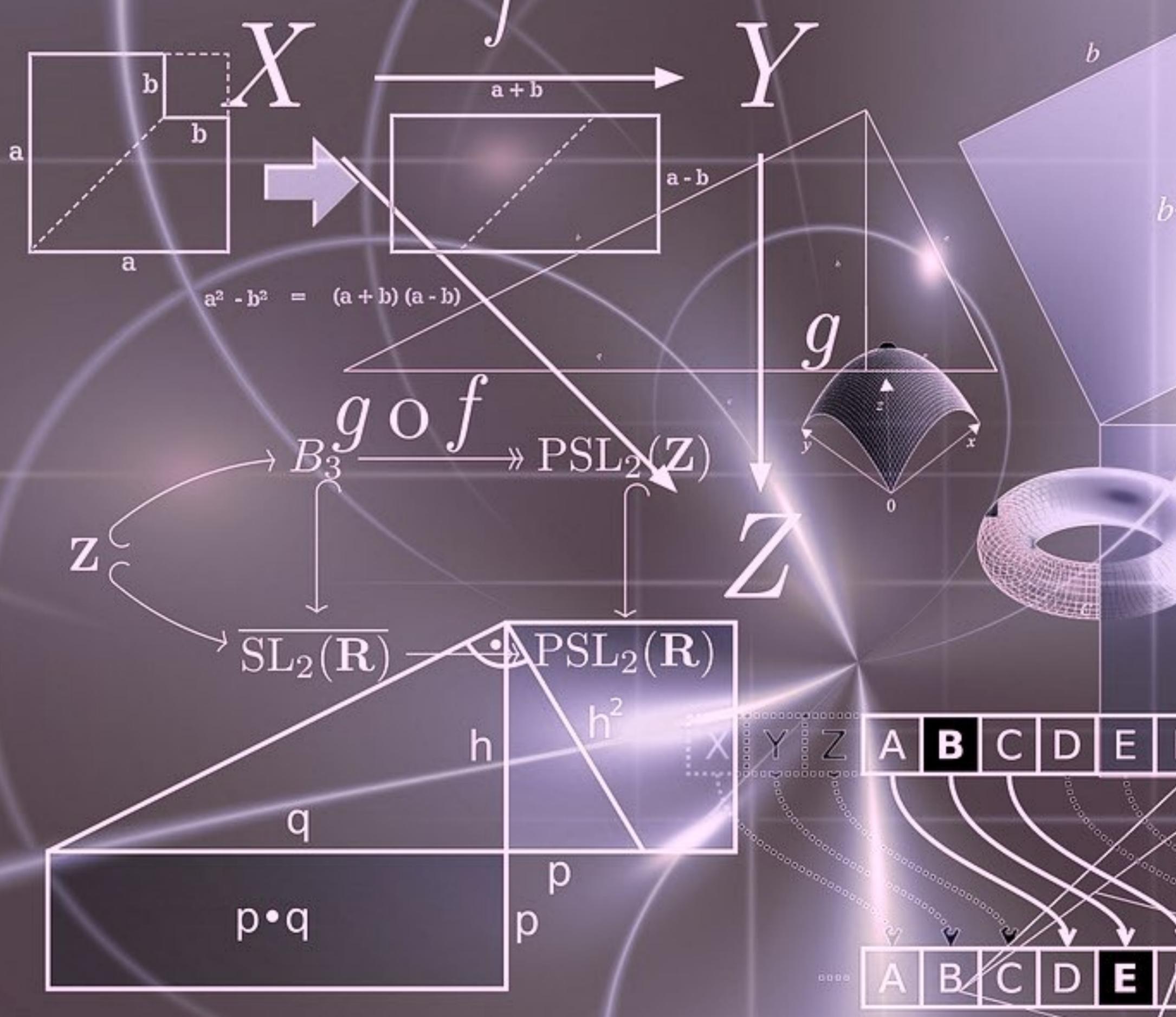


General requirements for legal rules

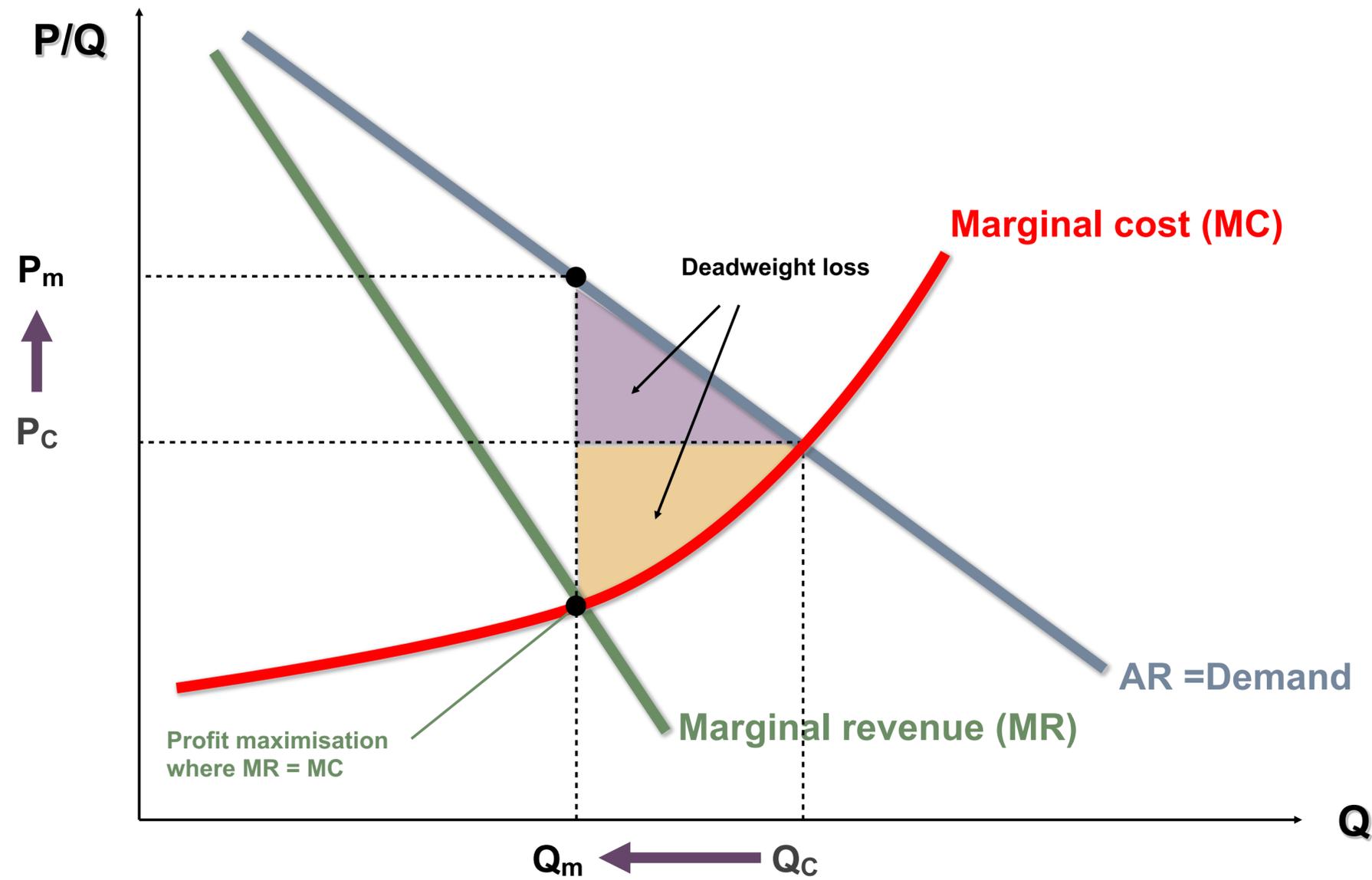
		Rule consistency with purpose according to economic theory	
		High	Low
Judicial quality of the rule	High	<p>Good law based upon good economics</p> <p><i>Successful regulation, administrable and good outlooks for correct interventions upon market failure</i></p>	<p>Good law based upon bad economics</p> <p><i>Regulatory failure. Arbitrary effects of clear and foreseeable rules</i></p>
	Low	<p>Bad law based upon good economics</p> <p><i>Regulatory failure, low foreseeability High uncertainty about the actual rule ex ante, high administration and enforcement burden + correct individual result</i></p>	<p>Bad law based upon bad economics </p> <p><i>Complete regulatory failure - arbitrary results of unpredictable processes</i></p>

+ Risk for enforcement failure, corruption, budgetary constraints etc...

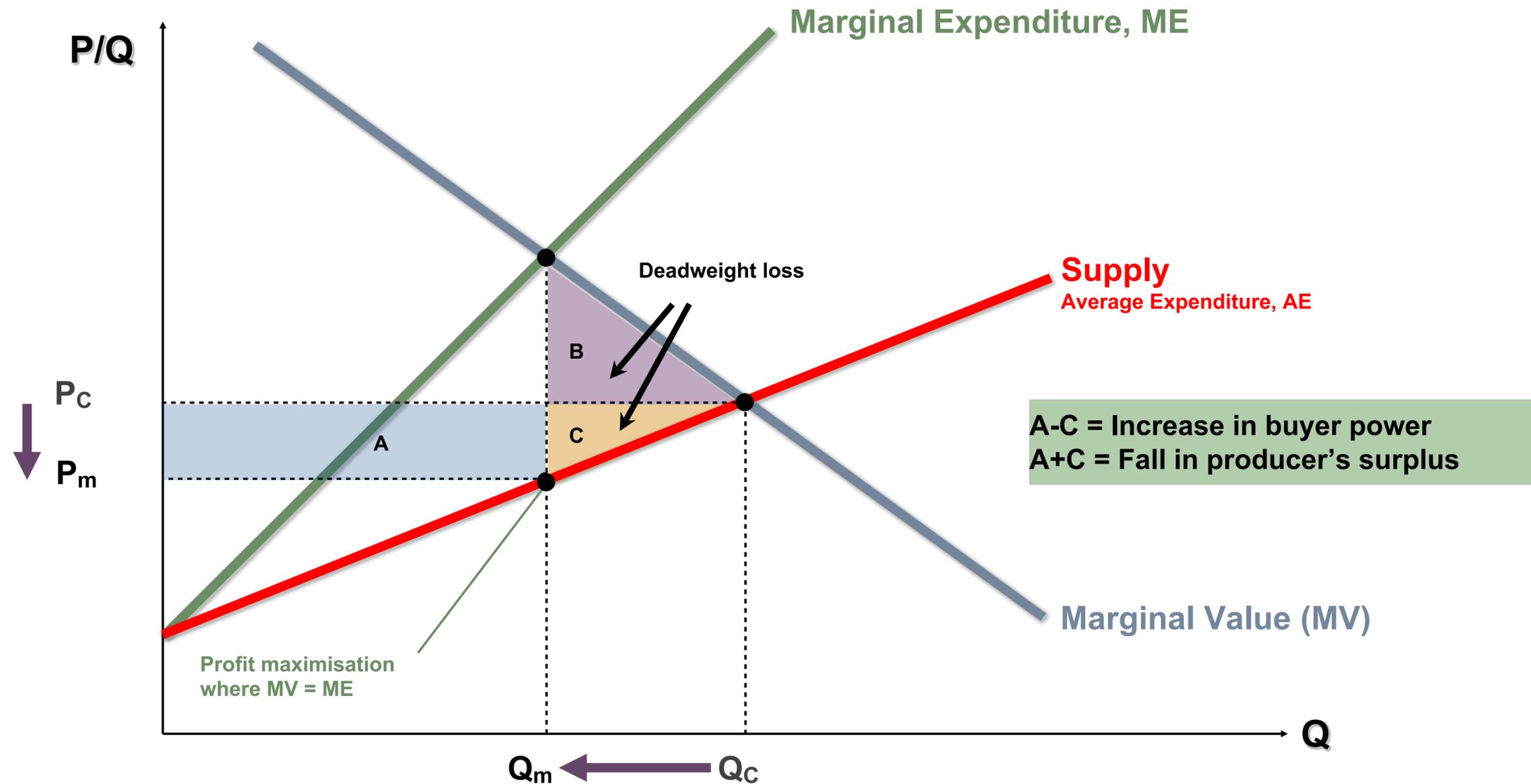
Theory



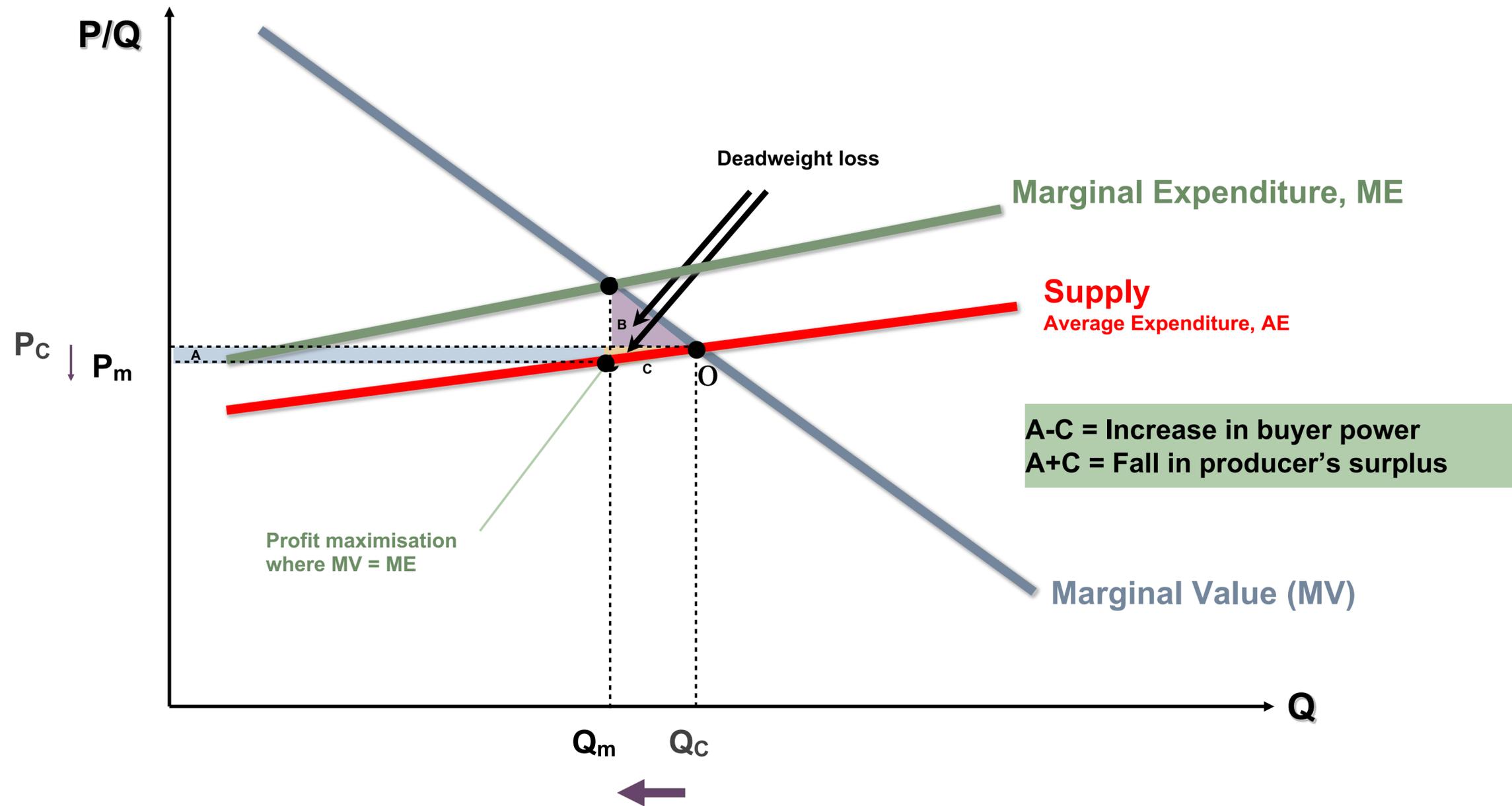
Market power: Monopoly



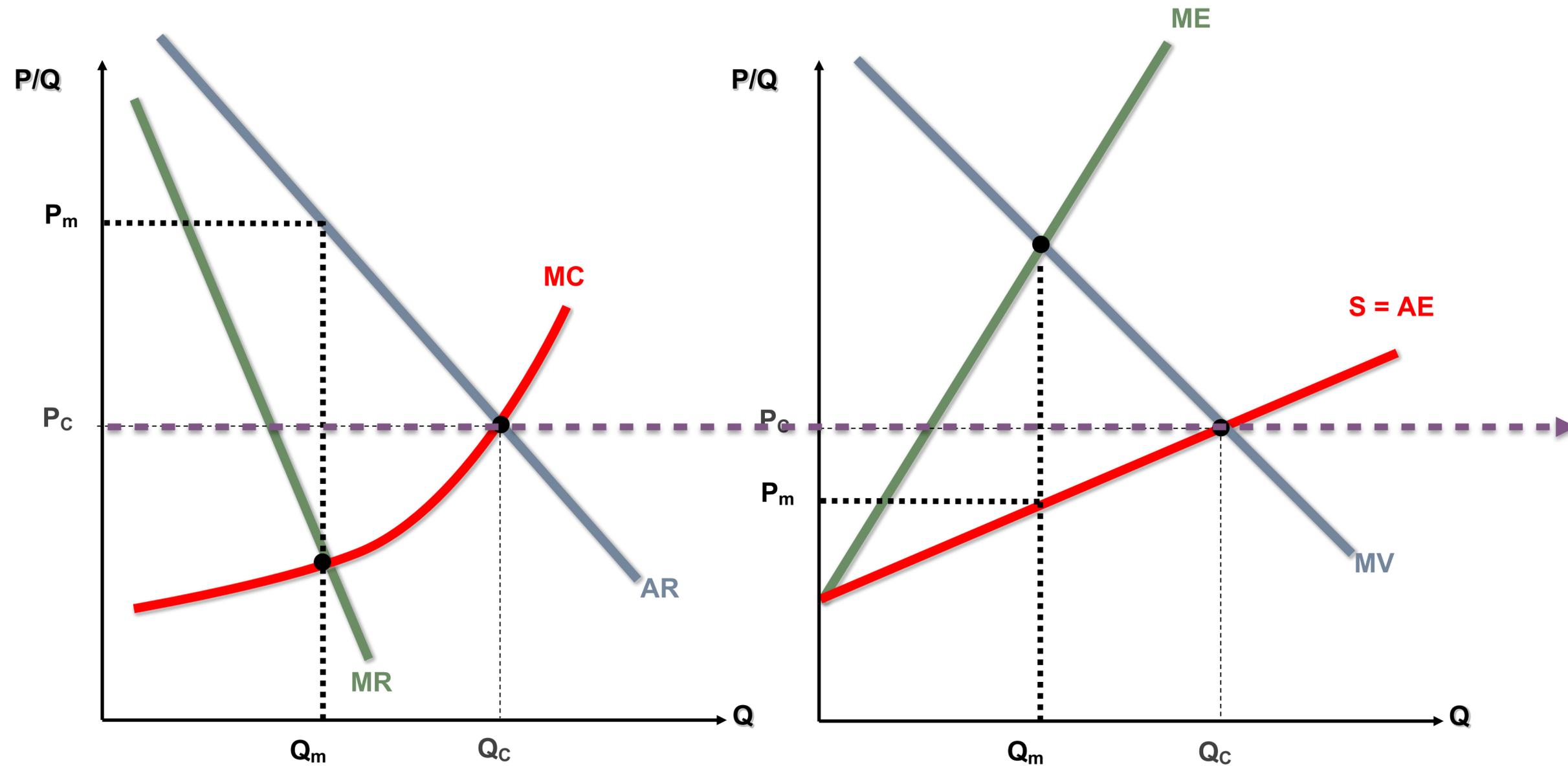
Market power: Monopsony



Market power: Monopsony – elastic supply



Monopoly and monopsony in theory



What is market power?

- **Neo-classical theory: The capacity of an undertaking to profitably maintain purchase prices below competitive levels, withhold demand and pay below marginal value**

- **In practice (perhaps)**

- Reduce purchase volumes
- Obtain substantial concessions / rebates in the short run
 - In relation to the benchmark or efficient competition

- **Other ways**

- The undertaking has greater commercial power than others
- The ability to harm other competitors and ripe the fruits of the conquest



Practice



Dominance or power?

- **Dominant seller = dominant buyer?**

- NO, very important to be careful and not apply rules and case law related to selling activities when assessing buyer markets
- **Considerably lower thresholds!**
 - Yes; power comes in very different shapes and forms ...

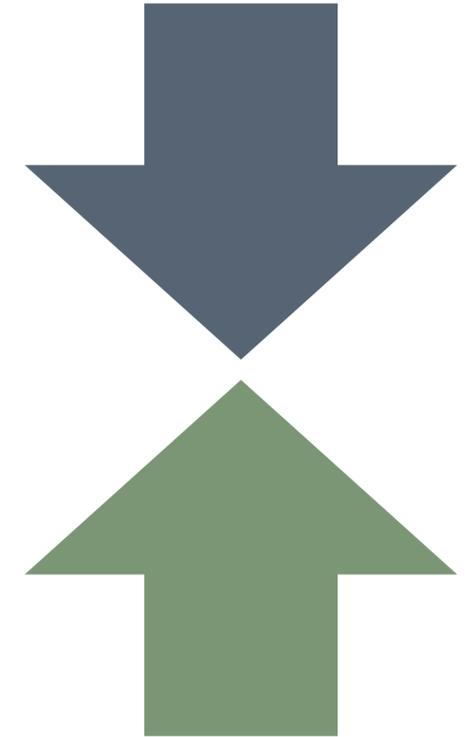


Countervailing buyer power

- **”The fact that a seller enjoys a measure of monopoly power, and is reaping a measure of monopoly return as a result, means that there is an inducement to those firms from whom he buys or those to whom he sells to develop the power with which they can defend themselves against exploitation. It means also that there is a reward for them, in the form of a share of the gains of the opponent’s market power, if they are able to do so. In this way the existence of market power creates an incentive to the organization of another position of power that neutralizes it.”**

- **John Kenneth Galbraith (1952, 1954)**

- **But: Can positive welfare effects be presumed to be endogenous to the creation of countervailing buying power?**



Bargaining power ≠ dominance

- **Bargaining Power**

- The ability of a person or group to get what they want
- The power that someone has in discussions with someone else to reach an agreement that is to their advantage

- **Nature of power is different!**

- "Bargaining power is the power to obtain a concession from another party by threatening to impose a cost, or withdraw a benefit, if the party does not grant the concession. ... [A] buyer might attempt to use bargaining power to obtain a discriminatory price by threatening to remove business for a supplier unless it grants the discrimination. Or it might threaten not to bring additional business to a supplier unless the favoritism is forthcoming. In either instance – whether the buyer threatens to withdraw existing business or withhold new business – the buyer's power rests on its ability to make a credible threat."

- Kirkwood (2005)



How to define market power?

- **Considerable buyer power / counterweight**
 - **≠ Dominance; < traditional seller power**
 - Buyer has often bargaining power already at lower market shares
 - Stemming from the role of gate-keeper, privileged positions as mandatory trading party
 - Seller is dependent on buyer in different ways
- **A dual approach includes analysis of downstream effects**
 - **A dynamic assessment necessary**
- **What are the tools?**
 - **Market shares, concentration levels, barriers to entry and exit**
 - To be combined with other factors such as gate-keeper, unavoidable trading party
 - **Preliminary indication of power, albeit rudimentary**

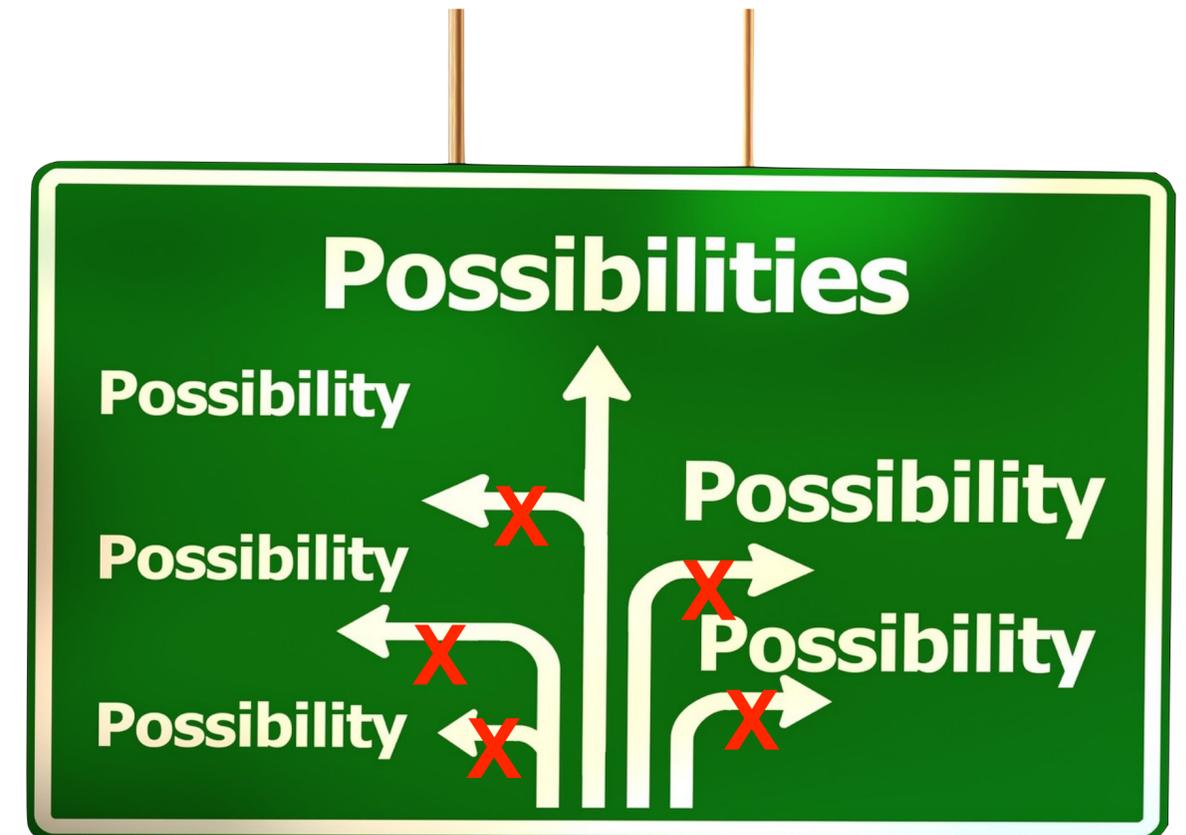
Check nature of downstream access

- **Important factors to consider if the buyer is a gate-keeper and amount to a bottleneck for the seller**
 - Supplier has access to end consumers through inferior sales channels (e.g. weaker distributor)
 - Supplier loses considerable economies of scale or network effect absent the buyer
 - Buyer has a large share of purchases from upstream sellers
 - Other buyers are much smaller
 - Entry barriers exist that prevents upstream actors to circumvent the strong buyer by facilitating alternative distribution channels



Is the buyer an unavoidable trading party?

- **Brings about considerable power vis-à-vis all suppliers**
 - Two edged sword ...
- **Nature of dependency**
 - Relative concept; dependence on certain supplier, lock-in effects, innovation, adjustment costs
 - What constitutes the unavoidableness?



Alternative measurements of buyer power

- **Inverted Lerner Index**

- **Great practical drawbacks**

- Competitive prices, single products, requires a proper starting benchmark etc.

- **BPI (Buyer Power Index)**

- **Derived from Lerner Index**

- Measures deviation between competitive result and volume purchased based upon supply elasticity
 - Difficult to apply in practice

- **Both say very little about whether the power off-sets negative effects**

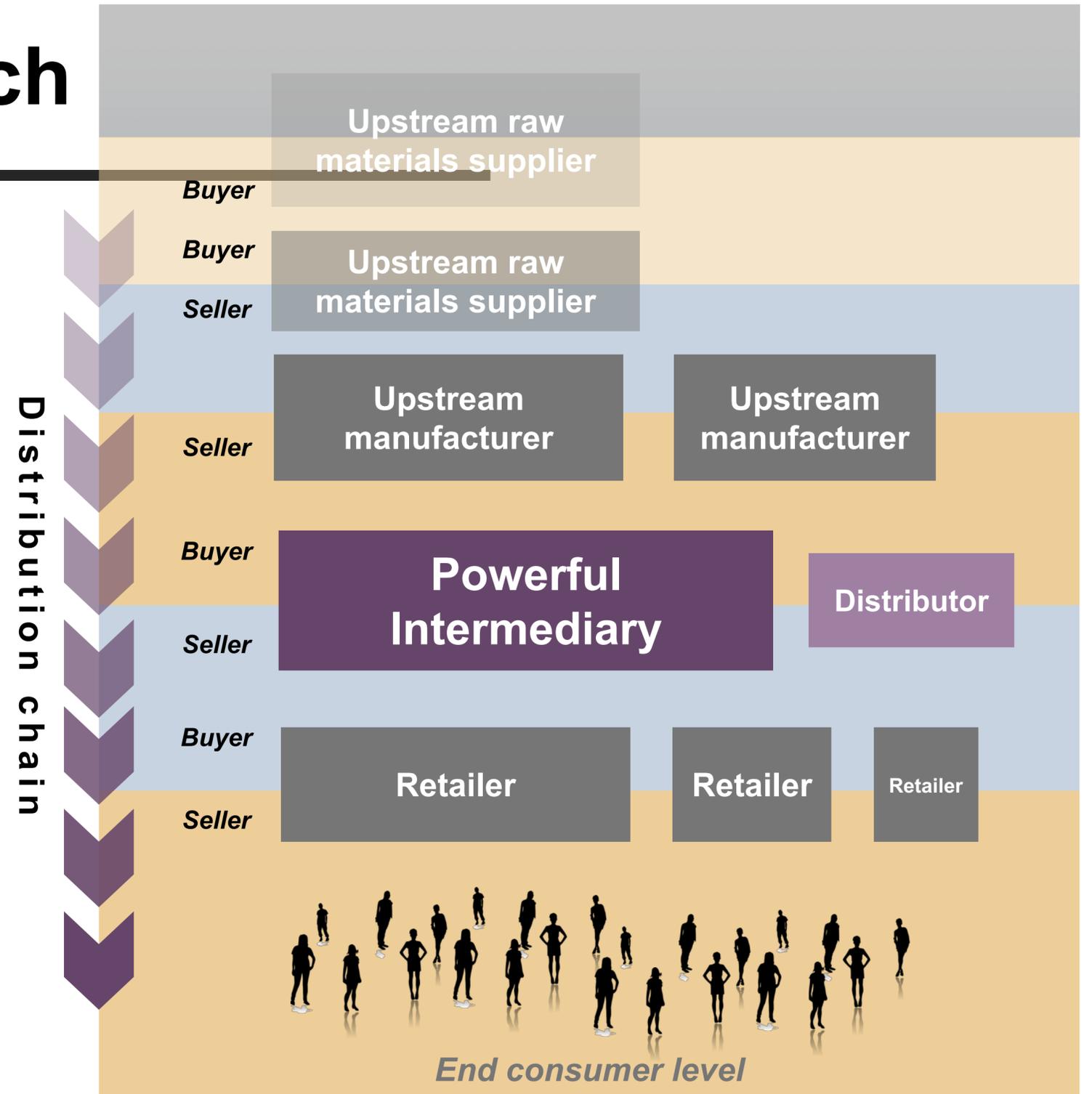
$$L = (P - MC) / P$$

$$L = -1 / E_d$$

CRAP

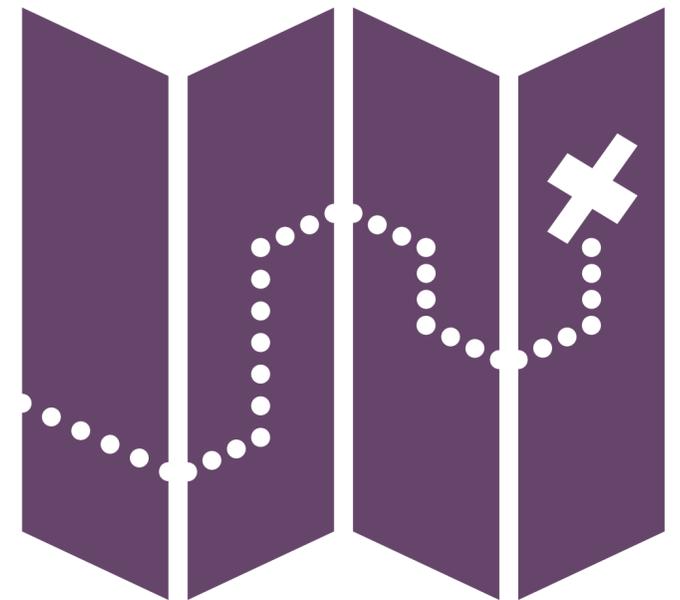
An economic-strategic approach

- **Avoid static models that builds on market structure!**
 - Buyer power does not always entail detrimental effects
- **Buyer power has simultaneous dual effects**
 - Affects up- and downstream competition
 - See Herrera Anchustegui, I., *Buyer Power in EU Competition Law*, 2016
- **Bargaining power most often welfare enhancing**
 - Depends on the markets concentration level, water-bed effects, spiral effects etc.



Market definition in cases with buyer power

- **Markets with buyer power deviates from markets with seller power**
 - Incentive, dynamics and purchase economics are different compared to seller markets - requires another method altogether
 - Every analysis requires that you factor in effects up- and downstream as inter-dependent
 - Clear risk of missing the other side
 - The market is a combined purchase and seller market
 - Having ultimate effects elsewhere



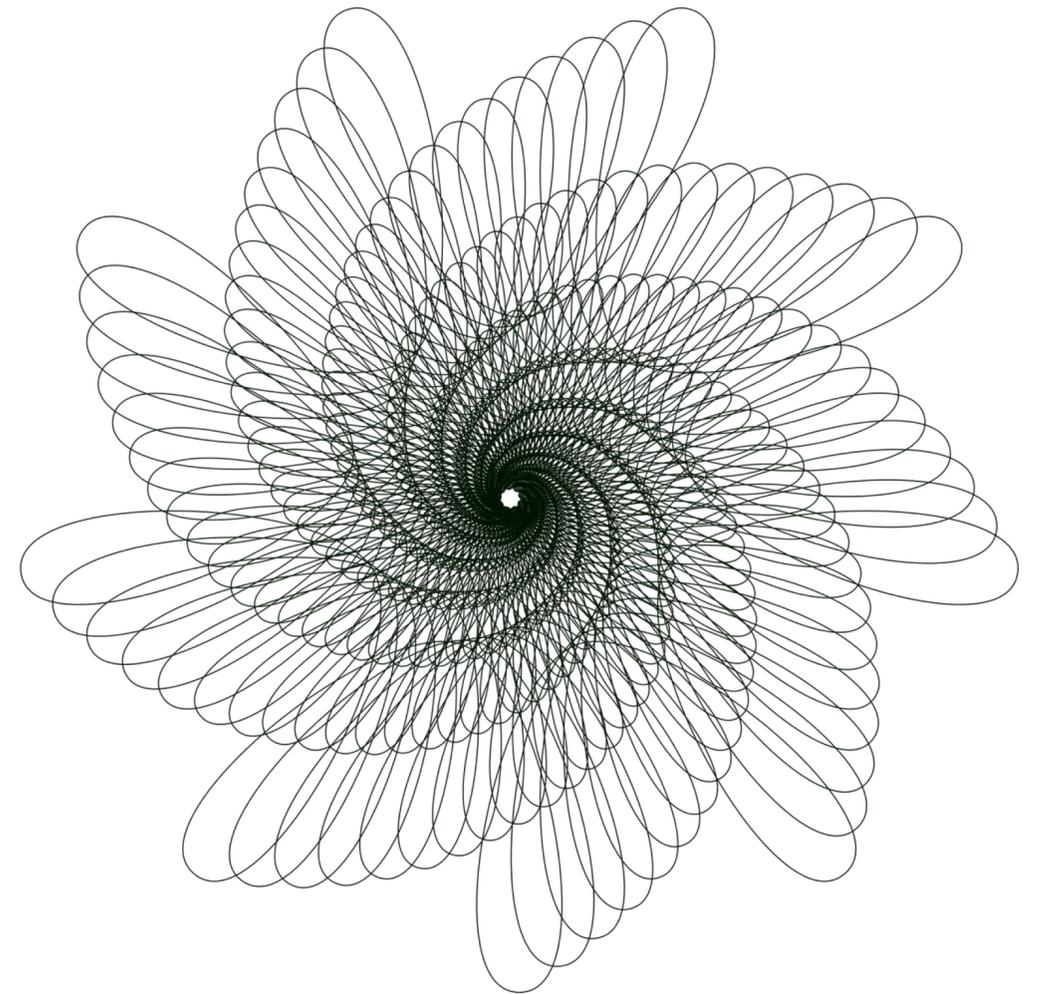
The Waterbed effect

- **Does it entail positive or negative welfare effects?**
 - In practice impossible to rule on *ex ante*
 - Absence of waterbed-effect likely to have positive effects
- **When does it arise?**
 - Amongst direct competitors to the undertaking with buyer power
 - Effects per se arise more probably on other related markets
 - Convext cost structures
 - When demand elasticity is affect amongst competitors
- **Harmfulness depending on origin**
 - Organic growth less harmful than growth by acquisitions



Network or spiral effects

- **What does buyer power bring about if downstream power is connected to the position on a downstream market?**
 - cf. Rewe/Meinl, Kesko/Tuko



Negative dynamic effects

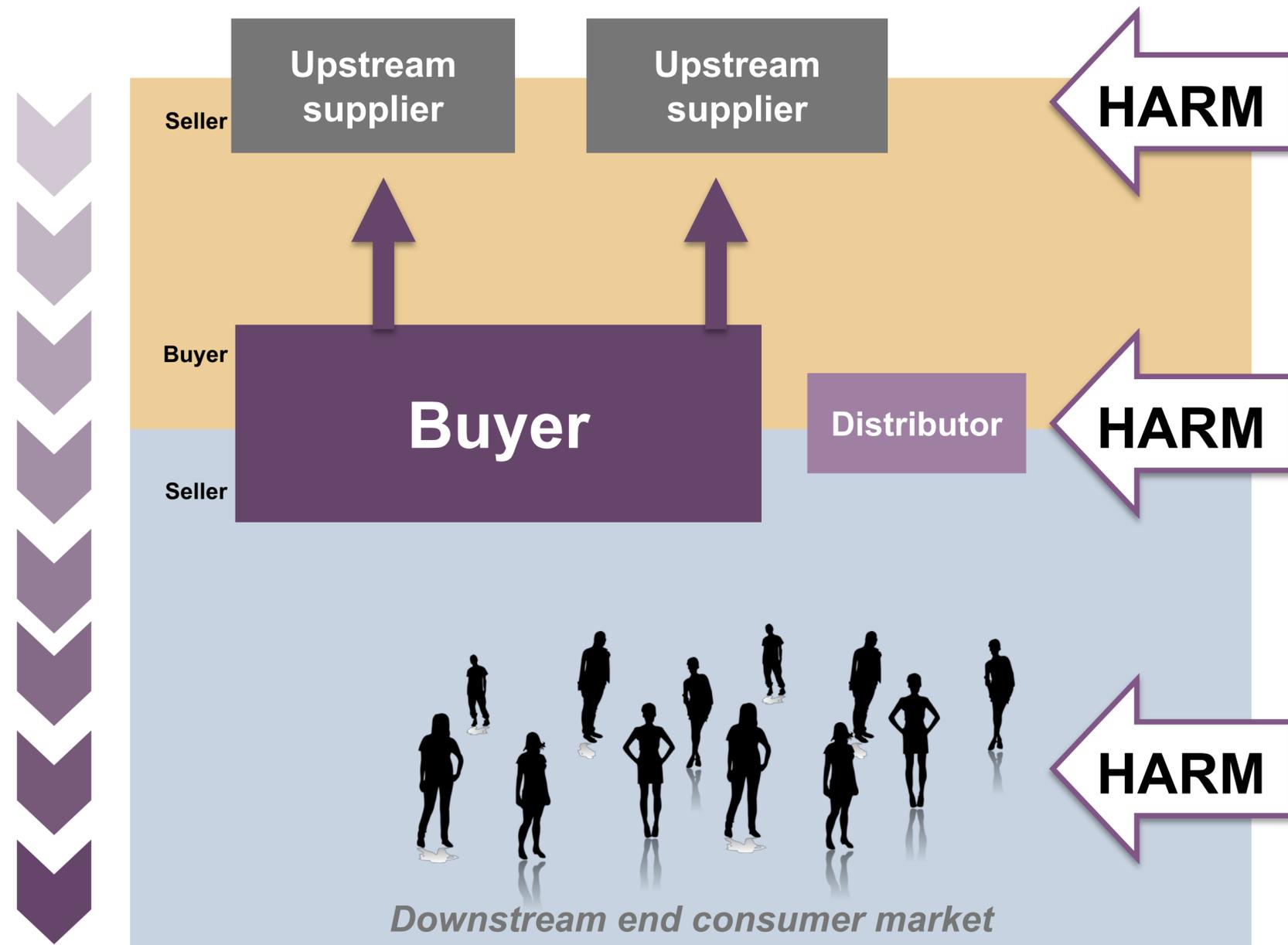
- **Does countervailing buyer power influence incentive to upstream innovation and quality adversely?**
 - Some authors claim that this the case, whereas other claim the opposite!



The nature of buyer power and its effects

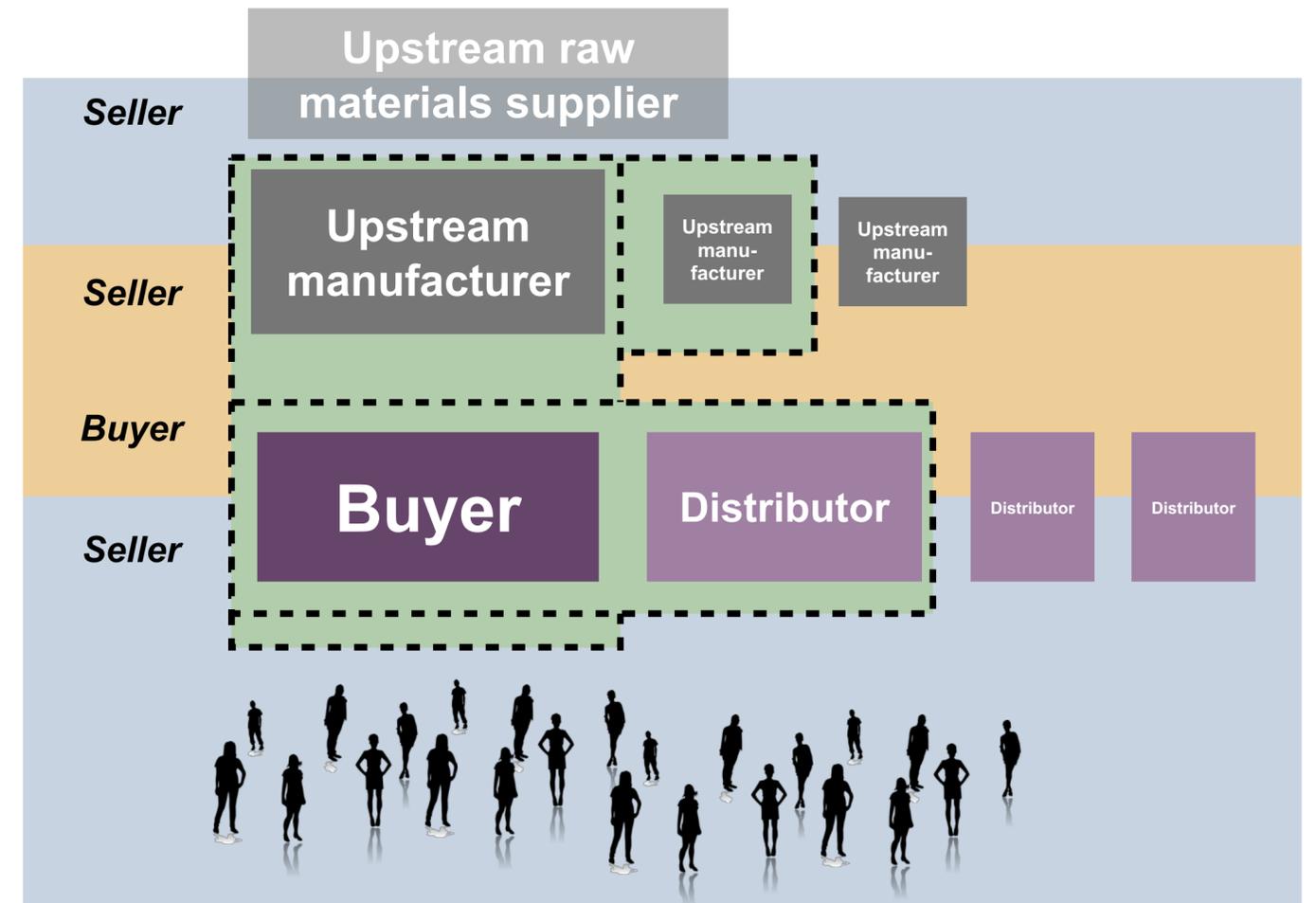
- **Necessary to understand**

- **Where buyer power has potential to cause harm**
 - If it indeed is possible to call it "harm" but rather competitive or structural "effects"
- **Whether "harm" actually affects welfare negatively**
 - How to assess it in relation to the benchmark standard in terms of welfare



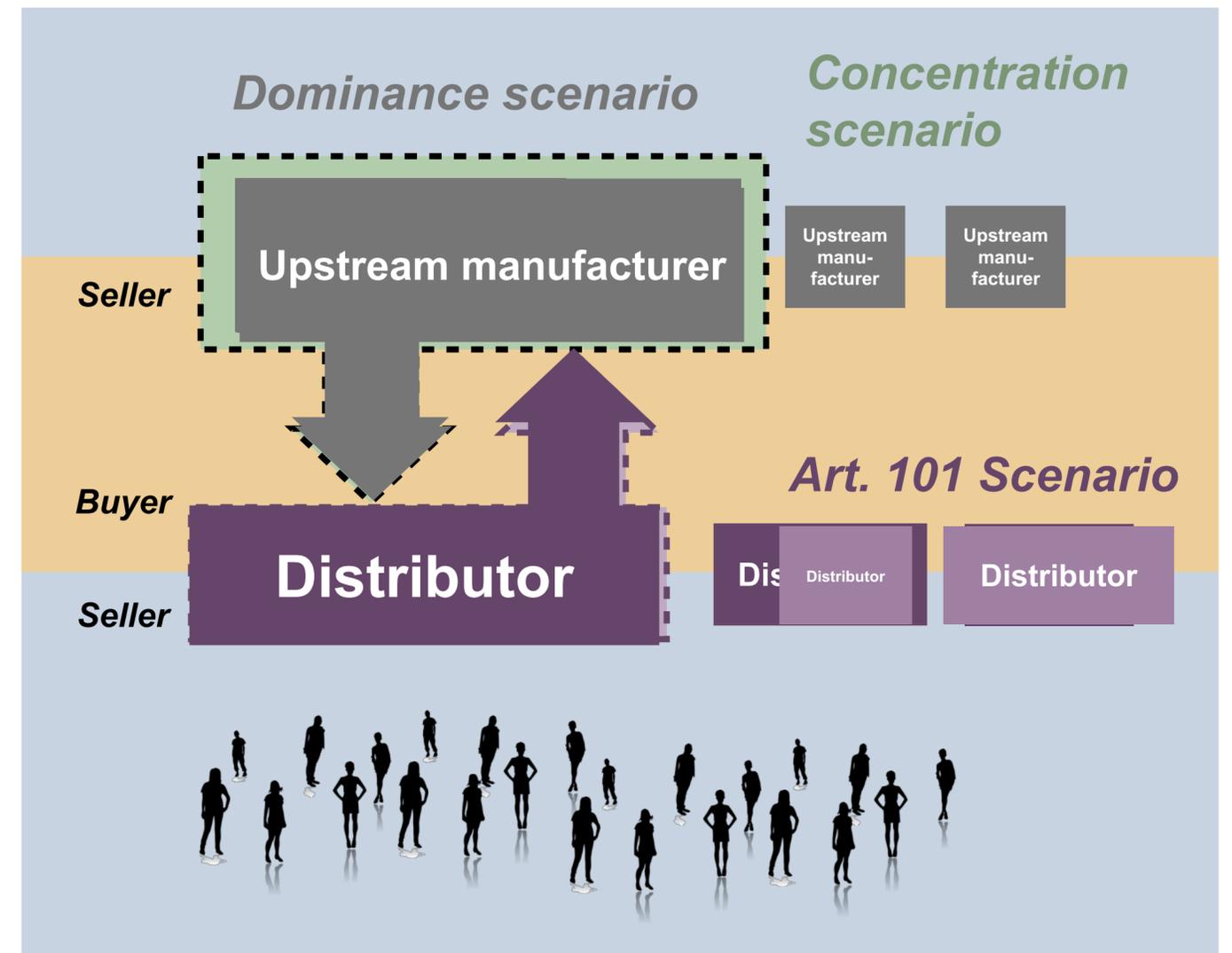
Competitive harm: Concentrations

- **Horizontal concentrations**
 - Can generate bottleneck effects
- **Vertical contractions**
 - Could be harmful
 - Possibility to cut off supply upstream
 - Incentive to foreclose others
 - Significant impediment to competition downstream



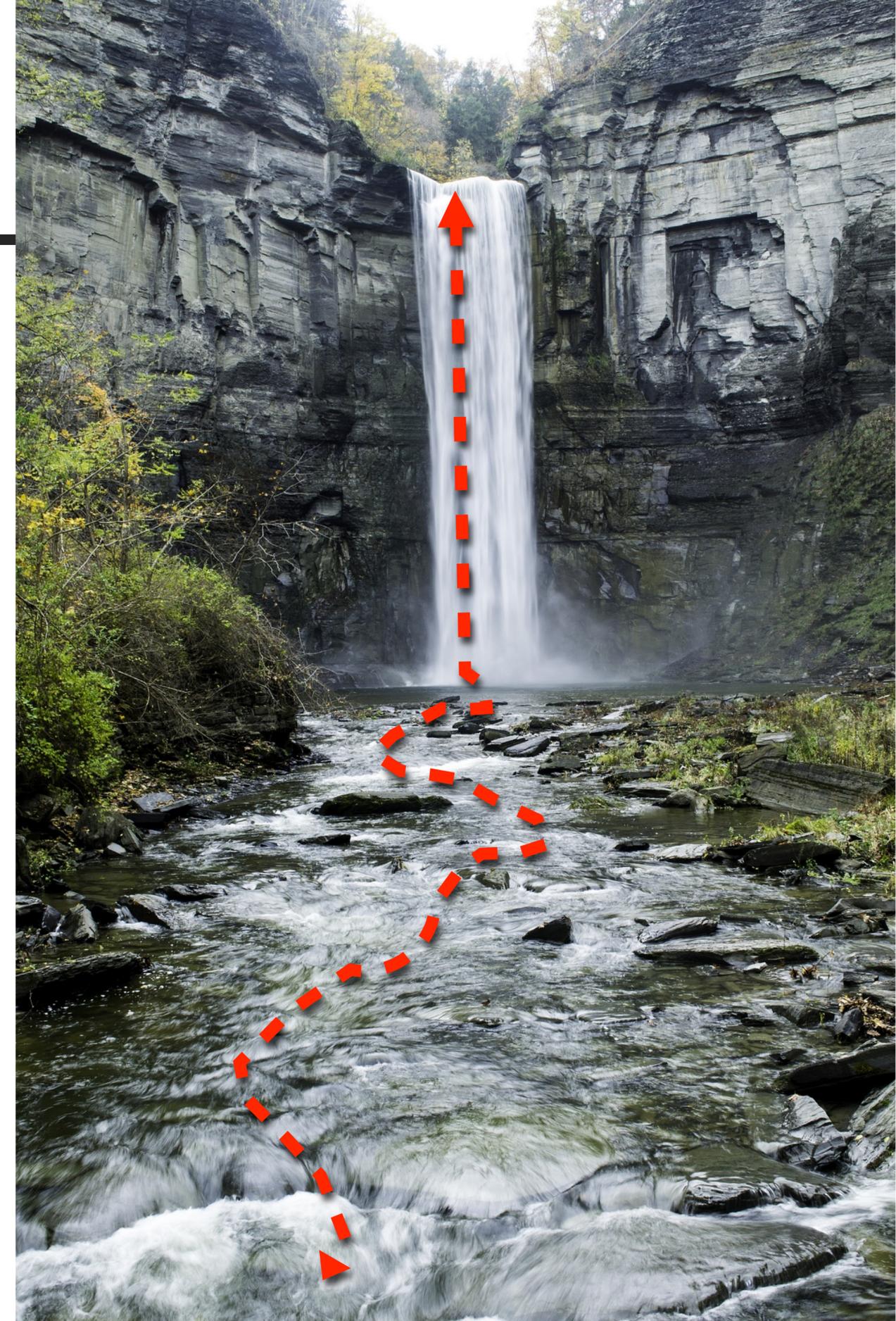
Countervailing buyer power

- So far mostly a defence against problematic concentrations upstream
 - Power arises through
 - Possibility to shift demand, relative size and concentration levels, purchase volumes, profitability, price differentiation etc.
 - A relatively ad hoc concept necessitating in casu analysis
 - Whether it is enough to curb seller power + filters down to consumers.
 - VERY hard to introduce rules on presumptions
- Relevant in different situations
 - Article 102 TFEU (no abuse), concentrations (not SIEC), Article 101 TFEU (allowed co-operation)
 - Spill-over effects
 - Raises the threshold for countervailing buyer power to benefit other buyers
 - Theory of harm because more comprehensive compared to direct harm - embodies competitive structure and nature of competition as such
 - Unclear effects regarding waterbed- and spiral-effects; innovation and quality
 - Revolves around the concept of bargaining power in general
 - Monoposony power in rare and extreme cases



A question of sequencing...

- **Presumption that downstream firms act as agents for consumer or someone else?**
 - There is a potential risk that downstream concentrations may negatively affect downstream selling prices and reduce consumer welfare
- **General effect of downstream concentration**
 - Dependent suppliers suffers lower prices and less cash-flow - especially those facing high entry barriers
- **In which direction of the distribution chain does concentration progress?**
 - Are upstream concentration exogenous in relation to downstream activities? - casual link problem!
 - Empirical evidences suggest that concentrations progress upwards, i.e. consolidation activities travels backwards - not forwards
 - What does this entail for concentration assessment?



Where do we go from here?



The road ahead

- **For enforcement**

- **Do not perceive buyer power as an exogenous factor!**
 - Important to ask the correct questions (avoid type 3 errors)
 - Yes; you'll come across it more often than you think!
- **Always address the dual effects of buyer power**
- **Horizontal merger guidelines should be revised**
 - Outdated view on countervailing buyer power
 - Somewhat odd view on the sequencing issue
 - Shift focus away from structural factors and outside options

- **For Competition policy in general**

- **Not necessarily negative effects of buyer power**
- **Buyer power is a complex and comprehensive concept requiring another approach compared other cases**
 - Important to acknowledge dual effects of buyer power + importance of downstream competition

