

The Law and Economics of Buyer Power in EU Competition Policy

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THE LAW AND ECONOMICS OF BUYER POWER IN EU COMPETITION POLICY

Een rechtseconomische analyse van inkoopmacht in het Europese mededingingsbeleid
(met een samenvatting in het Nederlands)

Proefschrift

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aan de Universiteit Utrecht op gezag van de rector magnificus,
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in het openbaar te verdedigen
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Frederik Albert Hendrik van Doorn

geboren op 2 juli 1984
te Utrecht

Promotor: Prof.dr. A.T. Ottow
Copromotor: Dr.mr. J.A. den Hertog

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ABOUT THE AUTHOR

Frederik van Doorn (1984) studied both Economics (2002-2006) and Law (2005-2009) at Utrecht University, Faculty of Law, Economics and Governance, where he obtained cum laude master degrees in 'Economics and Law' and 'European Law', respectively.

Next to his studies, Frederik van Doorn worked as a research assistant at economic consultancy firm Ecorys (2007-2009), where he was engaged in various studies in the field of competition and regulation. In 2009, he worked as a researcher at Utrecht University in the area of public economic law. He has published in the field of Competition Policy, Public Finance and European Law. His research specifically focuses on the interaction between Economics and Law, in search of a more successful cooperation between the two disciplines.

Since 2010, Frederik van Doorn is a (senior) policy advisor at the Competition and Consumer Policy Department at the Ministry of Economic Affairs in the Netherlands. It should be noted that the views expressed in this publication are solely those of the author in his private capacity and do not in any way represent the views of the Ministry of Economic Affairs or of any other entity of the Dutch government.

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1. INTRODUCTION

1.1 – Introduction

Buyer power refers to the ability of firms to obtain from their suppliers more favourable terms of trade and is a subject matter that is gaining substantial interest across the European Union (EU). For a great deal, the augmented attention to the topic of buyer power stems from a trend of ongoing concentration in the European retailing sector.¹ Especially in the groceries sector, changes in consumer preferences have induced retailers to implement substantial changes to their business models. As a result, retail chains that exploited considerable economies of scale and scope and that have implemented various innovating shopping models play an increasingly leading role in the EU retail landscape. While the emergence of large retail chains evidently comes at the cost of smaller and medium-sized retailers, it has also raised considerable concerns amongst primary producers and intermediate suppliers, which have become increasingly dependent on fewer alternative sales channels in order to reach consumers. Correspondingly, retail firms, either individually or through buying groups, have gained in their ability to exercise buyer power and thereby reduce suppliers' profitability and/or contractual freedom. Accordingly, suppliers increasingly claim that they are being 'exploited' and that retailers are 'abusing' their buyer power.

Interestingly, while the nature of competition in the retailing sector has therefore caused concern on producer and supplier margins in various distribution chains, this has not caused EU competition law, or its enforcement, to move in a similar direction.² Indeed, the modernisation of EU competition law, which is presumably the most influential change in competition policy in the European Union since its introduction, does not prescribe increased attention to the economic position of producers and suppliers. On the contrary, pursuant to the modernisation of EU competition law, EU competition policy has increasingly relied on an economics-oriented approach in which the focus is not on producers, suppliers or retailers (competitors) but on the protection of an effective competitive process (competition) and consumer welfare. The developments of, on the one hand, increasing pressure on suppliers' margins and, on the other hand, increased focus on consumers have caused concerns amongst politicians on both the national and the European level. Supported by various producer lobby groups, there is growing belief that the current substantive legal framework of

¹ See Section 1.2.

² See Section 1.3.

EU competition law is too narrow and unfit to address the (alleged) harmful effects of buyer power.

In the discussion on the appropriate treatment of buyer power, reference is often made to initiatives at the national level that are specifically designed to deal with disparities in market power in business-to-business relations.³ In various EU Member States, such as Germany, France and Italy, national competition authorities have the task to assess the compatibility of the exercise of buyer (and seller) power with specific prohibitions in national competition law on so-called ‘abuse of economic dependency’ or ‘abuse of superior bargaining position’. Alternative methods that might mitigate the exercise of buyer power and that have been included in the debate include prohibitions on sales below costs, which have for instance been implemented in France, Spain and Portugal, and measures that facilitate the organisation of countervailing seller power, such as in the Netherlands. There is increasing pressure on the European legislature to take according measures on the EU level to tackle the (alleged) harmful effects of buyer power.

The complaints that EU competition law is too narrow and unfit to tackle buyer power, as well as the requests that regulatory changes are warranted, crucially rely on the hypothesis that there is a ‘gap’ in the current substantive legal framework of EU competition law concerning the (alleged) harmful effects of buyer power. If this were true and there is indeed a ‘gap’ in EU competition law, measures at the EU level similar to Member States’ initiatives might be warranted. However, if current EU competition law is fully equipped to address the (potential) harmful effects of buyer power, the various national initiatives may inflict harm themselves and hamper the Internal Market, for instance by unduly increasing regulation costs, such as legal uncertainty and compliance costs. Using a Law and Economics approach, this research puts the question of whether there is a ‘gap’ in EU competition law concerning the (potential) adverse effects of buyer power to the test.⁴

1.2 – The Changing Retail Landscape

Since the 1960s, the landscape of the retail sector in the European Union has undergone drastic changes.⁵ With various comprehensive modernisation operations,

³ See Section 1.4.

⁴ See Section 1.5.

⁵ See for a more detailed description Dawson, J. (2010), ‘Retail Trends in Europe’, in: Kraft, M. and Mantrala, M.K., *Retailing in the 21st Century: Current and Future Trends*, Berlin: Springer-Verlag, pp. 63-81.

retailers have made substantial changes in their business models, with a view to better exploit economies of scale and scope and to implement innovative shopping models. Consumers are typically seen as the main beneficiaries of the transformation of retailers' business models. In its communication accompanying its 2010 Retail Market Monitoring Report *Towards more efficient and fairer retail services in the internal market for 2020*, the European Commission stated that "consumers have benefited through greater choice at competitive prices allowing them to reallocate a growing share of their income, traditionally used for satisfying basic daily needs, to the consumption of an ever broader range of goods and services, which, in turn, has stimulated innovation and economic growth".⁶ Moreover, the Commission explained that "[e]ven if European retailers have, at aggregate level, achieved lower productivity growth over the past decade than their counterparts in the United States, their growth and the waves of horizontal and vertical integration have contributed to making the retail sector more efficient and to lowering inflation".⁷

The comprehensive reform in the retail sector has substantially affected the structure of retail markets across the European Union. While the increased exploitation of economies of scale and scope and implementation of innovative shopping models therefore appears to have benefited consumers, it has also substantially reduced the importance of small independent retail shops. The increased popularity of large retailers amongst consumers and reduced role of smaller retailers have led to a trend of increasing consolidation in the EU retail sector. In 2014, a comprehensive study commissioned by the European Commission showed that concentration in the retail sector has increased in virtually all Member States, most notably due to increased penetration of so-called 'modern retail' (i.e. supermarket chains, hypermarkets and discounters with a centralised distribution system involving modern logistics).⁸ Indeed, the study showed that, at pan-European level, the top 10 European food retailers' market share increased from 26% in 2000 to 31% in 2011. The extent into which retail concentration has developed, however, appears to vary across product categories, as well as between Member States. In the edible grocery market as a whole including

⁶ European Commission (2010), *Retail market monitoring report "Towards more efficient and fairer retail services in the internal market for 2020"*, Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and The Committee Of The Regions COM(2010)355 final, p. 3.

⁷ European Commission (2010), *Retail market monitoring report "Towards more efficient and fairer retail services in the internal market for 2020"*, Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and The Committee Of The Regions COM(2010)355 final, p. 3.

⁸ Ernst & Young, Cambridge Econometrics, Arcadia International (2014), *The economic impact of modern retail on choice and innovation in the EU food sector*, Luxembourg: Publications Office of the European Union.

modern retail stores as well as smaller independent and traditional stores, a clear trend towards greater retailers' concentration was observed between 2004 and 2012. The study also showed, however, that the picture is more mixed when the focus is on modern retail, where the largest modern retail groups increased their market shares at the pan-European level, but where growth of modern retailers that had small market shares or were not present in 2004 led to a decrease in concentration in some Member States. Box 1 shows the development of the aggregated market share of the five largest retailers, as well as the Herfindahl-Hirschman Index (HHI),⁹ in the modern retail sector between 2004 and 2012.¹⁰

Box 1: Increased retail concentration in the European Union

Top-five concentration in the modern retail sector

	2004	2006	2008	2010	2012	CAGR
Belgium	94%	94%	93%	93%	94%	0%
Czech Republic	69%	76%	85%	85%	85%	3%
France	79%	79%	79%	79%	78%	0%
Hungary	69%	70%	71%	67%	68%	0%
Italy	72%	70%	69%	69%	68%	-1%
Poland	53%	59%	72%	72%	74%	4%
Portugal	86%	85%	86%	85%	85%	0%
Spain	69%	70%	76%	75%	72%	1%
Denmark	90%	93%	92%	94%	94%	0%
Finland	97%	100%	100%	100%	100%	0%
Germany	77%	85%	86%	90%	90%	2%
Netherlands	89%	88%	78%	84%	91%	0%
Romania	92%	81%	77%	76%	79%	-2%
United Kingdom	86%	83%	83%	85%	85%	0%
Average 14 MS	80%	81%	82%	82%	83%	1%
Austria	92%	91%	95%	95%	95%	0%
Bulgaria	99%	90%	92%	86%	86%	-2%
Croatia	85%	78%	78%	87%	87%	0%

⁹ The Herfindahl-Hirschman Index (HHI) is a measure of concentration that specifically takes into account asymmetric distribution of market shares. The HHI is calculated as the sum of the squares of firms' market shares and is therefore higher as asymmetry in market shares increases. CAGR is an abbreviation of compound annual growth rate.

¹⁰ Ernst & Young, Cambridge Econometrics, Arcadia International (2014), *The economic impact of modern retail on choice and innovation in the EU food sector*, Luxembourg: Publications Office of the European Union, p. 31.

Cyprus	100%	100%	100%	100%	100%	0%
Estonia	98%	100%	100%	100%	100%	0%
Greece	82%	82%	84%	86%	88%	1%
Ireland	95%	94%	94%	95%	100%	1%
Latvia	100%	98%	99%	97%	97%	0%
Lithuania	100%	92%	100%	99%	98%	0%
Luxembourg	99%	99%	96%	94%	94%	-1%
Slovakia	82%	90%	94%	95%	95%	2%
Slovenia	100%	98%	94%	93%	93%	-1%
Sweden	99%	97%	96%	96%	96%	0%

Herfindahl-Hirschmann Index in the modern retail sector

	2004	2006	2008	2010	2012	CAGR
Belgium	2116	2062	1992	1998	2023	-1%
Czech Republic	1199	1387	1690	1701	1779	5%
France	1533	1528	1492	1482	1410	-1%
Hungary	1251	1243	1308	1198	1229	0%
Italy	1299	1220	1188	1192	1170	-1%
Poland	826	926	1228	1353	1580	8%
Portugal	1681	1652	1830	1888	1901	2%
Spain	1335	1422	1686	1735	1701	3%
Denmark	2374	2481	2458	2385	2320	0%
Finland	2881	3736	3751	3862	3935	4%
Germany	1059	1266	1307	1604	1648	6%
Netherlands	2972	2893	2279	2043	2478	-2%
Romania	2302	1572	1394	1361	1880	-3%
United Kingdom	1749	1745	1793	1817	1811	0%
Average 14 MS	1756	1795	1814	1830	1919	1%
Austria	2262	2263	2615	2598	2617	2%
Bulgaria	2943	2047	1959	1646	1907	-5%
Croatia	1834	1622	1620	1986	2088	2%
Cyprus	6530	4049	3634	3572	2879	-10%
Estonia	2981	2522	2308	2246	2225	-4%
Greece	1708	1648	1681	1603	1682	0%
Ireland	2582	2511	2451	2294	2381	-1%
Latvia	3076	3460	3590	3244	3443	1%

Lithuania	2796	2282	2451	2525	2543	-1%
Luxembourg	3499	3343	2998	2704	2730	-3%
Slovakia	1659	1772	1964	2035	2127	3%
Slovenia	3183	2838	2216	2077	2015	-6%
Sweden	3418	3261	3386	3359	3305	0%

The increased level of consolidation at the retail level has substantial implications for primary producers and intermediate suppliers, since they have become increasingly dependent on fewer alternative sales channels in order to reach final consumers. In this context, it is often argued that the increase in retail market power has made suppliers ‘economically dependent’ on retailers, as the latter have become ‘unavoidable trading partners’.¹¹ This situation has given rise to increased concerns on the buyer power enjoyed by retailers vis-à-vis primary producers and intermediate suppliers. In this context, it should be noted traditional measures of concentration may not take into account the role of buying groups (or alliances). Buying groups purchase independently on behalf of their (independent) members to obtain substantial benefits and discounts from suppliers. While buying groups have existed quite some time, their importance has increased considerably since the 1980s, and buyer groups have developed various scopes and organisations.¹² Within the specific context of buyer power, some authors have therefore argued that merely looking at market shares of individual retailers might lead to an underestimation of the potential for buyer power.¹³

1.3 – Modernisation of EU Competition Law

Essentially, the substantive legal framework of EU competition law is formed by the prohibitions on cartels and abuse of a dominant position and provisions concerning merger control.¹⁴ Despite its consistent positioning in the *acquis communautaire*, the substantive EU legal framework on EU competition law has been very dynamic, to say the least. Probably the most influential change in EU competition policy has been the modernisation of EU competition law, which has been gradually implemented since the 1990s. In EU competition law, the term ‘modernisation’ usually refers to procedural

¹¹ See, for example, Dobson, P.W. and Chakraborty, R. (2008), ‘Buying power in the U.K. Groceries Market’, *The Antitrust Bulletin*, 53(2), pp. 333-368.

¹² See Ernst & Young, Cambridge Econometrics, Arcadia International (2014), *The economic impact of modern retail on choice and innovation in the EU food sector*, Luxembourg: Publications Office of the European Union, pp. 52-53.

¹³ See especially Dobson, P.W., Waterson, M. & Davies, S.W. (2003), ‘The Patterns and Implications of Increasing Concentration in European Food Retailing’, *Journal of Agricultural Economics*, 53(1), pp. 111-125.

¹⁴ See Chapter 4.

modernisation. Here, the European Commission used the term when referring to the package of important changes in the institutional and procedural structure of competition law. In this context, presumably the most influential change came with the adoption by the Council of Regulation 1/2003 on 16 December 2002 and the replacement of Regulation 17 on 1 May 2004.¹⁵ This change included inter alia the abolition of the notification procedure for the cartel prohibition, i.e. Article 101 of the Treaty on the Functioning of the European Union (TFEU). Instead, Regulation 1/2003 rendered Article 101(3) TFEU a directly applicable exception, which thus no longer required prior notification. Furthermore, pursuant to Regulation 1/2003, the enforcement of Article 101 and Article 102 TFEU were ‘decentralised’, so that both the Commission and national competition authorities have the competence to apply these rules.¹⁶

During the same period, however, another form of modernisation took shape, one that was of a substantive nature. This development has come to be known as the ‘more economic approach’ and concerns a fundamental reorientation to a much more economics-oriented formulation and enforcement of substantive EU competition law.¹⁷ The implementation of the ‘more economic approach’ has been inspired by developments in antitrust law in the United States. In the 1960s and 1970s, U.S. antitrust law had been greatly influenced by economic insights of the Chicago School of Economics, which sharply condemned the prevailing view that antitrust law should be preoccupied with the protection of small businesses.¹⁸ Instead, Chicago School scholars stressed that the objective of antitrust law should be the protection of competition as a means to promote economic efficiency and that the anti-competitiveness of a certain practice should be evaluated on its effects on consumer welfare.¹⁹

Until the 1990s, EU competition law, too, had a rather legal, formalistic approach, but one that was largely driven to achieve the goal of single market integration in the

¹⁵ Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (hereafter Regulation 1/2003) [2004] OJ L1/1.

¹⁶ See e.g. Jones, A. and Sufrin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, pp. 1026 ff.

¹⁷ Gerber, D.J. (2008), ‘Two Forms of Modernization in European Competition Law’, *Fordham International Law Journal*, 31(5), pp. 1235-1265.

¹⁸ See e.g. Orbach, B.Y. (2010), ‘The Antitrust Consumer Welfare Paradox’, *Journal of Competition Law & Economics*, 7(1), pp. 133-164.

¹⁹ See for example Bork, R.H. (1966), ‘Legislative Intent and the Policy of the Sherman Act’, *Journal of Law & Economics*, 9, pp. 7-48; Bork, R.H. (1978), *The Antitrust Paradox: A Policy at War with Itself*, New York: Basic Books.

European Union.²⁰ More specifically, European competition law adhered to the so-called ‘ordoliberal’ view on competition, where the protection of individual economic freedom – and not economic efficiency – is the primary goal. As a result, early EU competition policy has been highly criticised for being too interventionist. Especially within the context of vertical restraints, such as the treatment of maximum resale price maintenance,²¹ the European Commission’s approach was highly criticised. Similarly, as to the early application of the prohibition of abuse on a dominant position and merger control, the Commission had been regularly accused of confusing the protection of competition with the protection of competitors by sheltering inefficient competitors and paying little to no attention to efficiencies.²²

With the implementation of the ‘more economic approach’, the European Commission has responded to most of this criticism and substantially enhanced the role of economics in both the formulation and the enforcement of competition policy. Similar to the approach in U.S. antitrust law, the European Commission now considers that the anti-competitiveness of certain conduct should be evaluated on its actual effects on consumer welfare.²³ The increased focus on the role of consumer welfare has also been adopted in various notices and guidelines. For example, in its Guidelines on the application of Article 101(3) TFEU, the Commission states that “[t]he objective of Article 101 is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources”.²⁴ In relation to exclusionary conduct, the Commission’s enforcement is said to “ensure that dominant undertakings do not impair effective competition by foreclosing their competitors in an anti competitive way, thus having an adverse impact on consumer welfare, whether in the form of higher price levels than would have otherwise prevailed or in some other

²⁰ See e.g. Van Cayseele, P. and Van den Bergh, R.J. (2000), ‘Antitrust Law’, in: Bouckaert, B. and De Geest, G. (eds.), *Encyclopedia of Law & Economics*, Cheltenham: Edward Elgar, pp. 467-497.

²¹ Maximum resale price maintenance (RPM) concerns a contractual obligation between a supplier and a distributor which requires the distributor to respect a maximum resale price. Maximum RPM was considered by the Commission to be a ‘hardcore’ restriction until 2000, and therefore always fell under the scope of the cartel prohibition and was presumed not to satisfy the criteria of the legal exception of (now) Article 101(3) TFEU.

²² See e.g. Auricchio, V. (2007), ‘Discount Policies in US and EU Antitrust Enforcement Models: Protecting Competition, Competitors or Consumer Welfare?’, *European Competition Journal*, 3(2), pp. 373-409; Pera, A. (2008), ‘Changing Views on Competition, Economic Analysis and EC Antitrust Law’, *European Competition Journal*, 4(1), pp. 127-168.

²³ See more specifically Chapter 4.

²⁴ Commission Notice: Guidelines on the application of Article 101(3) of the Treaty (hereafter Guidelines on the application of 101(3)) [2004] OJ C101/97, par. 13.

form such as limiting quality or reducing consumer choice”.²⁵ Finally, within the context of merger control, the Commission points out that “[t]hrough its control of mergers, the Commission prevents mergers that would be likely to deprive customers of these benefits by significantly increasing the market power of firms”.²⁶

The Commission’s departure from the ordoliberal view on competition towards a more economics-oriented approach can presumably be best illustrated by the Commission’s approach towards the abuse of dominant provision of Article 102 TFEU. In its Guidance Paper on Article 102 TFEU, which has been published in 2009, the European Commission stresses that it “is mindful that what really matters is protecting an effective competitive process and not simply protecting competitors. This may well mean that competitors that deliver less to consumers in terms of price, choice, quality and innovation will leave the market”.²⁷ The development away from ‘protecting competitors’ towards ‘protecting competition’ and increased focus on consumer welfare is also clearly observable within the context of vertical restraints. In its Guidelines on Vertical Restraints, the European Commission entails a much more detailed description of various vertical restraints and their positive and adverse effects on the competitive process and consumer welfare, whereas it is clear that they can substantially limit economic freedom of contractual parties.²⁸

1.4 – Buyer Power Concerns

Especially in light of the changed nature of competition and increasingly leading role of large retail chains, the development away from ‘protecting competitors’ towards ‘protecting competition’ and a prominent position for *consumer* welfare has, however, only intensified the concerns on the economic position of primary *producers* and intermediate *suppliers*. Indeed, some authors have suggested that the traditional framework of EU competition law is unfit to address the market power by buyers vis-à-vis sellers. From their perspective, the traditional rules of competition law were conceived to deal with market power wielded by firms in their relation with customers

²⁵ Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, [2009] OJ C 45/7, par. 19.

²⁶ Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, [2004] OJ C 31/03, par. 8; Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings, [2008] C 265/07, par. 10.

²⁷ Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (hereafter Guidance Paper on Article 102) [2009] OJ C 45/2, par. 6.

²⁸ Guidelines on Vertical Restraints, [2010] OJ C 130/1, which inter alia no longer considers maximum RPM to be a hardcore restriction.

and appear to be ill-suited for addressing market power by firms in their relation with their suppliers.²⁹ In this context, various producer lobby groups have expressed their concerns on the behaviour of large retailers to the political level, while alleging that certain types of so-called ‘buyer power abuses’ are not treated adequately in EU competition policy. Box 2 entails a non-exhaustive list of illustrations of conduct that are often alleged to amount to ‘buyer power abuses’.

Box 2: Non-exhaustive list of buyer power concerns

Pricing behaviour

- Very low pricing;
- Retroactive discounts;
- Over-ordering of a product.

Unilateral changes to non-price contractual terms

- Payment delays;
- Unrealistic delivery terms;
- Exclusivity clauses and fees;³⁰
- Refusal to buy or delisting;³¹
- Imposition of standard model contracts.

*Access to retailers*³²

- Listing fees;
- Entry fees;
- Slotting allowances.

Joint or coordinated conduct

- Purchasing cartels;
- Joint purchasing.

The complaints on the (alleged) harmful effects of buyer power appear well received on the political level. On various occasions, the European Parliament has expressed its concern on the rising level of consolidation in the retail sector and the increased role of

²⁹ See Vogel, L. (1998), ‘Competition law and buyer power: the case for a new approach in Europe’, *European Competition Law Review*, 19(1), pp. 4-11; Kokkoris, I. (2009), *A Gap in the Enforcement of Article 82*, London: British Institute of International and Comparative Law. See also Vander Stichele, M and Young, B. (2008), *The Abuse of Supermarket Buying Power in the EU Food Retail Sector*, Amsterdam: SOMO.

³⁰ Exclusivity clauses or fees may, for instance, involve selective distribution.

³¹ Delisting implies withdrawal of products from store shelves.

³² Listing fees, entry fees and slotting allowances concern payment requirements for becoming a ‘listed’ supplier, for starting contractual negotiations, and for access to specific in-store locations, respectively.

retailers as ‘gatekeepers’, controlling suppliers’ access to (final) consumers. The European Parliament has repeatedly called upon the European Commission to investigate the impact that the concentration of the EU retail sector is having on the various actors, most notably the agricultural sector, and to assess any abuses of buyer power which may follow from such concentration.³³

The various complaints from market parties and concerns of the European Parliament on retailers’ buyer power led the European Commission to commission a comprehensive study on evolution of choice and innovation in food products in Europe.³⁴ The report has been published in 2014 and indicates that the increased concentration in the EU retail sector has not adversely affected consumer choice and innovation. On the contrary, the study shows that in the period between 2004 and 2012 both choice available to consumers and the number of innovations had increased though it should be noted that, perhaps for a large part due to the economic crisis, these figures were slightly less positive since 2008. Accordingly, in its press release accompanying the 2014 report on modern retailing, the European Commission stated that in many Member States, retail markets are not overly concentrated and that retailers’ buyer power does not seem to have a negative impact on choice and innovation.³⁵

While the 2014 report on modern retailing in the EU provides extensive economic evidence concerning the economic effects of developments in the retail sector on consumer choice and innovation, it does not reflect on the appropriate role of competition policy and does not specifically address the complaints that EU competition law is not suited to address the (potential) harmful effects of buyer power. In this context, it is interesting to note that the European Parliament also suggested in its resolutions referred to above to consider changes in EU competition law. For example, Parliament asked the Commission to examine whether the criteria that are used for establishing a ‘dominant position’ in a market are adequate considering

³³ See e.g. European Parliament resolution of 10 March 2009 on the Reports on competition policy 2006 and 2007 (P6_TA(2009)0099); European Parliament resolution of 26 March 2009 on food prices in Europe (P6_TA(2009)0191); European Parliament resolution of 7 September 2010 on fair revenues for farmers: A better functioning food supply chain in Europe (P7_TA(2010)0302); European Parliament resolution of 17 February 2011 on rising food prices (P7_TA(2011)0071); European Parliament resolution of 19 January 2012 on the imbalances in the food supply chain (P7_TA(2012)0012).

³⁴ Ernst & Young, Cambridge Econometrics, Arcadia International (2014), *The economic impact of modern retail on choice and innovation in the EU food sector*, Luxembourg: Publications Office of the European Union.

³⁵ See http://europa.eu/rapid/press-release_IP-14-1080_en.htm (visited on December 29th 2014).

developments in the retail sector.³⁶ Furthermore, Parliament requested measures aimed at strengthening the bargaining position of small suppliers. In this context, the European Parliament has specifically requested the Commission to study the differences in the various approaches by Member States towards buyer power issues.

It is in this context indeed interesting to note that various Member States have exercised the ability, pursuant to Article 3(2) of Regulation 1/2003, to adopt and apply on their territory stricter national laws that prohibit or sanction unilateral conduct engaged in by undertakings. Diverse studies indicate that various Member States have adopted specific measures in order to deal with disparities in market power in business-to-business relations.³⁷ Although these stricter national laws on unilateral conduct typically deal with both seller and buyer power issues, they are often discussed within the context of addressing the (potential) harmful effects of buyer power. The most common example in this context concerns Member States national rules on so-called ‘abuse of economic dependency’ or ‘abuse of a superior bargaining position’. Furthermore, reference is also often made to national laws that prohibit selling below (a certain measure of) costs. An exceptional example of a national measure to address the (potential) harmful effects of buyer power involves an amendment in the national cartel prohibition. Other Member States, such as the United Kingdom, have refrained from amendments to competition law and resorted to establishing sector-specific rules that address ‘unfair’ business practices. Box 3 elaborates on various national initiatives in this context.³⁸

Box 3: National initiatives that may apply to buyer power

Prohibitions on the ‘abuse of economic dependency’ or the ‘abuse of superior bargaining position’ are presumably the most commonly employed national stricter rules on unilateral conduct, and are for instance

³⁶ As to the concept of ‘dominance’, see Section 4.4.

³⁷ Vander Stichele, M and Young, B. (2008), *The Abuse of Supermarket Buying power in the EU Food Retail Sector*, Amsterdam: SOMO; Këlezzi, P. (2008), ‘Abuse below the Threshold of Dominance? Market Power, Market Dominance and Abuse of Economic Dependence’, in: Mackenrodt, M-O., Gallego, B.C. and Enchelmaier, S., *Abuse of Dominant Position: New Interpretation, New Enforcement Mechanisms?*, Berlin: Springer-Verlag, pp. 55-88; Jenny, F. (2008), *Abuse of Dominance*, Geneva, available at: http://www.unctad.org/subsections/ditc_ccpb/docs/ditc_ccpb0008_en.pdf.

³⁸ Këlezzi, P. (2008), ‘Abuse below the Threshold of Dominance? Market Power, Market Dominance and Abuse of Economic Dependence’, in: Mackenrodt, M-O., Gallego, B.C. and Enchelmaier, S., *Abuse of Dominant Position: New Interpretation, New Enforcement Mechanisms?*, Berlin: Springer-Verlag, pp. 55-88; Keirsbilck, B. (2012), ‘Does EU Economic Law Preclude National Prohibitions on Sales Below Costs?’, *Erasmus Law Review*, 5(4), pp. 253-266; Oosterhuis, G. and Huijts, S. (2012), ‘Current Developments in Member States – The Netherlands’, *European Competition Journal*, 8(1), pp. 276-282.

applied in Germany, France and Italy. These provisions mostly apply to situations in which one contractual party holds a structural (bargaining) advantage over its counterparty. Such a finding typically consists in the absence of alternative solutions to sell or to purchase its products in the market, derived from either high concentration of the market or from special features of the bilateral relation between the parties. The main cases involving the ‘abuse’ of economic dependency or superior bargaining position are discrimination, refusal to supply or to buy, excessive pricing and the imposition of unfair commercial terms.

Prohibitions on sales below costs are sometimes also mentioned in the discussion on buyer power.³⁹ Although it should be noted that the precise nature and scope of these national prohibitions vary widely, prohibitions on sales below costs are for instance applied in France, Spain and Portugal. These national prohibitions aim to establish a certain threshold price, typically directly related to some measure of costs, under which undertakings are not allowed to sell (except in a limited set of circumstances). Although prohibitions on sales below costs are often mentioned to prevent predatory pricing by firms with seller power, it has also been mentioned that they might prevent firms to be forced to sell at a loss as a result of buyer power.

The promotion of countervailing seller power is often also mentioned as a possible measure to address inequalities in bargaining power in the supply chain. An exceptional example in this context concerns the amendment of the so-called ‘de minimis’ exception in the Netherlands, pursuant to which practices by undertakings with a market share of 10% or less are exempted from the national cartel prohibition.⁴⁰ An interesting feature of the Dutch ‘de minimis’ exception, in contrast to the ‘de minimis’ Notice of the European Commission, is that it also provides for an exception for the most serious anti-competitive (i.e. ‘hardcore’) practices such as price-fixing and market-sharing (provided that the agreement does not affect trade between Member States). The amendment was specifically introduced with a view to promote primary producers and intermediary suppliers’ ability to create countervailing seller power to large retailers.

³⁹ See e.g. European Parliament resolution of 7 September 2010 on fair revenues for farmers: A better functioning food supply chain in Europe (P7_TA(2010)0302).

⁴⁰ Initially, the Dutch ‘de minimis’ exception applied to undertakings with a market share of 5% or less and when specific turnover criteria were satisfied.

1.5 – Methodology

The complaints on, and requests for amendments of, EU competition law crucially rely on the hypothesis that there is a ‘gap’ in the substantive legal framework of traditional EU competition law, which causes the underenforcement of the (potential) harmful effects of buyer power. In this research, this hypothesis will be put to the test. The central research question is:

Is there a gap in the current substantive legal framework of EU competition law that warrants changes in order to address the (potential) harmful effects of buyer power?

The object of this research is therefore the *current substantive legal framework of EU competition law*, which is analysed so to determine whether that legal framework has a ‘gap’ that prevents it to address the (potential) harmful effects of buyer power.⁴¹ This research thus analyses the substantive competition provisions in EU competition law, as laid down in the Treaty of the Functioning of the European Union (TFEU), the EU Merger Regulation, as well as various notices and guidelines issued by the European Commission. The goal of this exercise is to determine whether the competition rules offer a legal basis to address the potential competition concerns of buyer power. It is important that an assessment of whether the actual treatment of buyer power in EU competition law in practice is adequate falls outside the scope of the analysis. Accordingly, this research does not encompass an evaluation of the merits of decisions and judgements by the European Commission and the European Courts, which would moreover require an extensive analysis of case-specific (commercially sensitive) information that is typically not publicly available. Instead, the discussion of individual cases in this research merely serves an illustrative purpose in determining whether the potential competition concerns of buyer power can be addressed under the competition rules or that there is instead a gap. Similarly, and moreover because of the focus on EU competition law, this research also does not analyse the case law in the national legal order of the Member States.

Although the object of this study is perhaps similar to much legal research, this research aims to provide an original contribution by applying a *Law and Economics* approach. Law and Economics is defined as the economic analysis of law.⁴² It is

⁴¹ The focus will only be on general competition law. Sector-specific competition rules are therefore outside the scope of this research.

⁴² See for instance Friedman, D.D. (1987), ‘Economic Analysis of Law’, in: Eatwell, J., Milgate, M. and Newman, P. (eds.), *The New Palgrave: A Dictionary of Economic Theory and Doctrine*, London: McMillan. See also Kerkmeester, H. (2000), ‘Methodology: General’, in: Bouckaert, B. and De Geest, G. (eds.), *Encyclopedia of Law & Economics*, Cheltenham: Edward Elgar, pp. 383-401.

important to note that the Law and Economics approach does not necessarily qualify for traditional academic economic analysis in the sense that it for example introduces new theoretical models or empirically tests existing theories, nor does it take the same perspective as most traditional legal contributions, in which for instance a specific set of rules is analysed on the basis of developments in jurisprudence and a variety of (sometimes conflicting) interests and goals. Law and Economics is applied economics; it applies the conceptual apparatus of economics to the study of law.⁴³ Law and Economics is thus not multidisciplinary but an interdisciplinary method of research that uses economic concepts within the analysis of the law. Put differently, 'Law and Economics' does not involve separate analyses in 'Law' and 'Economics'.

Following various seminal contributions of influential scholars such as Ronald Coase, Guido Calabresi, Gary Becker, Richard Posner and Steven Shavell, the Law and Economics movement has provided for many valuable insights in most areas of the law, including contract law, tort law, criminal law and property law but also public economic law and its enforcement.⁴⁴ Whereas Law and Economics has been highly influential in the United States, judging from for instance its effect on the use of economics by judges, the number of economists working at law schools and analysis of academic references,⁴⁵ it has as of yet not had such an impact in Europe. In this context, Van Damme explains that there is resistance amongst lawyers that is for a large part based upon various misunderstandings on the applied method of research, but also that economists are less successful in explaining results and their meaning and, in turn, do not understand how lawyers derive normative conclusions.⁴⁶ Since there is, however, much to gain from the interaction between economists and lawyers, Van Damme recommends to address these mutual misunderstandings so to promote successful cooperation. This research embraces this view and aims to contribute to that end.

⁴³ Damme, E.E.C. van (2014), 'Verwevenheid van recht en economie', in: Groenhuijsen, M.S., Hondius, E. and Soeteman, A. (eds.), *Recht in geding*, pp. 259-296; Parisi, F. (2004), 'Positive, Normative and Functional Schools in Law and Economics', *European Journal of Law and Economics*, 18, pp. 259-272.

⁴⁴ See e.g. Shavell, S. (2004), *Foundations of Economic Analysis of Law*, Cambridge: Harvard University Press; Posner, R.A. (2007), *Economic Analysis of Law*, Austin: Wolter Kluwer Law & Business; Cooter, R. and Ulen, T. (2011), *Law & Economics*, Boston: Pearson Addison Wesley; Calabresi, G. and Melamed, A.D. (1972), 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral', *Harvard Law Review*, 85(6), pp. 1089-1128.

⁴⁵ Landes, W.M. and Posner, R.A. (1993), 'The Influence of Economics on Law: A Quantitative Study', *Journal of Law and Economics*, 36(1), pp. 385-424; Shapiro, F.R. and Pearse, M. (2012), 'The Most-Cited Law Review Articles of All Time', *Michigan Law Review*, 110, pp. 1483-1520; Cooter, R. and Ulen, T. (2011), *Law & Economics*, Boston: Pearson Addison Wesley.

⁴⁶ Damme, E.E.C. van (2014), 'Verwevenheid van recht en economie', in: Groenhuijsen, M.S., Hondius, E. and Soeteman, A. (eds.), *Recht in geding*, pp. 259-296.

In the existing economic literature, most contributions deal with market power enjoyed by suppliers in their relation with buyers (seller power) but do not specifically address the market power of buyers vis-à-vis sellers (buyer power).⁴⁷ In only a relatively small number of contributions, economic literature has addressed the context of buyer power. Much of this literature, however, primarily focuses on the effects of buyer power on economic efficiency in different competitive scenarios but does not assess the implications for (the formulation of) EU competition law and its enforcement.⁴⁸ Only sparsely, the Law and Economics literature analyses specific competition concerns of buyer power but typically does so within the context of the legal framework of U.S. antitrust law.⁴⁹ This research instead develops a general economic framework that identifies the potential competition concerns of buyer power and applies it to the current substantive legal framework of EU competition law. To that end, this research studies the economic literature on competition policy in the seller power context, as well as the literature on the efficiency effects of buyer power, in order to identify and explain the potential competition concerns of buyer power. Furthermore, in light of the implementation of the ‘more economic approach’ and corresponding increased focus on consumer welfare, this research assesses specific implications for competition policy design and in particular the use of the consumer welfare standard in the buyer power context. Finally, this research applies the economic framework that is developed to the current substantive competition provisions of EU competition law, so to determine whether they provide a legal basis or that there is perhaps a ‘gap’ concerning buyer power.

The Law and Economics approach in this research implies that the analysis relies on a number of assumptions that are relatively common in traditional economic analysis. One important assumption stems from the mere focus on *economic efficiency* (i.e. economic welfare). Economic efficiency is a fundamental concept in economics. Essentially, economic efficiency refers to making the best use of limited resources in

⁴⁷ See e.g. Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press.

⁴⁸ See e.g. Dobson, P., Waterson, M. and Chu, A. (1998), *The Welfare Consequences of the Exercise of Buying power*, Report prepared for the Office of Fair Trading; Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078; Church, J. (2008), ‘Monopsony and Buyer Power’, Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power.

⁴⁹ See especially Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press. See also Noll, R.G. (2005), ‘“Buyer Power” and Economic Policy’, *Antitrust Law Journal*, 72(2), pp. 589-624.

the economy given people's tastes.⁵⁰ Accordingly, this research analyses the concept of buyer power, and derives conclusions regarding its treatment in competition policy, merely on the basis of the effects on economic welfare. This is not to say that all policy choices should merely depend on effects on economic efficiency or that government intervention may not be justified by other motives than that of welfare. Indeed, the analytical (theoretical) approach that is known as 'welfare economics' explicitly recognises that the broader concept of 'well-being' (or 'utility') encompasses more than welfare, such as the well-being of others, a specific conception of fairness, aesthetic fulfilment, and so on.⁵¹ A notorious difficulty in economic analysis is, however, that individuals presumably have very different views and valuations of other sources of well-being than welfare. Consequently, an analysis that aims to include these factors would require a number of undertakings that are impossible in practice, such as measuring and aggregating individuals' well-being and engaging in interpersonal comparisons of well-being.⁵² Since these difficulties generally do not arise while measuring, aggregating and comparing economic welfare,⁵³ economic

⁵⁰ See for example, Connolly, S. and Munro, A. (1999), *Economics of the Public Sector*, London: Prentice Hall, pp. 25-30; Barr, N. (2004), *Economics of the Welfare State*, New York: Oxford University Press, pp. 66-69.

⁵¹ See in particular Kaplow, L. and Shavell, S. (2002), *Fairness versus welfare*, Cambridge: Harvard University Press. In the welfare economic approach advocated by Kaplow and Shavell, the overall desirability of legal rules for society is based upon social welfare, which is an increasing function of individuals' well-being, and no other factors. Well-being, in turn, may depend on various different factors, depending on whatever individuals value. Economic welfare, as well as other potential sources of well-being such as notions of fairness, can therefore be very relevant, though only insofar individuals value them. Accordingly, Kaplow and Shavell's method requires value judgements because "to adopt welfare economics is to adopt the moral position that one should be concerned, positively and exclusively, with individuals well-being" (p. 26). Furthermore, value judgements are also required with respect to the method of aggregating individuals' well-being into a single measure of social welfare. Such method may for instance range from the utilitarian approach, where social welfare is taken to be the sum of individuals' utilities, to the approach advocated by John Rawls, where social welfare is the utility of the worst-off individuals. Kaplow and Shavell, however, do not endorse a particular method of aggregation; they instead argue that policy analysis should always be guided by some coherent way of aggregating individuals' well-being. This notion of social welfare may also be expressed formally: $W(x) = F(U_1(x), U_2(x), \dots, U_n(x))$, in which W denotes social welfare, where it is assumed that there are n individuals, where U_1 denotes the well-being of the first individual and U_2 the well-being of the second, and so on, and where x stands for an exhaustive description of a situation that would arise under a certain (legal) regime.

⁵² See e.g. Parisi, F. (2004), 'Positive, Normative and Functional Schools in Law and Economics', *European Journal of Law and Economics*, 18, pp. 259-272; Damme, E.E.C. van (2014), 'Verwevenheid van recht en economie', in: Groenhuijsen, M.S., Hondius, E. and Soeteman, A. (eds.), *Recht in geding*, pp. 259-296.

⁵³ An exception to this general statement involves the (important) issue of the distribution of welfare. It is a well-established economic principle that money has more value in the hands of the poor than in those of the rich. Since economic theory typically suggests that competition

analysis typically refrains from making statements on, for instance, the appropriate conception of fairness, and leaves any (potential) trade-offs with economic welfare to the political arena. This research, too, takes this perspective and, unless explicitly stated differently, merely focuses its analysis on the effects of buyer power (and its treatment in EU competition law) on economic efficiency.

Another and somewhat related limitation of this research is that it only analyses the role of competition policy in a simplified context in which the only potential market failure is *market power*. Unless stated differently, it is thus assumed that other types of market failure are either absent or effectively remedied by other government instruments. As will be explained in Chapter 2, competition policy crucially relies on the premise that competition promotes economic efficiency. It is a well-established economic principle, however, that this mechanism can be distorted in the presence of market failure, such as market power, externalities, information asymmetry or when products or services have public good characteristics. Economic theory recognises that in such cases government intervention may be desirable. While government intervention through competition policy is typically justified by the (possible) presence of the market failure of market power,⁵⁴ it is possible that a specific market suffers from multiple types of market failure. Economic theory suggests that other market failures may be effectively remedied by other government instruments (such as regulation, taxes and/or subsidies).⁵⁵ For analytical convenience, this research assumes that any other market failures are either absent or effectively remedied so that the fundamental principle underlying competition policy – that competition promotes economic efficiency – holds. It should be noted, however, that failure by the government to effectively remedy other market failures might cause that competition results in inefficient market outcomes, which may raise relevant questions on the appropriate role of competition policy.⁵⁶

policy is not an effective instrument to redistribute income, however, this is considered not an important issue within the context of this research. See also Subsection 2.4.2.

⁵⁴ See e.g. Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press; Gual, J., Hellwig, M., Perrot, A., Polo, M., Rey, P., Schmidt, K. and Stenbacka, R. (2005), *An economic approach to Article 82*, Report by the Economic Advisory Group for Competition Policy (EAGCP).

⁵⁵ If, for instance, a manufacturer does not take into account that its production of cars imposes pollutes a nearby water supply causing various farmers to invest in water filters (i.e. a negative externality), appropriate solutions may be regulation prescribing pollution controls for the manufacturer or taxation or subsidies of the polluting or filtering activities, respectively. See e.g. Gruber, J. (2011), *Public Finance and Public Policy*, New York: Worth Publishers, pp. 121-318.

⁵⁶ Pursuant to the merger between the Dutch competition authority, the telecoms regulator and the consumer authority, the ability of competition policy to address other types of market failure than market power is subject to extensive discussion in the Netherlands. See, for instance, Ottow, A.T. (2012), 'Modernisering van het mededingingsrecht 2.0', *Markt & Mededinging*, 1, pp. 1-3;

The final set of assumptions concern a number of important assumptions on human behaviour which jointly have come to be known as *rational choice theory*.⁵⁷ Essentially, rational choice theory concerns the standard assumption in economic theory that individuals are rational maximisers.⁵⁸ As a result, it is assumed that all choices are the result of rational deliberation and that all individuals therefore act in their own interest (while taking into account the constraints they face). Correspondingly, consumers are assumed to buy products and services at the quantity and price that best meet their preferences, whereas firms are assumed to have as their sole aim to maximise their profits. It should be noted, however, that the use of rational choice theory has been subject to much criticism. It has been argued that real individuals in fact do not always make deliberate calculations for each decision they face. Instead, it has been pointed out that human rationality is typically bounded due to, inter alia, limited ability to process all relevant information.⁵⁹ Various studies show that actual human behaviour may deviate from rational choice predictions, most notably when it comes to the estimation of risks, changes of preferences and addiction.⁶⁰ The bounded rationality of economic agents forms the specific focus of the multidisciplinary field that has become known as ‘behavioural economics’.⁶¹

Recent contributions in the economic literature discuss, however, that although insights from the behavioural economics literature provide increasingly relevant in many policy

Baarsma, B. (2011), *Moelijke marktwerking en meedogenloze mededinging*, Amsterdam: Amsterdam University Press; Parlevliet, J. and Drahos, M. (2011), ‘Is mededingingsbeperking nodig voor duurzaamheid?’, *Markt & Mededinging*, 3, pp. 96-101; Bijl, P. de and Dijk, T. van (2012), ‘Mededingingsbeleid en publieke belangen: een economisch perspectief’, *Markt & Mededinging*, 4, pp. 149-156.

⁵⁷ See Becker, G.S. (1976), *The Economic Approach to Human Behavior*, Chicago: University of Chicago Press.

⁵⁸ See Ulen, T.S. (2000), ‘Rational Choice Theory in Law and Economics’, in: Bouckaert, B. and De Geest, G. (eds.), *Encyclopedia of Law & Economics*, Cheltenham: Edward Elgar, pp. 790-818, as well as Parisi, F. (2004), ‘Positive, Normative and Functional Schools in Law and Economics’, *European Journal of Law and Economics*, 18, pp. 259-272.

⁵⁹ It should be noted, however, that rational choice theory may take into account such issues by acknowledging that acquiring and processing information is costly and an individual’s choice to limit the collection of information does not necessarily involve ‘irrational behaviour’, see e.g. Posner, R.A. (1993), ‘The New Institutional Economics Meets Law and Economics’, *Journal of Institutional and Theoretical Economics*, 149(1), pp. 73-87.

⁶⁰ See e.g. Sunstein, C.R. (1997), ‘Behavioral Analysis of Law’, *University of Chicago Law Review*, 64, 1175-1195; Sunstein, C.R. (ed.) (2000), *Behavioural Law & Economics*, Cambridge: Cambridge University Press.

⁶¹ See e.g. Jolls, C., Sunstein, C.R. and Thaler, R. (1998), ‘A Behavioral Approach to Law and Economics’, *Stanford Law Review*, 50(5), pp. 1471-1550.

areas, they should not have a radical, if any, impact on competition policy.⁶² The theoretical models underlying competition policy are largely supported by empirical evidence. For instance, the standard predictions of price theory, such as that an increase in the relative price of a good will lead to a decrease in demand for that good, are generally confirmed by empirical evidence. Moreover, the complication that the behaviour of specific individuals may not act (perfectly) rationally need not have an impact on the aggregate behaviour of consumers and firms in markets.⁶³ Furthermore, the consumer biases for which behavioural economics finds an explanation typically involves phenomena such as search costs, switching costs and product differentiation that have long been understood in the industrial organisation literature and in competition policy.⁶⁴ For these reasons, this research takes the position that competition policy should continue to rely on standard neoclassical assumptions based on rational choice assumptions such as profit maximisation.⁶⁵

1.6 – Outline

As explained above, this research addresses, from an economic perspective, the question of whether there is a ‘gap’ concerning buyer power in the current substantive legal framework of EU competition law. To that end, this research, firstly, analyses the economic literature on competition policy in the seller power context as well as the literature on buyer power to develop an economic framework that identifies the potential competition concerns of buyer power for competition policy. Secondly, this research applies the economic framework that is developed to the current substantive legal framework so to determine whether there may be a ‘gap’ concerning buyer power. The research is structured as follows.

Chapter 2 discusses the objectives of competition policy within the traditional context of market power enjoyed by suppliers vis-à-vis buyers (seller power). More

⁶² See Federal Trade Commission (2010), ‘Behavioral Economics: Observations Regarding Issues That Lie Ahead’, Remarks of J.Thomas Rosch, Commissioner, Federal Trade Commission; Office of Fair Trade (2010), *What does Behavioural Economics mean for Competition Policy?*, OFT1224; Oxera (2013), *Behavioural economics and its impact on competition policy*, Study commissioned by the Netherlands Authority for Consumers and Markets (ACM); Authority for Consumers and Markets (2013), *Behavioural Economics and Competition Policy*, Monitor Financial Sector Paper.

⁶³ See also Becker, G. (1962), ‘Irrational Behavior and Economic Theory’, *Journal of Political Economy*, 70, pp. 1-13.

⁶⁴ Oxera (2013), *Behavioural economics and its impact on competition policy*, Study commissioned by the Netherlands Authority for Consumers and Markets (ACM).

⁶⁵ See also Werden, G., Froeb, L.M. and Shor, M. (2011), ‘Behavioral Antitrust and Merger Control’, *Journal of Institutional and Theoretical Economics*, 167(1), pp. 126-147.

specifically, Chapter 2 analyses the economic literature on competition policy so to establish the rationale for and appropriate role of competition policy and discusses the resulting implications for competition policy design. This involves, firstly, a discussion on the relation between competition, market power and economic efficiency, in which the important distinction is made between the context of ‘static equilibrium models’ and a dynamic context. Secondly, Chapter 2 discusses competition policy design and introduces the concept of a ‘welfare standard’ in competition policy.

Chapter 3 aims to establish the (potential) competition concerns of buyer power. That is, Chapter 3 extends the economic framework of competition policy in the traditional seller power context to the context of market power enjoyed by firms in their relation with suppliers. In this exercise, Chapter 3 analyses the economic literature on buyer power in order to establish what buyer power is, under what circumstances it may arise and what its effects are on economic efficiency. Using the economic framework on competition policy in the seller power context and insights from the economics of buyer power, Chapter 3 identifies the (potential) competition concerns of buyer power and moreover reflects on specific implications for competition policy design and in particular the role of the consumer welfare standard.

Chapter 4 assesses whether the (potential) competition concerns of buyer power that have been identified can be addressed under the current substantive legal framework of EU competition law. More specifically, Chapter 4 applies the economic framework developed in Chapters 2 and 3 to EU competition law. This involves, firstly, an assessment of whether and to what extent the substantive competition provisions of Articles 101 and 102 TFEU and the EU Merger Regulation can be applied to buyer conduct. Secondly, Chapter 4 specifically analyses whether the legal framework provides for a legal basis to address the (potential) competition concerns of buyer power.

Chapter 5 entails a concise summary of the main findings and conclusions in this research. Chapter 5 moreover formulates an answer to the central research question of whether there is a gap in the current substantive legal framework of EU competition law concerning buyer power, and moreover reflects on the desirability of possible regulatory changes.

2. THE OBJECTIVES OF COMPETITION POLICY

2.1 – Introduction

The debate on the appropriate treatment of buyer power raises fundamental questions concerning the objectives of competition policy. This is because the trend of increasing retail concentration and (alleged) increase in buyer power have raised concerns on the economic position of producers and suppliers, whereas competition policy appears increasingly occupied with consumer welfare. In the European Union, too, the European Commission has initiated a development towards increased focus on consumer welfare. More specifically, with the implementation of the ‘more economic approach’, the European Commission has responded to the early criticism of being too interventionist and confusing the protection of competition with the protection of competitors by sheltering inefficient competitors.⁶⁶ Accordingly, the European Commission has increasingly relied on economic analysis in both the formulation of competition policy in its notices and guidelines and in its enforcement of EU competition law. In this context, it should be noted, however, that the case law of the European Court of Justice provides for indications that it may not completely agree with the interpretation of the European Commission regarding the role of consumer welfare.⁶⁷

The interpretation of EU competition law concerning its objectives is a legal task that is specifically reserved to the European legislature and the European Courts. This chapter instead addresses the issue of the objective of competition policy from an economic perspective and, before addressing the context of buyer power, focuses on the traditional context of market power enjoyed by sellers in their relation with buyers (seller power). More specifically, this chapter analyses the economic literature on competition policy traditional in order to establish the rationale for and the appropriate role of competition policy concerning seller power. Furthermore, this chapter discusses implications for competition policy design and specifically focuses on the role of consumer welfare.

This chapter is structured as follows. Section 2.2 will discuss the rationale for competition policy within the traditional context of ‘static equilibrium models’ and

⁶⁶ See Section 1.3.

⁶⁷ See for instance Case C-501/06 P, *GlaxoSmithKline v. Commission* [2009] ECR I-9291; Case C-8/08, *T-Mobile Netherlands BV, KPN Mobile NV, Orange Nederland NV and Vodafone Libertel NV v. Raad van Bestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR I-45290. See also Chapter 4.

explains the potential harmful effects of so-called ‘monopoly power’. Section 2.3 however departs from the perspective of ‘static equilibrium models’ and instead assesses the role of competition policy while recognising competition not as a static concept but as a dynamic process of rivalry. While the recognition of competition as a dynamic process has important consequences for the appropriate scope of competition policy, it also has implications for competition policy design. Section 2.4 addresses these issues and specifically focuses on the role of welfare standard in competition policy. Finally, Section 2.5 will conclude with a short summary on the main findings of this chapter.

2.2 – The Traditional Rationale for Competition Policy

This section discusses the traditional rationale for competition policy from the traditional perspective of ‘static equilibrium models’. That is, this section assesses the basic reasons why, and from what, competition should be protected. Subsection 2.2.1 firstly analyses the relation between competition and economic efficiency. Then, Subsection 2.2.2 discusses the potentially harmful role played by so-called *monopoly power*, that is market power enjoyed by a seller in the relation with buyers that have no buyer power.

2.2.1 – Competition and Economic Efficiency

Rather than having an economy’s resources allocated by government decision-making, economists tend to favour allocation by market forces. In the market mechanism, a crucial role is played by the concept of rivalry between firms that is referred to as ‘competition’. Economists’ enthusiasm for competition stems from the well-established premise that competition promotes economic efficiency. This belief is not only based on the economic intuition that rivalry between firms may induce them to perform more efficiently but is for a great deal founded upon *static equilibrium models*. Box 4 entails a very concise discussion on some seminal contributions in the economic literature.

Box 4: Static equilibrium models and economic efficiency

Whereas one of the first (and one of the most) influential works on the beneficial effects of competition was presumably Adam Smith’s *The Wealth of Nations* in 1776, it was only until 1838 that Cournot and in 1874 Walras provided for mathematical proof of this statement.⁶⁸ Perhaps

⁶⁸ Smith, A. (1776), *An Inquiry into the Nature and Causes of the Wealth of Nations*, London: Strahan and Cadell; Cournot, A.A. (1838), *Researches on the Mathematical Principles of the Theory of Wealth*, reprint of the 1927 ed. translated by Bacon, N.T., New York: Augustus M.

the most influential works in this context are Arrow and Debreu's proof of what has come to be labelled as the 'First and Second Theorems of Welfare Economics'.⁶⁹ The Fundamental Theorems provide for mathematical proof that markets result in so-called Pareto Efficiency; a situation in which no one can be made better off without making someone else worse off. The First Fundamental Theorem of Welfare Economics demonstrates that every equilibrium reached through competition is Pareto Efficient, without there being a need for government intervention (i.e. Adam Smith's 'invisible hand'). The Second Fundamental Theorem of Welfare Economics recognises that different Pareto Efficient outcomes may exist and demonstrates that any Pareto Efficient outcome can always be achieved via competition by suitably redistributing resources amongst individuals and then allowing them to trade freely.

While static equilibrium models such as the Fundamental Theorems of Welfare Economics typically apply to the economy as a whole, they can be translated (and have been by for instance Alfred Marshall)⁷⁰ to only a part of the economy. Under so-called 'partial equilibrium analysis', only a small part of the economy is taken into account that is referred to as a 'market', while assuming that all other elements in the economy do not change (e.g. analysing the price of a single product while holding fixed the prices of all other products). In partial equilibrium analysis, different market outcomes are typically compared on the basis of their effects on consumer, producer and total welfare (or surplus).⁷¹

- *Consumer welfare* refers to the amount consumers would have been willing to pay over and above the market price.
- *Producer welfare* concerns the amount suppliers were paid for (the market price) over and above what they would have been willing to take.
- *Total welfare* is the sum of consumer and producer welfare.

Kelley 1971; Walras, L. (1874), *Elements of Pure Economics*, translated by Jaffe, W., New York: Kelley 1969. See Blaug, M. (2001), 'Is Competition Such a Good Thing? Static Efficiency versus Dynamic Efficiency', *Review of Industrial Organization*, 19, pp. 37-48.

⁶⁹ Arrow, K.J. (1951), 'An Extension of the Basic Theorems of Classical Welfare Economics', in: *Proceedings of the Second Berkeley Symposium on Mathematical Statistics and Probability*, Berkeley & Los Angeles: University of California; Debreu, G. (1959), *Theory of Value*, New York: Wiley. See also Baarsma, B. and Theeuwes, J. (2009), 'Publiek belang en marktwerking: Argumenten voor een welvaartseconomische aanpak', in: Damme, E. van and Schinkel, M.P. (eds.), *Marktwerking en Publieke Belangen*, Amsterdam: Koninklijke Vereniging voor Staathuishoudkunde, pp. 23-51.

⁷⁰ Marshall, A. (1920), *Principles of Economics: an introductory volume*, London: Macmillan.

⁷¹ See e.g. Pindyck, R.S. and Rubinfeld, D.L. (2001), *Microeconomics*, London: Prentice Hall, pp. 123-127; 266 ff.

Static equilibrium models typically demonstrate that the market mechanism is capable of achieving Pareto Efficiency, i.e. an ideal ‘end state’ (or equilibrium) in which no individual can be made better off without making someone else worse off. The scenario of Pareto Efficiency can be summarised as a situation in which three conditions simultaneously hold.⁷² Firstly, *consumptive efficiency* has implications for consumer behaviour. Consumptive efficiency requires that consumers allocate their income in a way that maximises their welfare, given their income and market prices. As a result, consumptive efficiency means that no further gains from trade between consumers can be made. Mathematically, consumptive efficiency requires that consumers’ so-called ‘marginal rates of substitution’ are equal. Secondly, *productive efficiency* concerns the extent to which an economy uses its factors of production to their full use. Productive efficiency implies that no more output can be achieved from the given inputs. Technically, this requires that the ‘marginal rates of transformation’ of all products are equal. Finally, *allocative efficiency* combines the previous two conditions and brings together the consumptive and productive sides of the economy. Allocative efficiency essentially implies that producers produce what consumers desire. As a result, the abovementioned trade-off between consumers is the same as on the production side of the economy (i.e. consumers’ marginal rate of substitution equal products’ marginal rate of transformation).

Static equilibrium models express a clear link between competition and economic efficiency. The relation between competition and economic efficiency especially applies to allocative and productive efficiency, both of which have implications for firms. Allocative and productive efficiency are jointly also known as *static efficiency*. From a static efficiency perspective, competition is desirable because it encourages firms to make more goods and sell them for less. Competition ensures that firms produce in accordance with consumer demand and operate against the lowest cost feasible. Because any mismatch between a firm’s production and consumer demand will lead to loss of customers, the equilibrium of Pareto Efficiency is in theory sustainable. However, the ability of competition to result in Pareto Efficiency, as explained by static equilibrium models, crucially depends on three series of assumptions. First, static equilibrium models require competition to satisfy a number of very specific properties, which allows it to be characterised as ‘perfect competition’. The specific features of ‘perfect competition’ are set out in Box 5.⁷³

⁷² See for example, Connolly, S. and Munro, A. (1999), *Economics of the Public Sector*, London: Prentice Hall, pp. 25-30; Barr, N. (2004), *Economics of the Welfare State*, New York: Oxford University Press, pp. 66-69.

⁷³ See for example Church, J. and Ware, R. (2000), *Industrial Organisation: A Strategic Approach*, Boston: McGraw-Hill, pp. 21-25; Van den Bergh, R.J. and Camesasca, P.D. (2006), *European*

Box 5: Conditions for perfect competition

- *Large (or infinite) number of suppliers:* On the supply side of the market, there is large (or infinite) number of producers that decide independently on their actions and are individually unable to affect market outcomes.
- *Large (or infinite) number of buyers:* Similarly, on the demand side of the market, a large number (or infinite) number of buyers operate that decide independently on their actions and are individually unable to affect market outcomes.
- *Free and easy entry and exit:* Both entry to and exit from markets may occur instantaneously without prohibitively high costs.
- *Homogeneous products:* Consumers perceive no quality differences and decide merely on the basis of prices from which producer they will buy.
- *Zero transaction costs:* There are no costs associated with exchanging products.
- *Perfect information:* All economic agents have full information on, amongst others, the price and quality of all products.

Secondly, since static equilibrium models show that, under a number of conditions, competition results an end state (or equilibrium), crucially rely on the assumption that consumer preferences, available production resources and the state of technology are fixed over time.⁷⁴ An important shortcoming of static equilibrium models is therefore that they do not recognise real-world dynamics. A third assumption is that static equilibrium models typically rely on the assumption that there is no so-called market failure. However, markets may for instance ‘fail’ due to the presence of market power, information asymmetry, externalities or in case of public goods. When there is market failure, competition typically does not promote economic efficiency and government intervention may be warranted.⁷⁵ For government intervention in the form of competition policy, the economic justification is typically found in the (possible) presence of the market failure of *market power*.

2.2.2 – Monopoly Power

There is no single definition of market power. Presumably the most important distinction between a state of ‘perfect competition’, on the one hand, and market

Competition Law and Economics: A Comparative Perspective, London: Sweet & Maxwell, pp. 19-21.

⁷⁴ See Section 2.3.

⁷⁵ See e.g. Gruber, J. (2011), *Public Finance and Public Policy*, New York: Worth Publishers.

power, on the other hand, concerns the ability to affect the terms of trade on a market. Whereas under ‘perfect competition’, firms are unable to alter market outcomes such as the price for which they sell their products or service, this is different when a firm has market power. A firm with market power is able to affect the terms of trade on a market, most notably market prices. In this context, the definition of market power that is most commonly used in legal and economic textbooks on competition policy is the ability of a firm to raise prices above the (perfectly) competitive level (marginal costs).⁷⁶ This definition of market power typically refers to one specific type of market power: monopoly power.

For the purposes of assessing the traditional rationale for competition policy, it is useful to firstly analyse the difference between ‘perfect competition’ and the simplified situation that will be referred to as a ‘single monopoly’. In this scenario, it is assumed that a market has a single seller (i.e. a monopolist), the position of which is unchallenged by the possible entry of rival firms. The monopolist is moreover assumed to face constant marginal costs and no fixed costs. Furthermore, the monopolist is assumed to face numerous downstream customers that possess no buyer power, a situation that most commonly occurs in practice on final goods markets on which a firm sells to final consumers (i.e. end users). Finally, it is assumed that price discrimination is not feasible, which means that the monopolist cannot use different terms of trade for different buyers.⁷⁷

When a firm is able to exercise monopoly power (in this simplified context), it charges prices above the competitive level. Since a price equal to marginal cost of production is, in principle, the lowest a firm may charge without making losses, marginal costs are usually used to reflect the competitive level. When a firm’s prices equal its marginal costs, it earns zero profit, though is just able to cover the costs of operating on the market. Firms typically charge prices equal to marginal costs when markets are perfectly competitive, though this may also occur in (theoretical) economic models of competition with less far-reaching and simplifying assumptions (e.g. so-called ‘Bertrand competition’). By contrast, a firm that enjoys monopoly power can charge a

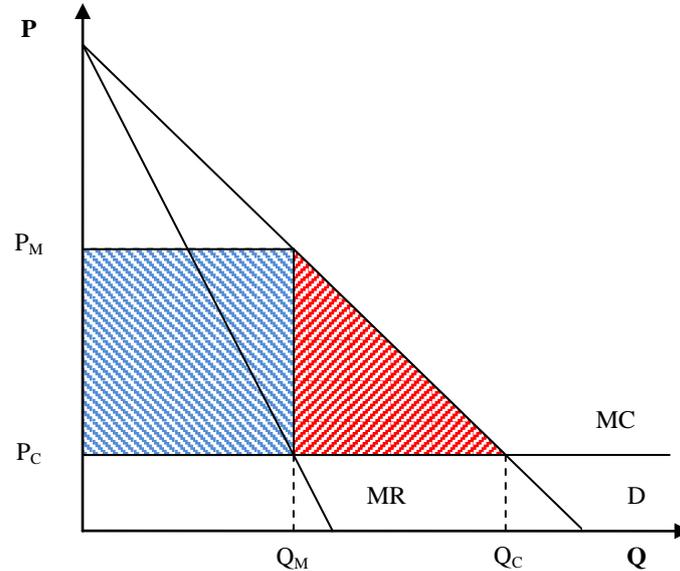
⁷⁶ For some discussions, see e.g. Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 39 ff.; Jones, A. and Sufrin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, pp. 61 ff.

⁷⁷ The analysis largely applies to the situation where there is not one, but multiple seller with monopoly power (e.g. the situation of an oligopoly). For more explicit and elaborate treatments, see e.g. Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 39-64; Van den Bergh, R.J. and Camesasca, P.D. (2006), *European Competition Law and Economics: A Comparative Perspective*, London: Sweet & Maxwell, pp. 16-35.

price above marginal costs, and thus earn economic profit. This is further elaborated upon in Box 6.

Box 6: A single monopoly

Assume that there is a market with a downward sloping demand curve (D) and constant returns to scale, represented by the horizontal marginal cost curve (MC). In the competitive outcome, equilibrium will eventually be reached where supply equals demand, with a corresponding price (P_C) and output (Q_C).



Now consider the other extreme case where there is not perfect competition but a monopolist that, similarly, faces a constant marginal cost curve. The monopolist recognises that its output choice affects market price; for each additional unit of output it sells, the price it can charge reduces for all goods sold. Instead of selling the competitive output (Q_C), the monopolist will therefore reduce its output to the monopolist level (Q_M), where its marginal revenue equals its marginal costs, and charge a monopoly price (P_M).

The welfare effects of the exercise of monopoly power can be summarised as follows. Pursuant to the exercise of monopoly power there is a shift of welfare from consumer surplus to producer surplus. This blue shaded area does not involve a net loss; the decrease in consumer surplus is compensated for by the increase in producer surplus. However, the exercise of monopoly power also involves a net loss in total surplus, i.e. the sum of consumer and producer surplus, which is not compensated.

This net loss, illustrated by the red shaded area, is referred to as the ‘deadweight loss’.

Box 6 shows that the exercise of monopoly power yields allocative inefficiency when compared with the scenario of ‘perfect competition’. However, it should be noted that a monopolist essentially does not operate any differently than a firm that faces significant competition. Since firms exhibit profit-maximising behaviour, the monopolist as well as a supplier that has no market power will increase its output up to the point where this will no longer be profitable. The key difference between a monopolist and a firm without market power therefore concerns the consequences of the firm’s choices. Since the market price is beyond control in a competitive market, an individual firm’s output choice in that market is determined by its costs. By contrast, a monopolist needs to take into account that an increase in output will reduce market price – not only for the additional unit but for all units sold. As a result, the monopolist will recognise that it can earn monopoly profit by reducing output and charging a price above the competitive level. This causes a decrease in consumer surplus but increases producer surplus. However, the increase in producer surplus is less than the decrease in consumer surplus, resulting in a net loss of total surplus, resembled by the ‘deadweight loss’.

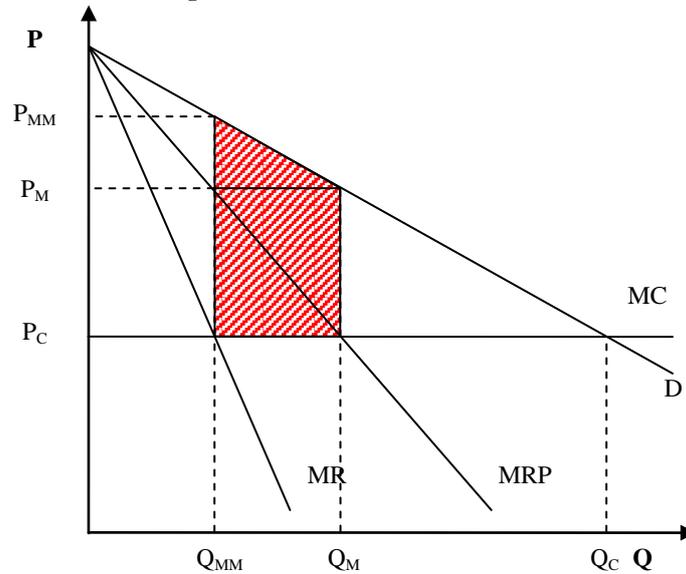
In the situation of a ‘single monopoly’ that is analysed above, seller power is exercised in the relation to customers that have no market power, such as is generally the case in final goods markets. On most markets, however, customers are not final consumers, because products and services are typically engaged in multiple transactions throughout the distribution chain. In the situation where a manufacturer needs to rely on a retailer to sell to final consumers, it is possible that market power is present on multiple stages in the distribution chain, for instance because not only the manufacturer but also the retailer possesses market power. Whereas it is of course possible that the retailer in this context will also possess (some degree of) buyer power,⁷⁸ the situation that is most commonly discussed in the competition policy literature concerns the situation of so-called ‘double marginalisation’. In the double marginalisation scenario, both manufacturers and retailers possess monopoly power (though neither of them has buyer power).⁷⁹ In the scenario of two successive monopolies, for instance, both the manufacturer and the retailer are the single seller on their stage of the distribution chain and exercise monopoly power. However, since both firms add a monopoly margin over their own costs and reduce their purchases, the double marginalisation scenario is even

⁷⁸ See Subsection 2.3.1.

⁷⁹ The double marginalisation scenario was first identified by Spengler, J.J. (1950), ‘Vertical Integration and Anti-Trust Policy’, *Journal of Political Economy*, 58, pp. 347-352.

more harmful to economic efficiency than the single monopoly scenario.⁸⁰ This is further elaborated upon in Box 7.⁸¹

Box 7: Double marginalisation



Assume a market in which a manufacturer makes use of a retailer in order to sell to final consumers. For simplicity, assume that the retailer has no other costs than the constant marginal costs (MC) of the manufacturer's product (i.e. the input product). The demand faced by the retailer is illustrated by D. However, since the retailer is a monopolist and enjoys monopoly power, the additional revenue it obtains by employing one additional unit of the input product is marginal revenue product (MRP). MRP thus reflects the retailer's marginal revenue but, since the manufacturer sells only to one retailer, MRP also denotes the manufacturer's derived demand curve for selling its input product to the retailer. Again, however, since the manufacturer, too, enjoys monopoly power, the additional revenue the manufacturer obtains by producing one additional input product is denoted by Marginal Revenue (MR).

⁸⁰ Since the allocative inefficiency in the situation of double marginalisation is typically larger than in the situation of a single monopoly, there is an economic saying: 'What's worse than a monopoly? Two monopolies!'

⁸¹ See e.g. Church, J. and Ware, R. (2000), *Industrial Organisation: A Strategic Approach*, Boston: McGraw-Hill, pp. 685-686; Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 307-313.

This scenario results in the following market outcomes. The manufacturer produces up to the point where the marginal revenue obtained by increasing the number of input products produced (MR) equals its marginal costs (MC). This results in the corresponding output choice Q_{MM} and manufacturer's (input) price P_M . Then, given the manufacturer's price P_M , which reflect the retailer's (only) marginal costs, the retailer, too, will produce a quantity where the additional revenue of increasing output (MRP) equals marginal cost, i.e. the input price (P_M), leading to the output price (for final consumers) of P_{MM} .

The double marginalisation scenario results in additional allocative inefficiency compared to the situation of a single monopoly. In the single monopoly situation, such as when the manufacturer and the retailer in the example above are an integrated firm, there is only one monopoly margin added to costs. That is, under the single monopoly situation, the output price that consumers pay would be P_M and the corresponding output would be Q_M . The red shaded area reflects the additional allocative inefficiency of the double marginalisation scenario. Because of the lower profit compared to the single monopoly situation, vertical integration typically benefits both firms and moreover promotes economic efficiency.

2.2.3 – Conclusion

Competition policy is based upon the principle that competition promotes economic efficiency. For a great deal, this premise is based upon seminal contributions in the welfare economics literature. Static equilibrium models explain that the market mechanism may result in an economically ideal 'end state' (or equilibrium) where no one can be made better off without making someone else worse off: so-called 'Pareto Efficiency'. Pareto Efficiency can be summarised as a scenario in which three conditions simultaneously hold. First, consumptive efficiency requires that consumers allocate their income in a way that maximises their welfare, given their income and market prices. Second, productive efficiency requires that no more output can be achieved from the given inputs. Finally, allocative efficiency requires that producers produce what consumers desire. Allocative and productive efficiency are jointly also known as static efficiency. From a static efficiency perspective, competition is desirable because it induces firms to produce in accordance with their customers' needs and operate against the lowest cost feasible.

Static equilibrium models require, for competition to result in the ideal 'end state' (or equilibrium) of Pareto Efficiency, a large number of unlikely conditions to be satisfied. First, static equilibrium models typically require competition to satisfy a number of very specific properties, such as a very large number (or infinite) of buyers and sellers

and the absence of entry costs, which allows it to be characterised as ‘perfect competition’. Secondly, static equilibrium models do not consider dynamics and for instance assume that consumer preferences, available production resources and the state of technology are fixed over time. Finally, static equilibrium models require the absence of market failure. The potential presence of the market failure of ‘market power’ is the economic justification for competition policy.

Market power is most commonly discussed in terms of monopoly power and compared with the situation of ‘perfect competition’. In this context, monopoly power concerns the ability of a firm to raise prices charged to its customers above the competitive level (marginal costs), and thus generate economic profit. However, since the higher prices are obtained by reducing output, the exercise of monopoly power typically harms economic efficiency because it reduces allocative efficiency. Since manufacturers often rely on retailers to sell on final consumers, it is also possible that market power is present on multiple stages of the distribution chain. A scenario that is in this context often analysed in textbooks on competition policy is the so-called ‘double marginalisation’ situation in which both a manufacturer and a retailer are the single seller on their stage in the distribution chain and enjoy monopoly power (but no buyer power). Since both the manufacturer and the retailer will in this scenario reduce their output and add a monopoly margin over their costs, the double marginalisation scenario typically results in additional allocative inefficiency compared to the situation in which only one firm exercises monopoly power.

2.3 – Competition Policy in a Dynamic Context

The previous section has discussed the relation between competition and economic efficiency from the traditional perspective of static equilibrium models. It has been explained that these models show that, when a large number of conditions are satisfied, competition can result in an end-state (or equilibrium) in which no one can be made better off without making someone worse off: Pareto Efficiency. It has moreover been discussed that market power may, however, harm economic efficiency. As discussed in terms of monopoly power, market power typically results in allocative inefficiency essentially because it results in a lower level of output than under the scenario of ‘perfect competition’. From the traditional perspective of static equilibrium models, one might therefore be tempted to conclude that competition policy should aim to eliminate all market power.

This section relaxes some of the unrealistic assumptions underlying static equilibrium models and explains that competition should be recognised, not as a static concept, but as a dynamic process. Section 2.3.1 explains that competition, as a dynamic process of

rivalry, may involve various efficiency trade-offs that competition policy should take into account. Section 2.3.2 discusses that the recognition of competition as a dynamic process has important implications for the appropriate scope of competition policy and introduces the concept of ‘anti-competitive behaviour’.

2.3.1 – Efficiency Trade-Offs

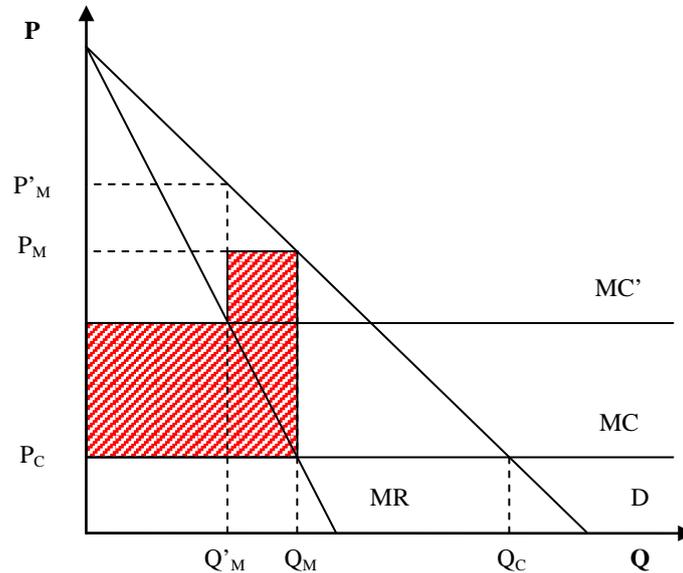
A first trade-off that may arise concerns the relation between *productive efficiency and allocative efficiency* (jointly known as ‘static efficiency’). As noted above, productive efficiency requires that firms can produce no more output from the given inputs, whereas allocative efficiency essentially requires that producers produce what consumers desire and are willing to pay for. The previous section has moreover explained that market power tends to result in allocative inefficiency due to reduced output. The ability to exercise substantial market power may, however, also harm productive efficiency. Although this is somewhat counterintuitive, since it is not straightforward why a firm with market power would choose to produce less with given inputs (and thereby reduce its profit), economic literature suggest various arguments why a firm with a very high degree of market power might be less productively efficient.⁸² For instance, within the context of monopoly power, it has been suggested that the absence of competitive pressure and the ability to exercise (now and in the foreseeable future) considerable market power can induce a firm to operate less cost-effectively. Such productive inefficiency may for instance arise due to a mismatch in the incentives of the firm’s owners (the ‘principal’) and the firm’s manager (the ‘agent’), possibly resulting in for instance higher salaries or excess capacity in production. The additional productive inefficiency, which has become known as ‘X-inefficiency’,⁸³ is concisely discussed in Box 8.

Box 8: Monopoly power and productive inefficiency

Similar to the analysis of a ‘single monopoly’ in Subsection 2.2.2, consider a market with a downward sloping demand curve (D) and constant returns to scale, resembled by the horizontal marginal cost (MC) curve. From the perspective of allocative efficiency, recall that the monopolist (compared to the scenario of ‘perfect competition’) will reduce output up to the point where marginal revenue (MR) equals marginal costs (MC), resulting in quantity Q_M and monopoly price P_M .

⁸² For a general and more extensive discussion, see Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 45-55, and the references therein.

⁸³ Leibenstein, H. (1966), ‘Allocative efficiency vs. “X-efficiency”’, *American Economic Review*, 56, pp. 392-415.



Suppose now that the lack of competition gives rise to higher unit costs for the monopolist, for instance because it employs a high number of managers and pays them excessively. Due to the presence of 'X-inefficiency', the monopolist's marginal cost curve shifts to MC' . As a result, the new profit-maximising output choice for the monopolist is Q'_M and price P'_M , thereby moreover resulting in additional allocative inefficiency. Total harm to (allocative and productive) efficiency is illustrated by the red shaded area.

In the simple illustration in Box 8, allocative and productive efficiency are aligned; the presence of monopoly power results in harm to both allocative efficiency and productive efficiency. The harmful effects on productive efficiency may therefore form an additional motive to challenge market power. However, it is also possible that allocative efficiency conflicts with productive efficiency.⁸⁴ A conflict between allocative and productive efficiency arises when some firms are more productive than others. This situation may for instance occur when there are economies of scale. As noted above, the scenario of 'perfect competition' assumes a large (or infinite) number of buyers and sellers and the absence of entry costs, so that any degree of market power (and hence allocative inefficiency) will be eliminated due to new entry.⁸⁵ This is different when this condition is relaxed and firms have to incur (recurrent or set-up)

⁸⁴ See also Van den Bergh, R.J. and Camesasca, P.D. (2006), *European Competition Law and Economics: A Comparative Perspective*, London: Sweet & Maxwell, pp. 29-35.

⁸⁵ See Subsection 2.2.1.

fixed costs.⁸⁶ This is because fixed costs give rise to economies of scale; because average costs fall, it pays for a firm to have substantial output. If scale economies are large enough, economic efficiency is not best served by the elimination of market power through the entry of new firms (or artificially prevent firms from exiting) because the corresponding duplication of fixed costs involves a significant loss of productive efficiency. In this situation, economic efficiency requires some allocative inefficiency for the promotion of productive efficiency.

Besides fixed costs, firms may also be more productive than their rivals when economies of scale allow a firm to operate at lower, or even decreasing, level of marginal costs. In many markets, a greater level of output may allow employees of a firm to specialise in their tasks or to make more productive use of important production equipment, which can result in lower per-unit production costs. Furthermore, superior productivity may also be the result of economies of scope, which typically allow a firm to operate more cost-effectively due to the joint production of various products and/or services. In these scenarios, too, there is a trade-off between allocative and productive efficiency. This is because allocative efficiency typically requires the maintenance of a high number of firms on the market, so that any market power will be eliminated. By contrast, productive efficiency requires that firms that operate more efficiently than others (e.g. by producing at lower costs) should take the business away from their less efficient rivals and, by doing so, gain market power and potentially harm allocative efficiency.⁸⁷ In these situations, economic efficiency generally requires productive efficiency to prevail over allocative efficiency. It should be noted that this may go as far as the situation where economic efficiency requires that there is only one firm operating on the market, a so-called 'natural monopoly'.

Another possible efficiency trade-off stems from the important shortcoming of static equilibrium models concerns their inability to take into account real-world dynamics. In marked contrast with what these models assume, consumer preferences, available production resources and the state of technology are not fixed; they change continuously. Accordingly, competition is not and does not result in an 'end state' or 'equilibrium'. Instead, competition is an ongoing dynamic process of rivalry in which firms constantly create and adopt new technologies, products and processes in order to gain a competitive advantage over their rivals. Competition thus functions as a selection mechanism that forces firms to exit that perform the least in the eyes of their

⁸⁶ Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 51-52.

⁸⁷ Van den Bergh, R.J. and Camesasca, P.D. (2006), *European Competition Law and Economics: A Comparative Perspective*, London: Sweet & Maxwell, pp. 29-30.

customers, not only in terms of prices but also in terms of new products and processes.⁸⁸ The extent in which firms introduce new products and processes is referred to as *dynamic efficiency*, which may conflict with allocative efficiency.⁸⁹ The relationship between competition and innovation is concisely discussed in Box 9.

Box 9: Competition, market power and innovation

The relation between competition, market power and innovation (or dynamic efficiency) is the subject of a long-standing and ongoing debate in the economic literature,⁹⁰ the essence of which can be illustrated by two opposing views.⁹¹ On one end, there is the view expressed by Kenneth Arrow.⁹² Arrow explained that market power distorts the incentive to innovate. For instance, a monopolist is less willing to invest in innovation than competitive firms because it has less to gain. The additional profit a monopolist may gain as a result of its investment in innovation will be relatively low if its position is fairly secure. The limited additional profit it will gain may therefore make it not worthwhile to invest in new products and processes. By contrast, firms operating in a more competitive environment have a strong incentive to invest in innovation in order to obtain a competitive advantage over their rivals. From this perspective, it can be concluded that competition drives innovation.

On the other end in the debate, there is the view expressed by various economic scholars of the Austrian school of economics, such as Joseph Schumpeter and Friedrich von Hayek.⁹³ These scholars argued that it is

⁸⁸ See e.g. Audretsch, D.B., Baumol, W.J. and Burke, A.E. (2001), 'Competition policy in dynamic markets', *International Journal of Industrial Organization*, 19, pp. 613-634; Blaug, M. (2001), 'Is Competition Such a Good Thing? Static Efficiency versus Dynamic Efficiency', *Review of Industrial Organization*, 19, pp. 37-48; Kerber, W. (2009), 'Should Competition Law Promote Efficiency? Some Reflections of an Economist on the Normative Foundations of Competition Law', in: Drexler, J., Idot, L. and Monéger, J. (eds.), *Economic Theory and Competition Law*, Cheltenham: Elgar, pp. 93-120; Werden, G.J. (2011), 'Consumer welfare and competition policy', in: Drexler, J., Kerber, W. and Podszun, R., *Competition Policy and the Economic Approach: Foundations and Limitations*, Cheltenham: Edward Elgar, pp. 11-43.

⁸⁹ See e.g. Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 55-64.

⁹⁰ See e.g. Gilbert, R. (2006), 'Looking for Mr. Schumpeter: Where Are We in the Competition-Innovation Debate?', in: Jaffe, A., Lerner, J. and Stern, S. (eds.), *Innovation Policy and the Economy*, Cambridge: National Bureau of Economic Research and MIT Press, pp. 159-215.

⁹¹ Baker, J.P. (2007), 'Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation', *Antitrust Law Journal*, 74, pp. 575-602.

⁹² Arrow, K.J. (1962), 'Economic Welfare and the Allocation of Resources for Invention', in: Nelson, R. (ed.), *The Rate and Direction of Inventive Activity: Economic and Social Factors*, Princeton, N.J.: National Bureau of Economic Research, pp. 609-625.

⁹³ For example, Schumpeter, J.A. (1934), *The Theory of Economic Development. An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, Cambridge: Harvard University Press;

not competition but market power that drives innovation. From this perspective, large firms or even monopolists may be more innovative than firms in competitive markets. Larger firms can for instance better finance large research and development (R&D) projects than small firms that will typically have to find financing outside their organisation. Moreover, the Austrians argued that too intense competition will discourage a firm to innovate, as its rivals will use its ideas and benefit from its investment. According to Schumpeter, innovation is the result of so-called 'creative destruction', by which newer technologies continuously supplant the old. Accordingly, firms that are successful in this process earn monopoly profit. It is the ability to earn these large profits that forms the very incentive to innovate. In this, the Austrians stressed the importance of so-called 'market contestability', which allows rivals to gain upon the investment and thereby make the presence of monopoly power (and accompanying static inefficiencies) of a temporary nature.⁹⁴

The relation between competition, market power and innovation has also been subject of numerous empirical studies. Generally, most studies indicate that there exists an 'inverted U' relationship between competition and innovation.⁹⁵ That is, innovation is the greatest neither in very competitive nor in monopolistic industries but in industries with an oligopolistic market structure. It should be noted, however, that the role of innovation typically differs per market. In high-tech markets, the ability to exercise monopoly power (i.e. to gain profit) is a condition 'sine qua non' for firms to innovate as it allows them to recoup their costly investments.⁹⁶ Another important conclusion from empirical literature is that innovation processes are highly uncertain and unpredictable, making it impossible to know the outcome beforehand.⁹⁷ Innovation cannot be treated as ordinary production processes (with predefined inputs and

Schumpeter, J.A. (1942), *Capitalism, Socialism and Democracy*, New York: Harper and Row; Hayek, F.A. von, 'The Meaning of Competition', in: Hayek, F.A. von (ed.), *Individualism and Economic Order*, London: Routledge and Kegan Paul, pp. 92-106; Hayek, F.A. von (1978), 'Competition as a Discovery Procedure', in: Hayek, F.A. von, *New Studies in Philosophy, Politics, Economics and the History of Ideas*, Chicago: Chicago University Press, pp. 179-190.

⁹⁴ See Kirzner, I.M. (1993), *Competition and Entrepreneurship*, Chicago: Chicago University Press. As to the concept of contestable markets, see also Baumol, W., Panzar, J. and Willig, R. (1982), *Contestable Markets and the Theory of Industrial Structure*, New York: Harcourt, Brace, Jovanovich.

⁹⁵ See Aghion, P., Bloom, N., Blundell, R., Griffith, R. and Howitt, P. (2005), 'Competition and Innovation: An Inverted U Relationship', *The Quarterly Journal of Economics*, 120(2), pp. 701-728.

⁹⁶ Posner, R.A. (2001), 'Antitrust in the New Economy', *Antitrust Law Journal*, 68, pp. 925-943.

⁹⁷ Kerber, W. (2009), 'Should Competition Law Promote Efficiency? Some Reflections of an Economist on the Normative Foundations of Competition Law', in: Drexler, J., Idot, L. and Monégier, J. (eds.), *Economic Theory and Competition Law*, Cheltenham: Elgar, pp. 93-120.

outputs) and should therefore not be analysed similar to the analysis of static efficiency.⁹⁸ However, it is well-established that the impact of innovation on overall economic efficiency can very easily dominate that of static efficiency (allocative and productive efficiency). That is, products and processes may have a much more significant effect on welfare, at least in the long run, than does any likely variation in price or output.⁹⁹

From the various contributions on the relation between competition, market power and innovation, economists typically conclude that both competition and market power stimulate dynamic efficiency. On the one hand, a firm with a significant degree of (unchallenged) market power may have limited incentives to invest in R&D. This is because the additional profit a firm might gain is less likely to be sufficient to cover its initial investments. On the other hand, however, firms' incentives to invest in R&D crucially depend on the possibility of appropriating the results of their investment.¹⁰⁰ That is, a necessary requirement for firms' incentives to innovate is the expectation to generate economic profit that is at least sufficient to cover the costs of such investments. Because of the highly risky nature of R&D investments, firms will typically only invest if they anticipate profit that well exceeds the corresponding costs. Accordingly, the presence of a substantial degree of market power thus need not imply that a market is not functioning well but may very well mean that economic efficiency requires the promotion of market power (and allocative inefficiency) in order to promote dynamic efficiency.

2.3.2 – *Anti-Competitive Behaviour*

The previous subsection explained that economic efficiency may require the competitive process to develop market power in order to promote productive and/or dynamic efficiency. It is also possible, however, that market power is created without there being overriding gains in productive and/or dynamic efficiency. This typically happens when firms exhibit so-called *anti-competitive behaviour*. Essentially, anti-competitive behaviour involves the creation, strengthening or maintenance of market

⁹⁸ See e.g. Dosi, G. (1988), 'Sources, Procedures and Microeconomic Effects of Innovation', *Journal of Economic Literature*, 26(3), pp. 1120-1171.

⁹⁹ Audretsch, D.B., Baumol, W.J. and Burke, A.E. (2001), 'Competition policy in dynamic markets', *International Journal of Industrial Organization*, 19, pp. 613-634. See also Easterbrook, F.H. (1992), 'Ignorance and Antitrust', in: Jorde, T.M. and Teece, D.J. (eds.), *Antitrust, Innovation, and Competitiveness*, New York: Oxford University Press, pp. 119-136.

¹⁰⁰ See also Hildebrand, D. (2002), 'The European School in EC Competition Law', *World Competition*, 25(1), pp. 3-23; Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 56 ff.

power not through but by harming the competitive process. The qualification of firm behaviour as ‘anti-competitive’ typically requires that two conditions are satisfied.¹⁰¹ First, anti-competitive behaviour requires that there is some kind of harm to the competitive process. Although this criterion is rather vague and therefore gives very little guidance, it reflects the fundamental principle underlying competition policy that competition itself (and not government allocation or intervention) is the best mechanism to promote economic efficiency. That is, competition policy should not try to let its own intervention replace the role of competition in the market place.¹⁰² Secondly, anti-competitive conduct involves firm behaviour that harms economic efficiency. Harm to economic efficiency is typically reflected in the creation, strengthening or maintenance of market power that results in allocative inefficiency, which is not compensated for by overriding gains in productive and/or dynamic efficiency. Economic literature typically recognises three types of anti-competitive behaviour: collusion, exclusionary conduct and mergers.

The first type of conduct that may amount to anti-competitive behaviour is *collusion*.¹⁰³ When firms engage in collusion, they inflict harm to competition by agreeing on the material terms on which the competitive process induces them to compete. Consequently, collusion enables firms to by-pass the competitive process, so as to create, strengthen or maintain market power. Unless accompanied with overriding efficiency gains, the (joint) exercise of market power can therefore harm economic efficiency in a similar fashion as the monopoly situation discussed in Box 6. Collusion may take many forms. Perhaps the clearest example of collusion is price-fixing, where firms eliminate price competition by agreeing on their prices. Alternatively, with so-called market-sharing, firms agree not to operate in some markets so to create, strengthen or maintain market power in other markets. Economic theory suggests that collusion is not always easy to reach. In the situation where firms have agreed on, for instance, the prices they charge, each individual firm has a strong incentive to deviate from the collusive strategy. This is because unilateral deviation from the collusive strategy typically increases a firm’s profit at the cost of the firms that stick to the collusive strategy. However, if other firms are able to detect this deviation, they may be

¹⁰¹ See Farrell, J. and Katz, M.L. (2006), ‘The Economics of Welfare Standards in Antitrust’, *Competition Policy International*, 2(2), pp. 3-28.

¹⁰² See especially Gual, J., Hellwig, M., Perrot, A., Polo, M., Rey, P., Schmidt, K. and Stenbacka, R. (2005), *An economic approach to Article 82*, Report by the Economic Advisory Group for Competition Policy (EAGCP); Werden, G.J. (2011), ‘Consumer welfare and competition policy’, in: Drexler, J., Kerber, W. and Podszun, R., *Competition Policy and the Economic Approach: Foundations and Limitations*, Cheltenham: Edward Elgar, pp. 11-43; Breyer, S.G. (1982), *Regulation and Its Reform*, Cambridge: Harvard University Press, pp. 156-157.

¹⁰³ See more extensively, Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 137-230.

able to punish it (e.g. by starting a price war), thereby providing all firms with an ex ante incentive to keep to the collusive strategy. If all firms expect that detection and punishment of deviation is sufficiently likely, a collusive outcome is in principle sustainable. Accordingly, collusion is typically easier to sustain when it involves explicit agreement (i.e. a cartel) between firms than tacit agreement. Moreover, the sustainability of collusion in a specific case depends on a variety of factors that affect the profitability of collusion, the likelihood of detection and the severity of punishment.¹⁰⁴ This is shortly discussed in Box 10.

Box 10: Factors facilitating or hindering collusion

- *Number of firms*: Collusion is easier to sustain when the number of firms on the market is low, because this makes coordination between firms easier.
- *Entry barriers*: High entry barriers reduce the likelihood of entry and thereby make collusion easier to sustain.
- *Market transparency*: Firms are better able to observe each other's behaviour, and thus to detect deviation from collusion, when the market is transparent. Transparency therefore makes collusion easier to sustain.
- *Innovation*: Collusion is more difficult to sustain in markets where innovation plays an important role because it allows innovating firms to suddenly gain a competitive advantage over their rivals, thereby making collusion less attractive.
- *Symmetry*: When firms have similar cost structures and production capacities, collusion is easier to sustain because this induces firms to make similar decisions.
- *Firm interaction*: When firms meet more frequently (on the same or on other markets) this enhances firms' abilities to punish deviation and hence facilitates collusion.

The second category of business conduct that may amount to anti-competitive behaviour is *exclusionary conduct*. Exclusionary conduct is a special – and perhaps counterintuitive – type of anti-competitive behaviour since it does not involve multiple

¹⁰⁴ Ivaldi, M., Julien, B., Rey, P., Seabright, P. and Tirole, J. (2003), *The Economics of Tacit Collusion*, Final Report for DG Competition, European Commission. It is in this context interesting to note that the Netherlands Competition Authority (now Authority for Consumers and Markets) has developed a Competition Indicator using, inter alia, the factors discussed in Box 10, and which is used to detect industries that are prone to anti-competitive behaviour. See e.g. Petit, L. (2012), *The Economic Detection Instrument of the Netherlands Competition Authority, The Competition Index*, NMa Working Papers No. 6; Petit, L. and Van Sinderen, J. (2011), 'Detectie van concurrentiegebrek in 2011', *Economische Statistische Berichten*, 96(4604), pp. 118-121.

firms but is typically exhibited by a single firm. Exclusionary conduct essentially concerns the unilateral effort of a firm with a (very) high degree of market power to use that power to exclude its rivals or to deter potential entrants from entering that, or an adjacent, market so as to gain market power.¹⁰⁵ Exclusionary conduct can involve a large number of practices that however work through a very similar mechanism. For this reason, economists typically argue that it is better not to assess a particular practice by its form (form-based) but instead focus on the effects of that practice (effects-based).¹⁰⁶ Furthermore, it is important to note that many types of behaviour that might be part of an exclusionary strategy and thus appear harmful, for instance because it restricts a firm's contractual freedom, may in fact promote economic efficiency. Even when specific pricing behaviour or contractual obligation leads to the exit of a firm (or failure to enter), this may in fact well reflect a firm's superior efficiency, for instance because the practice allows a firm to deliver better terms to consumers and should then form no concern for competition policy.¹⁰⁷ After all, since competition promotes economic efficiency precisely because it only allows the most efficient firms to survive on the market, competition policy should refrain from sheltering or protecting competitors but should instead protect this selection mechanism itself.

In the context of exclusionary conduct, especially noteworthy are the contributions by scholars of the Chicago School of Economics.¹⁰⁸ On the one hand, Chicago School scholars have shown that many practices that might appear anti-competitive can in fact be an important means to promote (and not harm) economic efficiency. On the other hand, even when such practices could be harmful, Chicago School insights have shown that, due to their primary goal to maximise profit, they will hardly have an incentive to engage in them.¹⁰⁹ In fact, it is only relatively recently that economists have been able to provide examples of when exclusionary conduct might be a profitable strategy, relaxing some of the (sometimes unrealistic) assumptions underlying the Chicago School critique. Modern economic theory suggests that, under specific circumstances,

¹⁰⁵ See especially Gual, J., Hellwig, M., Perrot, A., Polo, M., Rey, P., Schmidt, K. and Stenbacka, R. (2005), *An economic approach to Article 82*, Report by the Economic Advisory Group for Competition Policy (EAGCP).

¹⁰⁶ See especially Gual, J., Hellwig, M., Perrot, A., Polo, M., Rey, P., Schmidt, K. and Stenbacka, R. (2005), *An economic approach to Article 82*, Report by the Economic Advisory Group for Competition Policy (EAGCP).

¹⁰⁷ See e.g. West, J. (2005), *Competition on the merits*, OECD Roundtables on Competition Policy Working Paper No. 56.

¹⁰⁸ For a short discussion, see e.g. Posner, R.A. (1979), 'The Chicago School of Antitrust Analysis', *University of Pennsylvania Law Review*, 127, pp. 925-948.

¹⁰⁹ An important example is the so-called 'single monopoly profit theorem', which states that there is only one monopoly profit to be gained in the distribution chain. As a result, firms typically have little or no incentive to set up a second base of market power in the same distribution chain.

firms may have an incentive to harm the competitive process by incurring a short term sacrifice in the form of an economic loss (or lower profit), so as to force another firm to exit or to deter entry. That is, exclusionary conduct typically involves an act that would make ‘no economic sense’ but for the tendency to eliminate or lessen competition, after which initial losses can be recouped due to the ability to exercise considerable market power.¹¹⁰ However, since market power attracts entry, exclusionary conduct typically requires that the intensity of competition on a market already is very low. For instance, exclusionary conduct is typically only a viable strategy on markets with substantial economies of scale, and when a firm enjoys a very specific incumbency advantage which allows it to engage in behaviour that its rivals cannot replicate.¹¹¹

The third category of firm conduct that may amount to anti-competitive behaviour concerns the merger between two or more firms or when there is an acquisition of one or more firms; both scenarios are hereafter jointly referred to as ‘merger’. Mergers result, by their very nature, in some sort of harm to the competitive process. After all, the aim of mergers is to bring together the ownership and management of two or more firms. As a result, instead of expanding through the competitive process (e.g. for reasons of superior efficiency), a merger therefore allows a firm to take away the business of another firm at the price of the transaction.¹¹² However, whether or not a merger harms economic efficiency – and thus whether it can be considered ‘anti-competitive’ – is a far more difficult question to answer. For a great deal, the efficiency effects of a merger depend to a large extent on whether it involves direct competitors (horizontal merger) or firms operating in a different stage in the distribution chain (vertical mergers).¹¹³

¹¹⁰ For a discussion on the different tests to establish a theory of harm, see e.g. Werden, G.J. (2006), ‘Competition Policy on Exclusionary Conduct: Toward an Effects-Based Analysis’, *European Competition Journal*, 2, pp. 53-67; Werden, G.J. (2006), ‘Identifying Exclusionary Conduct Under Subsection 2: The “No Economic Sense” Test’, *Antitrust Law Journal*, 73, pp. 413-433. See also Salop, S.C. (2006), ‘Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard’, *Antitrust Law Journal*, 73, pp. 311-374.

¹¹¹ For instance, a rival may have developed through investments in R&D a must-have product, without which entry on an adjacent market is futile. For extensive discussions on exclusionary conduct, see especially Gual, J., Hellwig, M., Perrot, A., Polo, M., Rey, P., Schmidt, K. and Stenbacka, R. (2005), *An economic approach to Article 82*, Report by the Economic Advisory Group for Competition Policy (EAGCP), as well as O’Donoghue, R. and Padilla, A.J. (2006), *The Law and Economics of Article 82*, Oxford: Hart Publishing.

¹¹² Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, p. 70.

¹¹³ It is also possible that a merger is neither horizontal nor vertical as it involves firms in different industries. Such mergers may be referred to as conglomerate mergers.

Since horizontal mergers directly reduce the number of rivals on a market, they are typically more likely to allow firms to gain market power than vertical mergers. The phenomenon that a horizontal merger allows the merged entity to exercise market power is referred to as the ‘unilateral effects’ of a merger.¹¹⁴ Moreover, horizontal mergers can also have so-called ‘coordinated’ effects when it affects market conditions in a way that makes collusion between firms easier to sustain.¹¹⁵ However, the potential allocative inefficiency of horizontal mergers may be accompanied by for instance cost savings that can lead to substantial gains in terms of productive and/or dynamic efficiency.¹¹⁶ Efficiency gains typically play an even more prominent role in the context of vertical mergers. Presumably the most well-known situation in which vertical mergers solve a vertical price externality involves the so-called ‘double marginalisation’ scenario in which successive firms in the distribution chain have seller power (and there is little or no buyer power).¹¹⁷ In this scenario, the profit-maximising behaviour of the firms induces them to both charge monopoly prices, thereby causing a reduction of output and allocative efficiency on both the upstream and the downstream level. Following vertical integration, the two firms will only exercise monopoly power on one stage on the distribution chain, thereby improving economic efficiency.

2.3.3 – Conclusion

From the traditional perspective of static equilibrium models, one might be tempted to conclude that competition policy should aim to eliminate all market power. Such a view, however, suffers from an undue focus on the mathematical properties of static equilibrium models that are, although very useful as a mental exercise, of very limited relevance in practice. Instead of a static concept, competition policy should recognise competition as a dynamic process of rivalry in which firms constantly create and adopt new technologies, products and processes in order to gain a competitive advantage over their rivals.

The recognition of competition as an ongoing and dynamic process of rivalry has important implications for the appropriate scope of competition policy. Competition

¹¹⁴ Ivaldi, M., Julien, B., Rey, P., Seabright, P. and Tirole, J. (2003), *The Economics of Unilateral Effects*, Final Report for DG Competition, European Commission.

¹¹⁵ Ivaldi, M., Julien, B., Rey, P., Seabright, P. and Tirole, J. (2003), *The Economics of Tacit Collusion*, Final Report for DG Competition, European Commission.

¹¹⁶ See e.g. Williamson, O.E. (1968), ‘Economies as an Antitrust Defense: The Welfare Tradeoffs’, *American Economic Review*, 58, pp. 18-36.

¹¹⁷ Spengler, J.J. (1950), ‘Vertical Integration and Anti-Trust Policy’, *Journal of Political Economy*, 58, pp. 347-352. For a discussion, see Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 307-313. See also Subsection 3.4.3.

policy should acknowledge that economic efficiency can require the competitive process to develop market power due to the presence of efficiency trade-offs. One important efficiency trade-off involves the potential conflict between allocative and productive efficiency. It is for instance possible that some firms are more productive than others, for example due to the ability to utilise economies of scale or scope. In this scenario, economic efficiency generally requires productive efficiency to prevail over allocative efficiency. Another and perhaps even more important efficiency trade-off involves the relation between allocative efficiency and innovation, or so-called 'dynamic efficiency'. Since investments in more cost-efficient technologies and new products and processes are typically very risky and costly, they require the expectation to generate economic profit that well exceeds the corresponding costs. In fact, it is the very prospect of firms to exercise (a very high degree of) market power that encourages them to invest in new cost-efficient technologies and new products and processes. Competition policy should therefore refrain from preventing more productive and innovative firms to take away the business of their rivals and moreover refrain from challenging the corresponding ability to exercise market power.

Instead, competition policy should focus on anti-competitive behaviour, which concerns firm efforts to create, strengthen or maintain market power by harming the competitive process. Anti-competitive behaviour, firstly, harms the competitive process in some sense and, secondly, harms economic efficiency due to the creation, strengthening or maintenance of market power that results in allocative inefficiency, which is not compensated for by overriding gains in productive and/or dynamic efficiency. It is possible to identify three categories of behaviour that may amount to anti-competitive conduct. Under collusion, firms agree on the material terms on which they compete so to jointly exercise market power (e.g. price-fixing). Secondly, exclusionary conduct concerns the ability of a firm with a (very) high degree of market power to exclude a rival firm or to deter a potential entrant from that or an adjacent market. Finally, by merging, firms bring together the ownership of multiple firms in order to take away the business of another firm by means of compensation, instead of through the competitive process.

2.4 – Competition Policy Design

From the previous sections, it can be concluded that the objective of competition policy is to protect competition, which is a means to promote economic efficiency, from anti-competitive behaviour. The identification of anti-competitive behaviour is, however, not a straightforward task. This is because not only markets but also government institutions such as competition authorities can fail. Within the context of competition policy, the risk of government failure is most prominent in the form of a lack of

information by competition authorities, which may induce imperfect decision-making.¹¹⁸

This section discusses two challenges in the design of competition policy that arise due to imperfect information by competition authorities. Subsection 2.4.1 discusses the need for a set of legal rules that prohibit anti-competitive behaviour – that is, the need for competition law – and the role of case-by-case analysis in the enforcement of competition law. Subsection 2.4.2 discusses the function welfare standards in the enforcement of the competition law.

2.4.1 – Formulating Competition Policy

The desire to protect competition creates a need for a set of legal rules that prohibit anti-competitive conduct and that is moreover suitable for competition authorities to enforce. Presumably the simplest type of competition rules are so-called ‘per se rules’. With per se rules, conduct is either always legitimate (per se legal) or always illegitimate (per se illegal), without regard to the actual effects in an individual case. A per se illegal rule on horizontal mergers, for instance, would imply that all mergers between direct rivals are always prohibited, whereas a per se legal rule would imply that they are always allowed. However, since all conduct that may amount to anti-competitive behaviour can also in fact promote economic efficiency, (pure) per se rules typically induce imperfect decision-making. In this context, two types of enforcement errors can be distinguished.¹¹⁹ Type I errors (false positives) involve the prohibition of conduct that is not anti-competitive (i.e. ‘overenforcement’). By contrast, Type II errors (false negatives) concerns the failure to prohibit anti-competitive conduct (i.e. underenforcement) The harm to economic efficiency that is associated with Type I and II errors are referred to as *error costs*.¹²⁰ Error costs may be substantial. In fact, as noted by Schinkel and Tuinstra, enforcement errors might even cause competition policy to be counterproductive, in that it stimulates the very behaviour it intends to

¹¹⁸ Government failure is typically referred to as the inability or unwillingness of government institutions to act in accordance with society’s interest. See for example Gruber, J. (2011), *Public Finance and Public Policy*, New York: Worth Publishers, pp. 249-258; Whinston, C. (2006), *Government Failure versus Market Failure*, Washington D.C.: AEI-Brooking Joint Center for Regulatory Studies.

¹¹⁹ It should be noted that the terms ‘Type I’ and ‘Type II’ are used differently in the literature. The classification used here follows Schinkel, M.P. and Tuinstra, J. (2006), ‘Imperfect competition law enforcement’, *International Journal of Industrial Organisation*, 24, pp. 1267-1297.

¹²⁰ Christiansen, A. and Kerber, W. (2006), ‘Competition Policy with Optimally Differentiated Rules instead of “Per Se Rules vs Rule of Reason”’, *Journal of Competition Law and Economics*, 2(2), pp. 215-244.

deter. In this scenario, economic efficiency might be best served to have no competition policy at all.¹²¹

In order to mitigate error costs, competition policy may resort to competition rules with a higher degree of differentiation. Following Christiansen and Kerber, the differentiation of competition rules refers to the number and complexity of distinctions incorporated in the set of rules.¹²² A higher degree of differentiation of the competition rules requires a competition authority to engage in more case-by-case analysis and to take into account a higher number of assessment criteria. In contrast to per se rules, which require little or no case-specific analysis, differentiation of competition rules may go as far so to amount to a so-called 'rule of reason'. Under a (full) rule of reason, a competition authority must engage in each individual case in a full-scale market analysis in which it analyses all possible positive and negative effects of firm behaviour in order to ascertain its effect on economic efficiency. Besides the extremes of per se rules and the rule of reason, rules can also have a mixed form. A rebuttable per se rule, for instance, implies that the rule (legal or illegal) holds, unless arguments are put forward that prove otherwise. Similarly, by applying a structured rule of reason, analysis may be restricted to a specific set of criteria, using 'filters' or 'screens' (e.g. safe harbours) to select the scope of rules.

While more differentiated competition rules generally reduce error costs, it is important to note that they also have an important drawback. A higher degree of differentiation is typically associated with increased *regulation costs*. Regulation costs include all kinds of direct and indirect costs that are caused by the formulation and enforcement of competition rules.¹²³ In contrast to error costs, regulation costs typically increase as

¹²¹ Schinkel and Tuinstra explain that the incidence of anti-competitive behaviour increases in the enforcement error for two reasons. The first is that the possibility of escaping punishment decreases the expected punishment for anti-competitive behaviour. The second reason is that firms are induced to engage in anti-competitive behaviour when they face the risk of false conviction. See Schinkel, M.P. and Tuinstra, J. (2006), 'Imperfect competition law enforcement', *International Journal of Industrial Organisation*, 24, pp. 1267-1297.

¹²² Christiansen, A. and Kerber, W. (2006), 'Competition Policy with Optimally Differentiated Rules instead of "Per Se Rules vs Rule of Reason"', *Journal of Competition Law and Economics*, 2(2), pp. 215-244. See on this matter for instance Ehrlich, I. and Posner, R.A. (1974), 'An Economic Analysis of Legal Rulemaking', *Journal of Legal Studies*, 3, pp. 257-286; Polinsky, A.M. and Shavell, S. (1989), 'Legal Error, Litigation, and the Incentive to Obey the Law', *Journal of Law, Economics, and Organization*; Kaplow, L. (2000), 'General Characteristics of Rules', in: Bouckaert, B. and De Geest, G. (eds.), *Encyclopedia of Law & Economics*, Cheltenham: Edward Elgar, pp. 502-528.

¹²³ Christiansen, A. and Kerber, W. (2006), 'Competition Policy with Optimally Differentiated Rules instead of "Per Se Rules vs Rule of Reason"', *Journal of Competition Law and Economics*, 2(2), pp. 231-235.

rules become more differentiated. This holds for instance for the set-up costs of competition rules, that is the costs associated with the formulation of the rules, such as in laws or guidelines. Similarly, the enforcement of more differentiated competition rules typically requires that a competition authority collects and thoroughly analyses data, thereby enhancing information and assessment costs. However, not only competition authorities face regulation costs, so do firms. More differentiated competition rules typically require firms more often to hire professional legal advice than under more simple rules and thus increase compliance costs. Furthermore, since more differentiated rules in effect increase a competition authority's discretionary powers, they also reduce legal certainty. This holds especially for rules pursuant to which the legitimacy of firm behaviour is *prima facie* unknown but can only be established after extensive case-by-case assessment, such as under a rule of reason. Legal uncertainty in competition policy creates a serious risk of deterring firms from engaging in desirable investments, such as welfare-enhancing R&D agreements, vertical restraints and mergers.¹²⁴

Since both error and regulation costs affect economic efficiency, they should both be taken into account in the context of competition policy design. More specifically, from an economic perspective, the formulation of the competition rules should aim to minimise the sum of error costs and regulation costs. This has as a crucial implication that *competition policy is always imperfect*, in that the enforcement of competition policy does not lead to correct decisions in every single case.¹²⁵ That is, when regulation costs are taken into account, economic efficiency may require the application of more simple rules rather than to engage in each individual case in a full-scale market analysis. The optimal choice of competition rules typically depends on the frequency in which a specific type of firm behaviour can be expected to harm economic efficiency.¹²⁶ Accordingly, if a specific type of conduct can be expected to almost always harm (or promote) economic efficiency, competition policy should prefer a simpler rule, such as a (rebuttable) *per se* illegal (or legal) rule. Simple rules are, however, unsuitable if it is relatively difficult to establish whether conduct is anti-

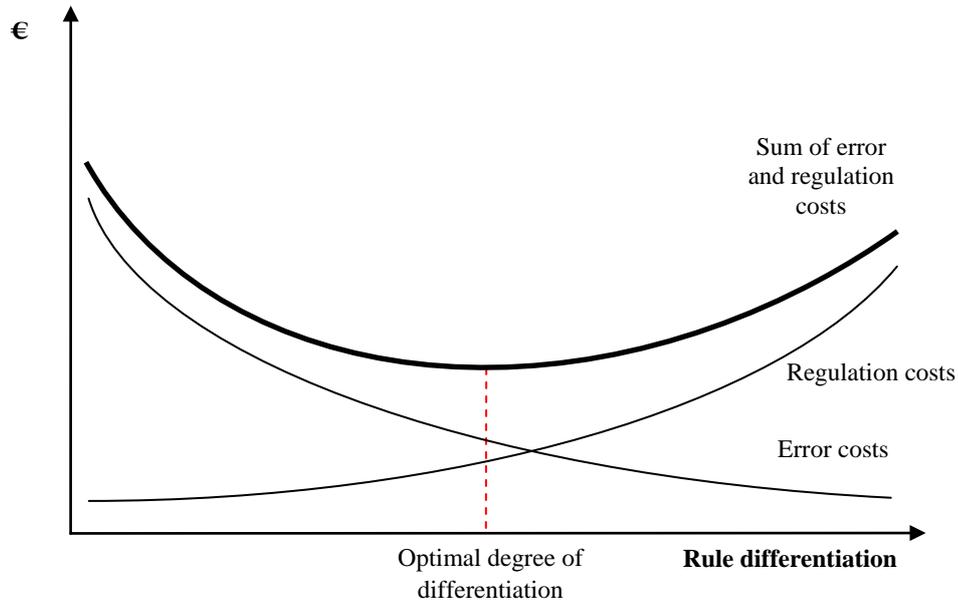
¹²⁴ See e.g. Barros, P.P. (2003), 'Looking behind the curtains – effects from modernization of European Union competition policy', *European Economic Review*, 47, pp. 613-624.

¹²⁵ See also Besanko, D. and Spulber, D.F. (1989), 'Antitrust Enforcement under Asymmetric Information', *Economic Journal*, 99(396), pp. 408-425; Easterbrook, F.H. (1992), 'Ignorance and Antitrust', in: Jorde, T.M. and Teece, J.D. (eds.), *Antitrust, Innovation, and Competitiveness*, New York: Oxford University Press, pp. 119-136; Joskow, P.L. (2002), 'Transaction Cost Economics, Antitrust Rules, and Remedies', *Journal of Law, Economics, and Organization*, 18(1), pp. 95-116.

¹²⁶ See also Gual, J., Hellwig, M., Perrot, A., Polo, M., Rey, P., Schmidt, K. and Stenbacka, R. (2005), *An economic approach to Article 82*, Report by the Economic Advisory Group for Competition Policy (EAGCP).

competitive. In such cases, it can be worthwhile to apply a rule that requires a competition authority to engage in more extensive case-specific analysis. This is further discussed in Box 11.

Box 11: The optimal complexity of competition rules



The figure above plots three functions. Error costs refer to all costs associated with decision errors of Type I and II. In the absence of competition rules, or when the rules are extremely simple, error costs will be very high. As rules become more differentiated, and therefore require a competition authority to take into account more case-specific elements, error costs typically reduce. The benefit of competition policy in terms of higher economic efficiency is thus reflected by the negative slope of the error cost curve. However, increased complexity also affects regulation costs. Regulation costs typically increase in the degree of differentiation, because this makes competition law more costly to formulate, to enforce, to comply with and moreover increases legal uncertainty. This is reflected in the positive slope of the regulation costs curve. Economic efficiency is best served when the sum of error and regulation costs are minimised. This implies that competition policy may, concerning specific practices, better resort to more simple rules instead of comprehensive case-by-case analysis.

The degree of differentiation may range from per se rules, which require very little to no case-specific analysis, to a rule of reason, the enforcement of which requires extensive case-specific analysis. However, even under a rule of reason it is conceivable that a competition authority is still unable to acquire all relevant information, so that enforcement errors are virtually impossible to prevent. If enforcement errors are very harmful, competition policy might also resort to the specific category of so-called 'ex ante competition rules'. Ex ante competition rules typically refer to the empowerment of a competition authority with the ability to impose regulatory measures on firm behaviour. The main advantage of ex ante competition rules is that the ability to intervene before harm to economic efficiency is established may better prevent anti-competitive behaviour (and reduce Type II errors) but where regulatory measures are only taken after extensive analysis of the market (so to mitigate Type I errors). For instance, in order to prevent (anti-competitive) refusal to deal, ex ante competition rules may empower a competition authority to regulate the specific conditions under which a firm is obliged to accept a transaction. However, since ex ante competition rules in effect imply an even higher degree of differentiation due to increased discretionary powers, they also substantially increase regulation costs, most notably information and assessment costs and legal uncertainty.

Furthermore, since ex ante competition rules increase the discretionary powers of a competition authority, they may also increase the likelihood of a specific type of government failure that is referred to as 'regulatory failure'.¹²⁷ For instance, when the relationship between the authority and firms becomes too close and leads to so-called regulatory capture, there is a risk that competition policy follows the interest of the regulated firms, rather than motives that are based on economic efficiency.¹²⁸ Similarly, increasing the discretionary powers of a competition authority can give rise to distortions in the so-called 'agency relation' between for instance the central government and the competition authority, which might provide a competition authority with an incentive to pursue its own interests.¹²⁹

¹²⁷ See e.g. Baldwin, R., Cave, M. and Lodge, M. (2012), *Understanding Regulation: Theory, Strategy and Practice*, Oxford: Oxford University Press, pp. 68-82.

¹²⁸ Stigler, G. (1971), 'The Economic Theory of Regulation', *Bell Journal of Economics*, 2(1), pp. 3-21.

¹²⁹ A rather extreme (and more general) example in the economic literature on government failure concerns Niskanen's model on bureaucracy, in which government institutions typically aim at increasing public budget and power; Niskanen, W.A. (1968), 'The peculiar economics of bureaucracy', *American Economic Review*, 58, pp. 293-305.

2.4.2 – Welfare Standards

Except when a per se rule applies, the enforcement of competition law requires a competition authority to engage in some degree of case-by-case analysis. Depending on the precise formulation of a competition rule, the case-specific analysis involves an assessment of specific criteria in order to establish that conduct harms competition and economic efficiency. Finding conclusive evidence on the effect on economic efficiency is very difficult, however, especially with regard to dynamic efficiency. This is because the high degree of uncertainty and unpredictability of the innovation process typically makes it impossible to ascertain the effects on dynamic efficiency beforehand.¹³⁰ As a result, competition authorities may engage in a more qualitative assessment of dynamic efficiency (e.g. assessment of the incentive to innovate) and focus their quantitative assessment on static efficiency. For this latter exercise, competition authorities may use a so-called ‘welfare standard’. The issue of the appropriate welfare standard is one of the most controversial issues in the Law and Economics literature on competition policy.¹³¹ On one end in the debate, there are proponents of the *consumer welfare standard*.¹³² Under the consumer welfare standard, firm behaviour will be condemned if this leads to a reduction in the welfare of buyers (i.e. consumers).¹³³ On the other end, there are those who favour the *total welfare standard*.¹³⁴ Under the total welfare standard, business conduct will be condemned if this results in a decrease in the aggregate welfare of buyers and sellers.

One argument in favour of the consumer welfare standard concerns *distributive concerns*. By considering welfare transfers irrelevant, the total welfare standard implicitly assumes that money holds the same value to consumers and producers. It is,

¹³⁰ See also Easterbrook, F.H. (1992), ‘Ignorance and Antitrust’, in: Jorde, T.M. and Teece, D.J. (eds.), *Antitrust, Innovation, and Competitiveness*, New York: Oxford University Press, pp. 119-136.

¹³¹ See e.g. Orbach, B.Y. (2010), ‘The Antitrust Consumer Welfare Paradox’, *Journal of Competition Law & Economics*, 7(1), pp. 133-164.

¹³² See e.g. Lande, R.H. (1989), ‘Chicago’s False Foundation: Wealth Transfers (Not Just Efficiency) Should Guide Antitrust’, *Antitrust Law Journal*, 58, pp. 631-644; Pittman, R. (2007), ‘Consumer Surplus as the Appropriate Standard for Antitrust Enforcement’, *Competition Policy International*, 3(2), pp. 205-224; Salop, S.C. (2010), ‘Question: What Is the Real and Proper Antitrust Welfare Standard? Answer: The True Consumer Welfare Standard’, *Loyola Consumer Law Review*, 22(3), pp. 336-353.

¹³³ In the context of buyer power, various interpretations are possible, see Subsection 3.5.2.

¹³⁴ See e.g. Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 20-22; Heyer, K. (2006), ‘Welfare Standards and Merger Analysis’, *Competition Policy International*, 2(2), pp. 29-54; Carlton, D.W. (2007), ‘Does Antitrust Need to Be Modernized’, *Journal of Economic Perspectives*, 21(3), pp. 155-176; Werden, G.J. (2011), ‘Consumer welfare and competition policy’, in: Drexler, J., Kerber, W. and Podszun, R. (eds.), *Competition Policy and the Economic Approach: Foundations and Limitations*, Cheltenham: Edward Elgar, pp. 11-43.

however, a well-established economic principle that money has more value in the hands of the poor than in those of the rich. If application of the consumer welfare standard would then work as a distribution mechanism, it might promote economic efficiency. However, if the economy would not already have an effective redistributive mechanism (e.g. through the tax and transfer system), it is very questionable whether would be an effective alternative, since this would inter alia require that people on the consumption side of a market are typically less wealthy than those on the supply side.¹³⁵ However, in some markets, consumers can well be wealthier than the owners of firms. Moreover, it is important to note that producers are themselves consumers too (though in different markets), whereas consumers may in fact be the owners of firms (either directly or through pension or investment funds). Economic theory therefore typically suggests that competition policy is not an effective redistributive mechanism.¹³⁶

Another argument for the consumer welfare standard is that it could be used to *counterbalance a lack of information* by the competition authority. For instance, in the context of merger control, it is conceivable that the merging firms have an information advantage over the competition authority, in particular concerning the alternatives of a proposed merger.¹³⁷ Similarly, application of the consumer welfare standard could introduce a pro-consumer bias so to counter-balance the bias that can arise from firm lobbying.¹³⁸ In both situations, however, it may not be possible to anticipate on which information the competition authority does have and which information is lacking (or is incorrect). It may for instance be not true that a competition authority has no knowledge at all about possible alternatives to proposed mergers, nor is it always true that consumer interests are underexposed.¹³⁹ The consumer welfare standard may therefore not always help in solving informational problems.

¹³⁵ See more generally Barr, N. (2004), *Economics of the Welfare State*, Oxford: Oxford University Press, pp. 213-231.

¹³⁶ Farrell, J. and Katz, M.L. (2006), 'The Economics of Welfare Standards in Antitrust', *Competition Policy International*, 2(2), pp. 3-28; Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 20-22.

¹³⁷ See e.g. Lyons, B.R. (2003), 'Could Politicians Be More Right Than Economists? A Theory of Merger Standards', European University Institute Working Paper 2003/14; Pittman, R. (2007), 'Consumer Surplus as the Appropriate Standard for Antitrust Enforcement', *Competition Policy International*, 3(2), pp. 205-224.

¹³⁸ See e.g. Neven, D.J. and Röller, L-H. (2005), 'Consumer Surplus vs. Welfare Standard in a Political Economy Model of Merger Control', *International Journal of Industrial Organization*, 23, pp. 829-848.

¹³⁹ Werden, G.J. (2011), 'Consumer welfare and competition policy', in: Drexler, J., Kerber, W. and Podszun, R. (eds.), *Competition Policy and the Economic Approach: Foundations and Limitations*, Cheltenham: Edward Elgar, pp. 11-43.

A third argument for the consumer welfare standard concerns its relative advantage in the *information and assessment costs* associated with its application. Under the total welfare standard, the competition authority will have to assess the effects in an individual case on buyers and sellers. By contrast, the consumer welfare standard merely focuses on consumers, and the competition authority therefore need not analyse other effects. However, it is important to note that the consumer welfare standard generally does not lead to different decisions than a total welfare standard.¹⁴⁰ After all, anti-competitive behaviour by definition distorts the process of rivalry that forces firms to respond to their customer's needs. As a result, the harm to economic efficiency caused by anti-competitive conduct will almost always be reflected in reduced consumer welfare. The question therefore rises whether it is, from the perspective of regulation costs, worthwhile for a competition authority to also assess the effects of firm behaviour on sellers, once the effects on consumer welfare have already been established.¹⁴¹

While the consumer welfare standard generally does not lead to different decisions than the total welfare standard, there are a number of situations in which it does. One important argument for the total welfare standard is that it allows for a better treatment of *efficiency gains*.¹⁴² In the context of horizontal mergers, for instance, the transaction may enhance market power and harm economic efficiency but may at the same time realise substantial cost savings. More specifically, horizontal mergers may lead to marginal cost savings, which reduce the production cost of (additional) units for the merged entity, but also to fixed cost savings, such as cost savings associated with a reduction in the number of production plants. Whereas all cost savings are always relevant under the total welfare standard, the consumer welfare standard only considers them relevant insofar they are passed on to consumers. However, whether and, if so, marginal cost savings are passed on to consumers depends on various market characteristics, such as consumer demand and the intensity of competition. Fixed cost

¹⁴⁰ See e.g. Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 20-22

¹⁴¹ See, however, also Heyer, K. (2006), 'Welfare Standards and Merger Analysis', *Competition Policy International*, 2(2), pp. 29-54, who argues that the consumer welfare standard is not necessarily less costly to apply, especially in mergers with marginal cost savings, since the consumer welfare standard requires a careful examination of whether and, if so, in what degree they are passed on to consumers.

¹⁴² Williamson, O.E. (1968), 'Economies as an Antitrust Defense: The Welfare Tradeoffs', *American Economic Review*, 58, pp. 18-36. See also Heyer, K. (2006), 'Welfare Standards and Merger Analysis', *Competition Policy International*, 2(2), pp. 29-54; Carlton, D.W. (2007), 'Does Antitrust Need to Be Modernized', *Journal of Economic Perspectives*, 21(3), pp. 155-176; Werden, G.J. (2011), 'Consumer welfare and competition policy', in: Drexler, J., Kerber, W. and Podszun, R. (eds.), *Competition Policy and the Economic Approach: Foundations and Limitations*, Cheltenham: Edward Elgar, pp. 11-43.

savings are moreover generally never passed on to consumers, at least in the short run, since they typically do not affect a firm's profit-maximising output or price choice. However, both marginal and fixed cost savings can well promote economic efficiency because the resources that are saved can be put to use elsewhere, for instance to solve for excess capacity problems,¹⁴³ attract entry¹⁴⁴ and even encourage investments in R&D that allow for new products and processes in the future.¹⁴⁵ Application of the consumer welfare standard might therefore cause a competition authority to wrongfully ignore efficiency gains and thus might cause overenforcement (i.e. Type II error). Box 12 shortly discusses this argument.

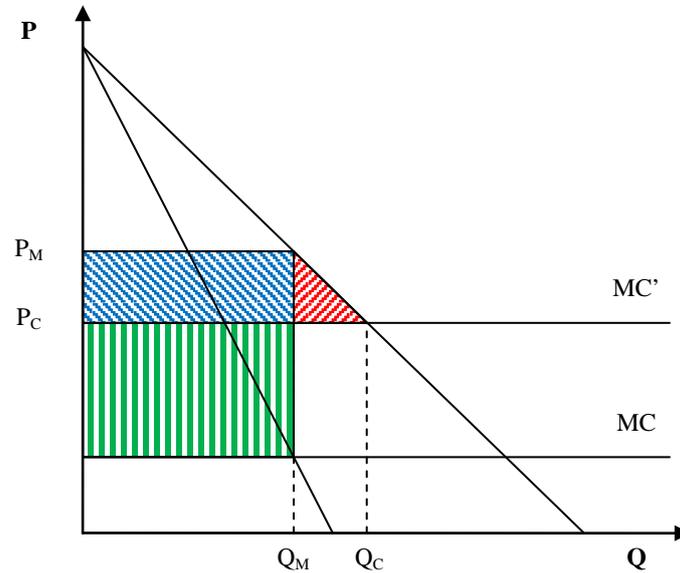
Box 12: Welfare standards and cost savings

Consider the extreme scenario where perfectly competing rivals merge to a monopoly, but by doing so, they realise (very) substantial marginal cost savings. The merged entity will therefore choose to produce up to the point where its marginal revenue equals its (lowered) marginal costs and charge the monopoly price. Instead of the competitive market outcome (P_C and Q_C), the merged entity will therefore produce Q_M and charge price P_M . Due to marginal cost savings, the merger will increase producer surplus (the green shaded area). However, since the merger creates monopoly power, it will also result in allocative inefficiency (the red shaded area). Moreover, pursuant to the exercise of monopoly power there is also a transfer of surplus from buyers to sellers (the blue shaded area).

¹⁴³ Heyer, K. (2006), 'Welfare Standards and Merger Analysis', *Competition Policy International*, 2(2), pp. 29-54.

¹⁴⁴ Werden, G.J. (2011), 'Consumer welfare and competition policy', in: Drexler, J., Kerber, W. and Podszun, R. (eds.), *Competition Policy and the Economic Approach: Foundations and Limitations*, Cheltenham: Edward Elgar, pp. 11-43.

¹⁴⁵ Carlton, D.W. (2007), 'Does Antitrust Need to Be Modernized', *Journal of Economic Perspectives*, 21(3), pp. 155-176.



Under the total welfare standard, the merger review involves a balancing between the allocative inefficiency caused by monopoly power, and the productive efficiency gains due to the marginal cost savings. Assuming there is no effect on dynamic efficiency, the merger has a net positive effect and should therefore be cleared. By contrast, the consumer welfare standard only takes into account the marginal cost savings insofar they are passed on to consumers. Since the creation of monopoly power harms consumer welfare, the merger should be blocked under the consumer welfare standard, even though there is a net positive effect on economic efficiency. A similar scenario applies when a merger realises fixed cost savings. Since these typically do not affect the profit-maximising price or output, fixed cost savings are not (or at least not in the short run) passed on to consumers. As a result, fixed cost savings may therefore be considered irrelevant under the consumer welfare standard, whereas they are fully taken into account under the total welfare standard.

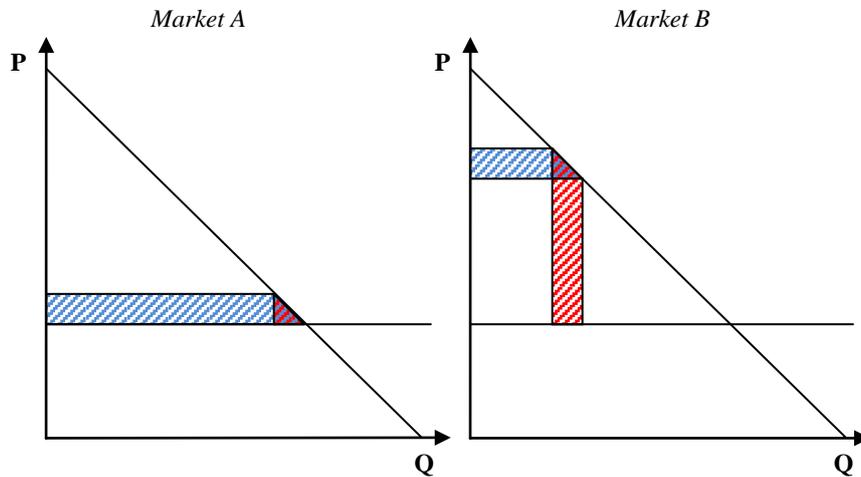
Another argument in favour of the total welfare standard is explained by Kaplow and concerns a competition authority's *prioritisation policy*.¹⁴⁶ Since competition authorities' resources are limited, a selection of which cases to pursue is typically required. Under the total welfare standard, a competition authority will tend to pursue cases where harm to aggregate surplus in the market is the greatest. By contrast, under the consumer welfare standard, priority will be given to cases with the largest reduction

¹⁴⁶ Kaplow, L. (2012), 'On the Choice of Welfare Standards in Competition Law', in: Zimmer, D. (ed.), *The Goals of Competition Law*, Cheltenham: Edward Elgar, pp. 3-26.

of consumer welfare. As discussed in Box 13, this may induce a competition authority to not pursue the most harmful cases.

Box 13: Welfare standards and prioritisation

Suppose that a competition authority has received complaints on collusion in two markets, markets A and B, but is due to limited resources able to pursue only one case. Now consider that the initial degree of monopoly power in the market prior to collusion differs. In market A, there is perfect competition and the initial price level is the competitive level. In market B, however, there is already some monopoly power present, so that prices are already relatively high.



The red shaded area in the figures above represents the net adverse effect on economic efficiency (deadweight loss) accompanied with collusion on the market. Due to the difference in the initial level of monopoly power, collusion in market B will cause greater harm to economic efficiency than in market A. As a result, the total welfare standard will induce a competition authority to pursue the case in market B. Under the consumer welfare standard, however, the (blue shaded) transfer of surplus is explicitly taken into account. As market A has the greatest reduction in consumer welfare, the consumer welfare standard will induce the competition authority to give priority to competition law enforcement in market A.

2.4.3 – Conclusion

The objective of protecting competition creates a need for a set of legal rules that prohibit anti-competitive behaviour: competition law. However, because competition

authorities typically suffer from a lack of relevant information, it is very difficult to ascertain that specific firm behaviour actually harms economic efficiency, and can thus be qualified as ‘anti-competitive’. As a result, competition authorities run the risk of enforcement errors, of which there are two types: a Type I error involves the prohibition of conduct that is not anti-competitive, whereas a Type II error concerns the failure to prohibit anti-competitive conduct. In order to mitigate the costs of enforcement errors (error costs), competition policy may require a competition authority to engage in more case-by-case analysis and to take into account a higher number of assessment criteria. However, increasing the degree of case-specific analysis also increases regulation costs, that is all kinds of direct and indirect costs that are caused by the formulation and enforcement of competition rules, such as enforcement costs, compliance costs and legal uncertainty. An economics-oriented competition policy design implies that both error and regulation costs are taken into account. This implies, however, that the application of more simple rules to specific types of conduct may be preferable to a rule that requires extensive case-by-case analysis and that competition policy enforcement may not lead to correct decisions in each individual case.

Except when a per se rule applies, the enforcement of competition law requires a competition authority to engage in case-specific analysis to determine whether firm behaviour is harmful to competition and economic efficiency. In order to establish effects on static efficiency, a competition authority may use a so-called welfare standard. Economic literature typically distinguishes between two welfare standards. Under the consumer welfare standard, firm behaviour will be condemned if this leads to a reduction in the welfare of buyers (i.e. consumers). Under the total welfare standard, business conduct will be condemned if this leads to a decrease in the aggregate welfare of buyers and sellers. The application of the consumer welfare standard generally does not lead to different decisions than the application of the total welfare standard. After all, since anti-competitive conduct distorts the process that forces firms to respond to their customers’ needs, harm to economic efficiency will almost always be reflected in reduced consumer welfare. In many cases, it may, from the perspective of regulation costs, therefore not be worthwhile for a competition authority to assess the effects of business behaviour on the welfare of other firms, once the effects on consumer welfare have already been established.

There are, however, situations in which the consumer welfare standard is less accurate in reflecting effects on economic efficiency than the total welfare standard. One important argument against the consumer welfare standard concerns its treatment of efficiency gains. Whereas all conduct that might amount to anti-competitive behaviour can enhance market power and harm economic efficiency, it may also promote productive and/or dynamic efficiency, for instance because it allows for substantial

cost savings. Whereas all cost savings are always relevant under the total welfare standard, the consumer welfare standard only considers them relevant insofar they are passed on to consumers. This may induce a competition authority to ignore efficiency gains and, consequently, wrongfully prohibit conduct that is not anti-competitive (Type I error).

2.5 – Conclusion

Before addressing the subject of buyer power, this chapter aimed to establish the objectives of competition policy in the traditional context of seller power. Pursuant to the analysis of the economic literature, it is possible to derive three main conclusions.

Competition policy is based upon the premise that competition promotes economic efficiency. From an economic perspective, competition policy can be justified by the possible presence of market power.

Competition policy is based upon the premise that competition promotes economic efficiency. The principle that competition promotes economic efficiency is well established in the economic literature. For a great deal, the premise that competition promotes economic efficiency is founded upon static equilibrium models. These models provide for mathematical proof that, under a number of assumptions, competition will result in an ideal end state (or equilibrium) of so-called Pareto Efficiency, in which no individual can be made better off without making someone else worse off. By forcing firms to produce in accordance with consumer demand and to operate against the lowest cost feasible, competition thus promotes so-called allocative and productive efficiency (jointly known as static efficiency).

However, the ability of competition to result in the ideal end state of Pareto Efficiency, as illustrated by static equilibrium models, requires a large number of unlikely conditions to be satisfied. First, static equilibrium models typically require competition to satisfy a number of very specific properties, such as a very large number (or infinite) of buyers and sellers and the absence of entry costs, which allows it to be characterised as ‘perfect competition’. Secondly, static equilibrium models do not consider dynamics and, for instance, assume that consumer preferences, available production resources and the state of technology are fixed over time. Finally, static equilibrium models require the absence of market failure, such as market power, externalities, information asymmetry or in case of public good characteristics.

Economic theory suggests that the potential presence of the market failure of market power justifies government intervention in the form of competition policy. Market power is most commonly discussed in terms of monopoly power and in static

equilibrium models compared with the situation of 'perfect competition'. In this context, monopoly power concerns the ability of a firm to raise prices charged to its customers above the competitive level (marginal costs) by reducing output, and thus generate economic profit. However, since the higher price is obtained by reducing output, monopoly power typically harms economic efficiency by reducing allocative efficiency.

Competition policy should recognise competition as a dynamic process of rivalry that works as a selection mechanism of firms that are the most successful in meeting the preferences of their customers. Accordingly, competition policy should refrain from challenging the exercise of market power that is the result of superior efficiency. Instead, competition policy should address anti-competitive behaviour, which essentially refers to the creation, strengthening or maintenance of market power not through but by harming the competitive process.

From the traditional perspective of static equilibrium models, one might be tempted to conclude that competition policy should aim to eliminate all market power. Such a view, however, suffers from an undue focus on the mathematical properties of static equilibrium models that are, although very useful as a mental exercise, of very limited relevance in practice. In reality, however, competition is not the concept of 'perfect competition' that is used in traditional static equilibrium models, in which competition reflects an ideal 'end state' (or equilibrium). Instead of a static concept, competition is a dynamic process of rivalry in which firms constantly create and adopt new technologies, products and processes in order to gain a competitive advantage over their rivals. Firms that are the most successful in the competitive process will gain market power.

Accordingly, competition policy should acknowledge that economic efficiency can require the competitive process to develop market power due to the presence of efficiency trade-offs. One important efficiency trade-off involves the potential conflict between allocative and productive efficiency that may arise when some firms are more productive than others, for example due to the ability to utilise economies of scale or scope. In this scenario, economic efficiency typically requires productive efficiency to prevail over allocative efficiency. Another and perhaps even more important efficiency trade-off involves the relation between allocative efficiency and innovation: dynamic efficiency. Since investments in more cost-efficient technologies and new products and processes are typically very risky and costly, they require the expectation to generate economic profit that well exceeds the corresponding costs. In fact, it is the very prospect of firms to exercise (a very high degree of) market power that encourages them to invest in new cost-efficient technologies and new products and processes. Competition policy should therefore refrain from preventing more productive and

innovative firms to take away the business of their rivals and moreover refrain from challenging the corresponding ability to exercise market power.

Instead, competition policy should focus on anti-competitive behaviour, which concerns firm efforts to create, strengthen or maintain market power by harming the competitive process. Anti-competitive behaviour, firstly, harms the competitive process in some sense and, secondly, harms economic efficiency due to the creation, strengthening or maintenance of market power that results in allocative inefficiency, which is not compensated for by overriding gains in productive and/or dynamic efficiency. It is possible to identify three categories of behaviour that may amount to anti-competitive conduct. Under collusion, firms agree on the material terms on which they compete in order to jointly exercise market power (e.g. price-fixing). Secondly, exclusionary conduct concerns the ability of a firm with a (very) high degree of market power to exclude a rival firm or to deter a potential entrant from that or an adjacent market. Finally, by merging, firms bring together the ownership of multiple firms in order to take away the business of another firm by means of compensation, instead of through the competitive process.

Since harm to economic efficiency is almost always reflected in reduced consumer welfare, the consumer welfare standard is a useful guide in the identification of anti-competitive conduct. While the consumer welfare standard may be preferable from the perspective of regulation costs, it also has drawbacks. One important drawback is that the consumer welfare standard may lead a competition authority to ignore efficiency gains and, consequently, wrongfully prohibit conduct that is not anti-competitive (Type I error).

The enforcement of competition law typically requires a competition authority to engage in some degree of case-specific analysis in order to assess effects on economic efficiency. In order to establish effects on static efficiency, a competition authority may use a so-called welfare standard, of which two kinds are typically distinguished. Under the consumer welfare standard, firm behaviour will be condemned if this leads to a reduction in the welfare of buyers (i.e. consumers). Under the total welfare standard, business conduct will be condemned if this leads to a decrease in the aggregate welfare of all buyers and sellers. In general, the consumer welfare standard does not lead to very different decisions than the total welfare standard. Since anti-competitive conduct distorts the process that forces firms to respond to their customers' needs, harm to economic efficiency will almost always be reflected in reduced consumer welfare. In many cases, it may from the perspective of regulation costs therefore not be worthwhile for a competition authority to assess the effects on other firms, once the effects on consumer welfare have already been established.

There are, however, a number of situations in which the consumer welfare standard is less accurate in reflecting effects on economic efficiency than the total welfare standard and may therefore induce imperfect decision making. One important argument against the consumer welfare standard concerns its treatment of efficiency gains. All types of conduct that may amount to anti-competitive behaviour, and thus harm economic efficiency, may in practice also promote economic efficiency because of gains in productive and/or dynamic efficiency, for instance because it allows for substantial cost savings. Whereas all cost savings are always relevant under the total welfare standard, the consumer welfare standard only considers them relevant insofar they are passed on to consumers. This may induce a competition authority to ignore efficiency gains that are not passed on and, consequently, wrongfully prohibit conduct that is not anti-competitive (Type I error).

3. BUYER POWER AND COMPETITION POLICY

3.1 – Introduction

Judging solely from the public and political debate, there appear to be two, sharply contrasting, positions concerning the appropriate treatment of buyer power in competition policy. On one end in the debate, there is the position that is often advocated by primary producers, intermediate suppliers and their lobby groups.¹⁴⁷ From their perspective, buyer power is a very harmful phenomenon that endangers the viability of their industry. Especially pursuant to the increasingly concentrated retail sector and the important role of retail groups, producers and suppliers are confronted with increasingly powerful and, allegedly, unavoidable trading partners. The important role of retailers as a ‘gatekeeper’ for the access to consumers is in this context often said to give rise to a situation of ‘economic dependence’. Suppliers and producers, however, increasingly complain that retailers are ‘exploiting’ their position and claim that they demand unreasonably low prices or contractual obligations. From this view, these so-called ‘buyer power abuses’ should induce competition policy to intervene.

On the other end in the debate, however, there is the position that is typically put forward by large retailers and buying groups. From their perspective, buyer power is not really different from a situation with very effective competition and should not give rise to much concern at all. In this context, the ability of large buyers to obtain more favourable terms of trade by using their ‘buying muscle’ is often claimed to be a mere means to deliver better conditions to consumers. From this perspective, instead of having harmful effects, buyer power typically promotes economic efficiency. Indeed, large retailers and buyer groups often portray themselves as ‘consumer’s champions’ that negotiate discounts, which they then pass on to consumers, in the form of lower prices.¹⁴⁸ In their view, since the exercise of buyer power is fundamentally about lower prices and benefiting consumers while seller power is about raising prices and harming consumers, competition policy should not respond to, or might even want to stimulate, buyer power.

This chapter aims to establish the (potential) competition concerns of buyer power within the context of competition policy. The chapter is structured as follows. Section

¹⁴⁷ See for instance Vander Stichele, M and Young, B. (2008), *The Abuse of Supermarket Buying power in the EU Food Retail Sector*, Amsterdam: SOMO.

¹⁴⁸ Dobson, P.W. and Inderst, R. (2007), ‘Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers?’, *European Competition Law Review*, 28(7), pp. 393-400.

3.2 analyses the economic literature on buyer power in order to establish what buyer power is and under what circumstances it may arise. Section 3.3 will then assess the effects of buyer power on economic efficiency. Using the insights from the literature on the efficiency effects on buyer power, Section 3.4 will then extend the economic framework of competition policy in the traditional seller power context in order to identify the potential competition concerns of buyer power. Section 3.5 will then assess various implications in the context of competition policy design. Section 3.6 concludes with a summary of this chapter's main findings.

3.2 – Buyer Power: Definition and Sources

From the different perspectives taken in the public and political debate on buyer power, one might infer that buyer power is both the problem and the solution for a variety of issues that may arise in the relation between suppliers and purchasers.¹⁴⁹ This section analyses the economic literature in order to establish what buyer power actually is and under what circumstances it may arise. Subsection 3.2.1 introduces a relatively broad definition that allows for differentiation depending on the various competitive scenarios on the market. Subsection 3.2.2 analyses the sources for buyer power and assesses the necessary requirements for buyer power to arise.

3.2.1 – The Definition of Buyer Power

In the 'single monopoly' scenario, which is most commonly relied upon in textbooks on competition policy, seller power is exercised in relation to customers that have no market power, such as is generally the case in final goods markets. On most markets, however, customers are not final consumers, as products and services are typically engaged in multiple transactions throughout the distribution chain. Depending on market situations, such customers may be able to exercise buyer power. It is important to note, however, that the categorisation of 'seller power' and 'buyer power' crucially relies on the premise that it is possible to identify on the market which firm is the seller and which is the buyer. In practice, however, this may not be so straightforward. In many market situations, it is possible to reframe the transaction to present a buyer as a seller, and vice versa.¹⁵⁰ Suppose for instance that a manufacturer, initially selling its products to a retailer, decides to retain ownership of the goods until they are sold to final customers. Instead of being a seller in the relation to the retailer, the manufacturer

¹⁴⁹ See e.g. the various contributions for the OECD 2008 Roundtable on Monopsony and Buying Power.

¹⁵⁰ Orbach, B.Y. (2010), 'The Antitrust Consumer Welfare Paradox', *Journal of Competition Law & Economics*, 7(1), p. 139.

has now become a buyer of distribution services. For analytical convenience, the analysis assumes that a clear classification between sellers and buyers can usually be made. However, the interesting finding that the difference between ‘seller power’ and ‘buyer power’ may be mostly of a semantic nature provides for an important argument for treating both concepts symmetrically in competition policy.¹⁵¹

Buyer power is typically exercised on a so-called *input market* (or procurement market). The input market concerns the market where firms buy from their suppliers the necessary inputs for selling their products or services on their output markets. On most occasions, input and output markets are ‘linked’ in the sense that developments on the input markets will also affect the output market (and vice versa). Any distortion in the input market will therefore mostly also harm economic efficiency in the output market. It is important to note, however, that this need not be the case.¹⁵² Input and output markets are not linked, for instance, when their geographical scope differs. Input products may, for example, be sold in a local (or global) market, whereas the output product is sold at a global (or local) market. Similarly, it is possible that rivals in the output markets compete while using different technologies, for which they obtain different input products on different markets.

Economic literature recognises different definitions of buyer power.¹⁵³ In very general terms, buyer power is market power on the purchasing side of a market. In marked contrast with the situation of ‘perfect competition’, buyer power therefore allows a firm to affect market outcomes on its input market, most notably the price for which the buyer purchases products or services (i.e. the input price). However, since the exercise of buyer power may involve also other terms of trade than the input price, it seems appropriate to include in the definition of buyer power also non-price elements. The definition of buyer power should moreover take into account the state of competition

¹⁵¹ Schwartz, M. (2004), ‘Should Antitrust Assess Buyer Market Power Differently than Seller Market Power’, Paper Presented at DOJ/FTC Workshop on Merger Enforcement, Washington DC. A similar situation may arise when firms have a role as an intermediary ‘platform’ on a market. Firms that provide payment card systems, for instance, typically operate as a platform to attract both merchants and cardholders, making it difficult to identify whether such a firm operates as a seller or a buyer. See e.g. Armstrong, M. (2006), ‘Competition in two-sided markets’, *RAND Journal of Economics*, 37(3), pp. 668-691; Rochet, J-C. and Tirole, J. (2008), ‘Competition Policy in Two-Sided Markets, with a Special Emphasis on Payment Cards’, in: Buccirosi, P. (ed.), *Handbook of Antitrust Economics*, Cambridge: MIT Press, pp. 543-582.

¹⁵² Werden, G.J. (2011), ‘Consumer welfare and competition policy’, in: Drexler, J., Kerber, W. and Podszun, R., *Competition Policy and the Economic Approach: Foundations and Limitations*, Cheltenham: Edward Elgar, pp. 11-43.

¹⁵³ For a discussion on the definitions of buyer power, see especially Chen, Z. (2008), ‘Defining buyer power’, *Antitrust Bulletin*, 53(2), pp. 241-249. See also Chen, Z. (2007), ‘Buyer Power: Economic Theory and Antitrust Policy’, *Research in Law and Economics*, 22, pp. 17-40.

amongst suppliers against whom buyer power is exercised, since – as will be elaborated upon below – economic literature suggests that this has important implications for the effects of buyer power on economic efficiency. In order to adequately take into account both elements, this research uses the definition that has been proposed by Chen, and which is displayed in Box 14.¹⁵⁴

Box 14: The definition of buyer power

“*Buyer power* is the ability of a buyer to reduce price profitably below a supplier’s normal selling price, or more generally the ability to obtain terms of supply more favourable than a supplier’s normal terms. The normal selling price, in turn, is defined as the supplier’s profit-maximizing price in the absence of buyer power. In the case where there is perfect competition amongst suppliers, the normal selling price of a supplier is the competitive price, and the buyer power is *monopsony power*. On the other hand, in the case where competition amongst suppliers is imperfect, the normal selling price is above the competitive price, and the buyer power is *countervailing power*.”

Buyer power therefore concerns the ability of a buyer to obtain from its supplier(s) more favourable terms of trade. Economic literature typically distinguishes between two types of buyer power. When buyer power is exercised in the relation with suppliers that have no seller power, it is referred to as ‘monopsony power’. By contrast, ‘countervailing buyer power’ (which is also often referred to as ‘bargaining power’) refers to the ability of a buyer to obtain more favourable terms of trade in relation with suppliers that do have seller power.¹⁵⁵ As will be explained further below, the distinction between monopsony power and countervailing buyer power (or bargaining power) is an important determinant for the effects of buyer power on economic efficiency.¹⁵⁶

It is important to note that this differentiation as to whether a firm’s trading partner(s) possess market power does not only apply to buyer power but should also be applied in the context of seller power. As has been discussed in the previous chapter, the concept of seller power incorporates monopoly power, i.e. the ability of a firm to charge a price

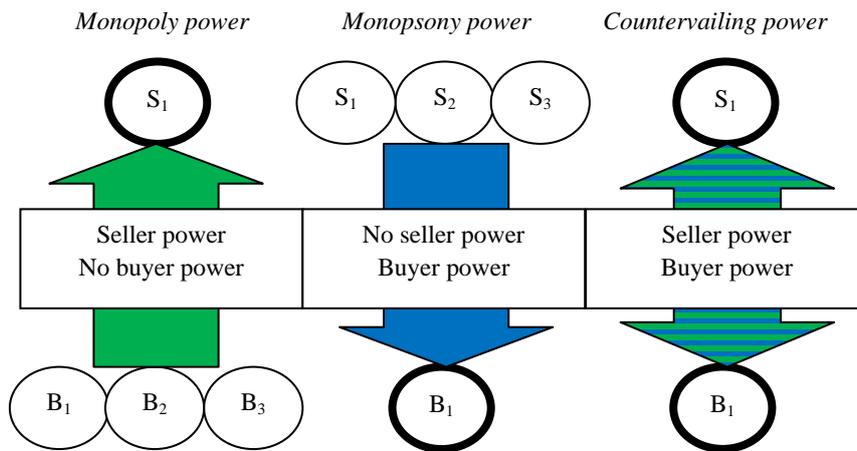
¹⁵⁴ Chen, Z. (2008), ‘Defining buyer power’, *Antitrust Bulletin*, 53(2), p. 247.

¹⁵⁵ The term ‘countervailing’ is used to reflect that buyer power is used vis-à-vis parties that also have market power but need not imply that the market power on the other side of the market is cancelled out. See Chen, Z. (2008), ‘Defining buyer power’, *Antitrust Bulletin*, 53(2), p. 245, who notes that the term ‘countervailing power’ was first used by John Kenneth Galbraith to describe the power developed on one side of the market as a way to counter the market power on the other side of the market. See Galbraith, J.K. (1952), *American Capitalism: The Concept of Countervailing Power*, Boston: Houghton Mifflin.

¹⁵⁶ See Section 3.3.

above the competitive level. However, when exercised in relation with buyers that have buyer power, seller power is typically referred to as countervailing seller power (or bargaining power). The various differentiations between selling and buyer power are summarised in Box 15.

Box 15: Monopoly, monopsony and countervailing power



Monopoly and monopsony power concern market power exercised in the relation with trading partners that have no market power. In the figure above, this has been illustrated in terms of a single firm (monopolist or monopsonist). It should be noted, however, that monopoly or monopsony power can also be exercised when there are multiple firms (e.g. in the situation of an oligopoly or oligopsony).

When both sellers and buyers have market power, there is a situation of so-called bilateral market power. The figure above depicts bilateral market power in the most extreme case of one seller (monopolist) and one buyer (monopsonist); the scenario of so-called 'bilateral monopoly'. Bilateral market power may however also occur in the case of a relatively limited number of sellers and buyers (i.e. so-called 'bilateral oligopoly'). When there is bilateral market power, the market power of firms is referred to as countervailing market power (i.e. countervailing seller power or countervailing buyer power). Since countervailing buyer power is in this context not exercised to affect the (uniform) market price but with the goal to obtain individual discounts in bilateral negotiations,

countervailing buyer or seller power is in this scenario often referred to as bargaining power.¹⁵⁷

3.2.2 – Sources for Buyer Power

Since buyer power involves the ability of a buyer to obtain from its supplier(s) more favourable terms of trade, its exercise can reduce suppliers' profitability. However, this does not mean that suppliers' difficulty to generate economic profit is necessarily caused by buyer power, because this can well be the result of effective competition. The inability to generate economic profit, or when suppliers suffer losses, may for instance be the result of excess production capacity in the market.¹⁵⁸ Indeed, in the scenario of 'perfect competition', the competitive equilibrium is one in which supply exactly meets demand and where excess supply, or suppliers, will be forced to exit the market. Instead, buyer power may also be present in the absence of excess production capacity and may for instance also be exercised when all conditions for 'perfect competition' amongst suppliers are satisfied. The ability of a buyer to exercise buyer power concerns a specific ability of a firm to obtain more favourable terms of trade than a supplier's terms in the absence of buyer power. Buyer power typically requires some kind of economic rent amongst suppliers.¹⁵⁹ The presence of economic rent is the most straightforward within the context of countervailing buyer power. As noted above, countervailing buyer power is buyer power that is exercised in the relation with suppliers that have seller power. In this scenario, buyer power arises due to the presence of *seller power* since – in the absence of buyer power – this would enable suppliers to enjoy monopoly power and generate economic profit.

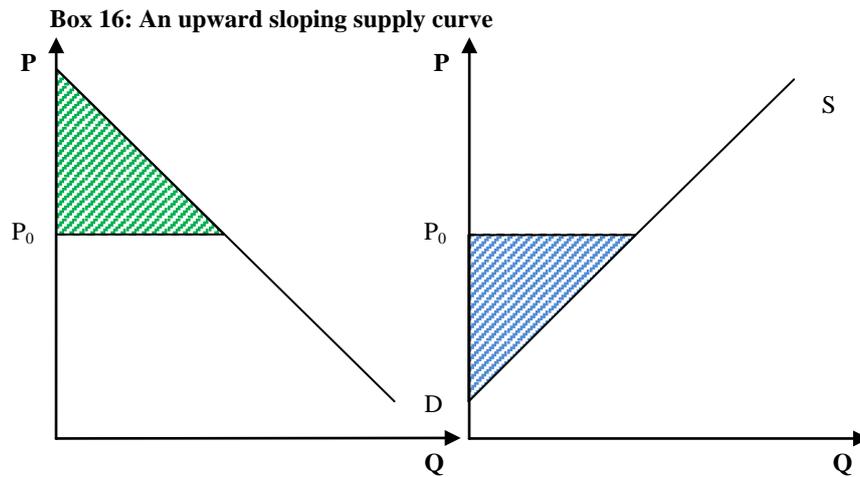
Perhaps less straightforward is the presence of economic rent in the scenario in which suppliers have no market power. In this scenario, suppliers are unable to affect market outcomes and typically do not generate economic profit. However, economic rent will be present when a market has an *upward sloping supply curve*. Basically, an industry's supply curve shows the relation between the quantity of a good (or service) that suppliers on a (competitive) market are able and willing to sell and the price of that

¹⁵⁷ See Subsection 3.3.2.

¹⁵⁸ See e.g. Baarsma, B., Van der Noll, R. and Akker, I. (2011), *Boer zoekt duurzaamheid*, SEO report for the Ministry of Economic Affairs, Agriculture and Innovation in the Netherlands.

¹⁵⁹ See Noll, R.G. (2005), "'Buyer Power" and Economic Policy', *Antitrust Law Journal*, 72(2), pp. 589-624; Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power; Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078.

good (or service).¹⁶⁰ An upward sloping supply curve essentially reflects that, the higher the price, the more firms are able and willing to supply. This situation arises when the factors of production that are used by suppliers are differentiated in terms of their productivity.¹⁶¹ That is, instead of the commonly discussed scenario of constant or increasing returns to scale (scale economies), an upward sloping supply curve reflects the presence of decreasing returns to scale. This implies that the higher the price, the more suppliers are able and willing to sell. This can be illustrated both within and between firms. Within a firm, an expansion in output may require the input of less productive employees or the exploitation of a less productive piece of land (or require existing employees to work overtime). This may give rise to an increasing marginal cost curve; as output increases, it becomes more costly to produce one additional unit of output. Similarly, productivity may also differ between firms. That is, a higher market price may attract new, though less productive firms to the market. In this case, the entrants face higher costs because of a lack of skill or experience on the market and would therefore have found entry inefficient at a lower market price. The situation of an upward sloping supply curve therefore gives rise to economic rent. This is explained in Box 16.



The analysis of an upward sloping supply curve is directly analogous to the analysis of a downward sloping demand curve. A downward sloping demand curve, as depicted on the left hand side of the figure above, reflects the difference in valuation of a product or service amongst consumers. As the price falls, more consumers will be willing to purchase

¹⁶⁰ See more extensively e.g. Pindyck, R.S. and Rubinfeld, D.L. (2001), *Microeconomics*, London: Prentice Hall, pp. 20 ff.

¹⁶¹ Noll, R.G. (2005), “Buyer Power” and Economic Policy’, *Antitrust Law Journal*, 72(2), p. 593.

the product or service. The consumers that were already willing to purchase at a higher price (i.e. those with a higher valuation of the product or service) will earn an economic rent equal to the difference between their maximum willingness to pay and the price actually paid (consumer surplus). This is the green shaded area. An upward sloping supply curve is the mirror image of the downward sloping demand curve. While the supply curve typically shows the quantity of goods or services suppliers are willing and able to sell at a given price (holding constant other factors), an upward sloping supply curve shows that the higher the price, the more suppliers are able and willing to sell.¹⁶² This gives rise to economic rent for the owners of the most productive input factors (so-called ‘Ricardian rent’).¹⁶³

Since an upward sloping supply curve is an important condition for monopsony power, the question rises how often industries have upward sloping supply curves. From a theoretical perspective, there are important reasons why per-unit costs can actually decrease at a higher production level. That is, instead of decreasing returns to scale, supply of a good or service may often have increasing returns to scale (or economies of scale). Increasing returns to scale can for instance arise because the larger production level allows employees of a firm to specialise in their tasks or to make more productive use of important production equipment. When supply of a good or service is characterised by increasing returns to scale, there is no upward sloping supply curve. Instead, under increasing returns to scale, it ‘pays to be big’ and suppliers often have seller power (and if there would be buyer power, it would thus amount to countervailing buyer power, not monopsony power). Alternatively, it is also possible that the level of production does not affect the productivity of its factors, and there are therefore constant returns to scale, a scenario in which the supply curve is flat. From an empirical perspective, however, it is interesting to note a study that was conducted in 1993 on 26 manufacturing industries in the United States.¹⁶⁴ In this study, only three industries exhibited downward sloping supply functions (prepared feeds, construction equipment and aircraft), while seven industries had flat supply functions (including plumbing and heating products, floor coverings, and animal and marine fats and oils). Sixteen industries, more than half of the markets studied, were however found to have an upward sloping supply curve. This concerned markets for e.g. lumber, drugs, paints, tires, stone, clay and glass, cement and electronic components. The assumption of an

¹⁶² See e.g. Pindyck, R.S. and Rubinfeld, D.L. (2001), *Microeconomics*, London: Prentice Hall, pp. 20-21.

¹⁶³ Noll, R.G. (2005), ‘“Buyer Power” and Economic Policy’, *Antitrust Law Journal*, 72(2), pp. 589-624.

¹⁶⁴ Shea, J. (1993), ‘Do Supply Curves Slope Up?’, *The Quarterly Journal of Economics*, 108(1), pp. 1-32.

upward sloping supply curve therefore appears to have empirical relevance. Accordingly, it has been noted that monopsony power might therefore specifically arise in a number of industrial and agricultural markets.¹⁶⁵

A third scenario that gives rise to economic rent concerns the situation where suppliers face *sunk costs*.¹⁶⁶ Sunk costs refer to firm expenditure that cannot be recovered in the short run. For instance, sunk costs may refer to a long-run investment in capital such as a building or machine that cannot be shifted easily to another productive use. The economic rent generated to recover sunk costs is referred to as ‘quasi-rents’.¹⁶⁷

3.2.3 – Conclusion

Buyer power is market power on the input market, that is the market on which firms purchase from their suppliers the necessary inputs for selling their products or services on their output markets. Essentially, buyer power concerns the ability of a buyer to obtain more favourable terms of trade from its supplier(s). As a result, the exercise of buyer power can reduce suppliers’ profitability. This does not mean, however, that suppliers’ difficulty to generate economic profit is necessarily caused by buyer power, because this can well be the result of effective competition. The inability to generate economic profit, or when suppliers suffer losses, may for instance be the result of excess production capacity in the market. In this situation, the perceived ‘market failure’ by suppliers is not market power but is in fact the result of effective competition.

Instead, buyer power may also be present in the absence of excess production capacity. The ability of a buyer to exercise buyer power concerns a specific ability to obtain more favourable terms of trade than a supplier’s terms in the absence of buyer power. Buyer power typically requires some kind of economic rent amongst suppliers. The presence of economic rent is most straightforward when suppliers have seller power. In this scenario, suppliers are able to affect market outcomes such as market price and are – in the absence of buyer power – able to exercise monopoly power and thus generate economic profit. When buyer power is exercised in the relation with suppliers that

¹⁶⁵ Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078, pp. 12-13.

¹⁶⁶ Noll, R.G. (2005), “‘Buyer Power’ and Economic Policy”, *Antitrust Law Journal*, 72(2), pp. 589-624; Church, J. (2008), ‘Monopsony and Buyer Power’, Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power.

¹⁶⁷ See e.g. Church, J. and Ware, R. (2000), *Industrial Organisation: A Strategic Approach*, Boston: McGraw-Hill, pp. 21-25.

enjoy seller power, the buyer power is usually referred to as countervailing buyer power. Buyer power may, however, also arise when suppliers have no market power, a scenario in which it is referred to as monopsony power. The economic rent that is necessary for the exercise of buyer power may for instance arise when there is an upward sloping supply curve. The presence of an upward sloping supply curve essentially reflects the presence of so-called decreasing returns to scale, which means that, as output increases, it becomes more costly to produce one additional unit of output. Alternatively, economic rent may also be present when suppliers face sunk costs.

3.3 – Buyer Power and Economic Efficiency

In order to establish whether buyer power should, at all, be a concern within the context of competition policy, it is necessary to assess its effects on economic efficiency. This section addresses the efficiency effects of buyer power in a similar fashion as in the traditional analysis of monopoly power in Chapter 2, but where two scenarios are distinguished. Section 3.3.1 analyses the efficiency effects of buyer power when exercised in the relation with suppliers that have no seller power (monopsony power). Section 3.3.2 addresses the effects of buyer power on economic efficiency when it is exercised vis-à-vis sellers that do have seller power (countervailing buyer power or bargaining power).

It should be stressed, however, that the analysis of the efficiency effects of buyer power in this section is not complete but relies instead on a rather basic treatment of buyer power in the economic literature. Since buyer power may arise on various stages in the distribution chain, can have different degrees and may moreover be confronted with various degrees of (countervailing) seller power (giving rise to many different bargaining scenarios), actual effects on economic efficiency may be somewhat ambiguous. Whereas such an analysis is not essential in this stage of this research, in which the purpose is to establish whether buyer power should, at all, be a concern for competition policy and how this relates to the traditional seller power context, it may however be very important in the context of competition policy enforcement in order to ascertain whether conduct is harmful or not.

3.3.1 – Monopsony Power

Monopsony power is market power exercised by buyers in their relation with suppliers that have no seller power. For analytical convenience, this section analyses the effects

of monopsony power on economic efficiency in a very simplified scenario, similar to the discussion above on monopoly power in terms of a 'single monopoly'.¹⁶⁸ Instead of a single seller (monopolist) facing numerous (perfectly) competitive buyers, this subsection analyses the situation in which a single buyer (monopsonist) faces numerous (perfectly) competitive sellers. This will be referred to as the 'single monopsony' scenario. In this scenario, the monopsonist thus has monopsony power (on its input market) but no seller power (on its output market). As a result, the monopsonist is able to affect market outcomes on the input market, but not on the output market. As discussed above, this situation can occur when the link between the input and the output market is 'broken'. For example, it is possible that a firm competes on its output market with different technologies than its rivals, for which it thus requires different inputs than its rivals. In such a situation, a firm may be a monopsonist on its input market though face fierce competition on its output market.¹⁶⁹ Similarly, it is possible that the geographic scope of the input market is narrower (e.g. local) than that of the output market (e.g. national). The traditional example in this context is an isolated town where one mill buys from numerous suppliers (e.g. farms), though competes with many rivals on a national output market.¹⁷⁰

Similar to the discussion on monopoly power, the difference between a buyer with monopsony power and a competitive purchaser does not concern its intentions. Like any firm, the monopsonist will seek to maximise its profit. When purchasing on an input market, a firm therefore typically wants to purchase additional units of input until its marginal benefit equals its marginal costs. The marginal benefit of purchasing one additional unit of input is referred to as 'marginal revenue product', which depends on conditions on the output market. More specifically, the marginal revenue product is equal to the additional output produced from purchasing another unit of input multiplied by the marginal revenue in the downstream market. If, as is assumed here, there is no seller power on the output market, marginal revenue is simply the market price received downstream (i.e. the output price).¹⁷¹

The key difference between a buyer with monopsony power and a competitive purchaser concerns the consequences of their profit-maximising behaviour. A competitive purchaser is unable to influence the output price and the input price.

¹⁶⁸ See Subsection 2.2.2.

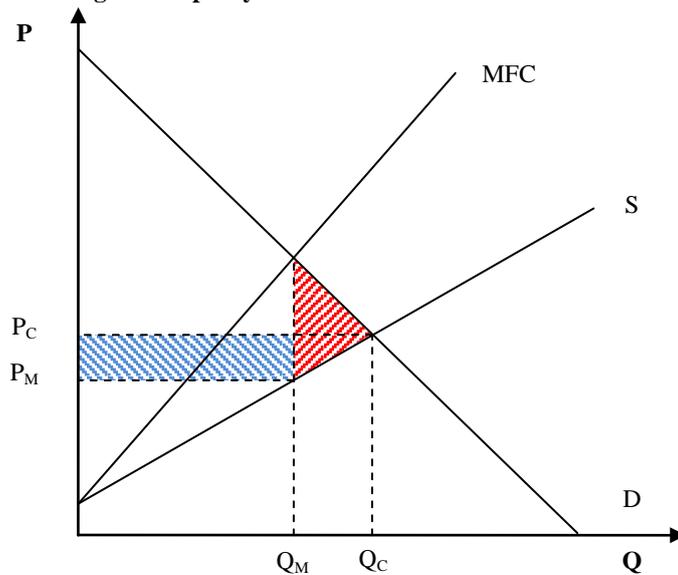
¹⁶⁹ Werden, G.J. (2007), 'Monopsony and the Sherman Act: Consumer Welfare in a New Light', *Antitrust Law Journal*, 74, pp. 707-737.

¹⁷⁰ Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 41-43.

¹⁷¹ Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, pp. 28-29.

Accordingly, the competitive purchaser will purchase the quantity where its marginal revenue product equals the (given) input price.¹⁷² The crucial difference with the monopsonist is, however, that for the monopsonist the input price is not beyond its control. When the monopsonist purchases an additional unit of the input, it must pay a higher price (in order to accommodate the higher costs due to the increased output). Under the assumption that price discrimination is not possible, this higher input price is not only charged for additional units of the input but for all units purchased. As a result, the monopsonist will want to internalise the effect of its decisions on the input price. The monopsonist will thus recognise that by reducing the quantity of inputs purchased, it is in fact able to depress the input price to a level below the competitive price, and thereby generate economic profit. However, since the lower input price is obtained by reducing purchases, the exercise of monopsony power typically harms economic efficiency because it reduces allocative efficiency. This point is further explained in Box 17.¹⁷³

Box 17: A single monopsony



¹⁷² In this case, marginal revenue product is known as the value of marginal product. See Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power.

¹⁷³ Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 41-45; Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078, pp. 8-10.

The figure above illustrates the efficiency effects of monopsony power compared to the situation where the purchasing side of the market is (perfectly) competitive. A competitive buyer's decision on how much units of the input to purchase has, by definition, no impact on the input price. As a result, a competitive purchaser would purchase the amount of inputs where demand (D) and supply (S) are equal, as illustrated by Q_C , with the corresponding input price P_C .

Now consider instead that the purchaser is a monopsonist. Being the only purchaser of the input, the monopsonist's decision to buy one additional unit of the input needs to be accommodated by a higher level of production. Assuming that price discrimination is impossible, the higher input price will have to be paid not only for additional units, but for all units purchased. Accordingly, the monopsonist will take this effect into account when deciding upon the quantity of inputs it wants to buy. This is reflected by the Marginal Factor Cost (MFC) curve. The monopsonist thus recognises that its purchasing decision affects the input price, and that it can depress input prices below the competitive level by purchasing less of the input. The profit-maximising purchasing decision is illustrated by Q_M , while the corresponding price is P_M .

The effects of the exercise of monopsony power on economic efficiency can be summarised as follows. The blue shaded area illustrates the transfer of welfare from suppliers to the buyer. Since this merely concerns a shift of welfare this does not involve a net welfare loss; the loss in producer surplus is made up for the increase in buyer surplus. However, since the lower input price is obtained by reducing purchases, there is also net loss in total surplus, i.e. the sum of buyer and supplier surplus. Similar to monopoly power, the exercise of monopsony power is therefore accompanied by a deadweight loss, which is illustrated by the red shaded area.

Box 17 shows that the economic analysis of monopsony power is analogous to that of monopoly power.¹⁷⁴ That is, the effects of the exercise of monopsony power on economic efficiency are the mirror image of the efficiency effects of the exercise of monopoly power. Whereas monopoly power involves a transfer of welfare from buyers

¹⁷⁴ See Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 41-67, as well as Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078; Noll, R.G. (2005), “‘Buyer Power’ and Economic Policy”, *Antitrust Law Journal*, 72(2), pp. 589-624; Church, J. (2008), ‘Monopsony and Buyer Power’, Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power.

to sellers, monopsony power causes surplus to shift from sellers to buyers. This transfer in welfare associated with the exercise of monopsony power, however, is not harmful. After all, because whatever is lost by sellers is compensated for by a gain in the welfare of buyers, the net effect on total surplus is zero. It is therefore not the change in the distribution of welfare that forms the concern of monopsony power within the context of competition policy. However, similar to monopoly power, the exercise of monopsony power also harms allocative efficiency. The allocative inefficiency of monopsony power is caused by the reduction in the value of output in the input market. Besides affecting the distribution of welfare, monopsony power thus moreover harms economic efficiency in the input market in a way that is very similar to monopoly power.

Because a firm with monopsony power is able to depress the input price below the competitive level, it might be tempting to assume that monopsony power benefits consumers because the lower input prices are passed on to consumers in the form of lower output prices. However, as noted above, a firm with monopsony power recognises that each production increase in its output market requires additional units from the input market, which will increase its input prices. That is, the marginal factor cost for a monopsonist therefore exceeds its input price. This implies that even though monopsony power allows a firm to obtain a lower price on the input market, the effect of monopsony power on the output market is that it raises the firm's marginal costs. That is, despite the reduced input prices, the marginal costs for the monopsonist are in fact higher than for a competitive purchaser. Monopsony power thus induces a firm to reduce production on the output market below the level that a firm would choose in the absence of monopsony power would set. Since the lower input price obtained by the exercise of monopsony power is therefore not passed on to consumers, it can be concluded that monopsony power never benefits consumer welfare.¹⁷⁵

However, even though monopsony power never benefits consumers, this also does not mean that consumers are necessarily harmed by the exercise of monopsony power. After all, if the output market is (perfectly) competitive (for instance when the geographic scope of the input market is narrower than the output market), the monopsonist does not affect market conditions in the output market. As a result, the reduction in the monopsonist's output does not lead to a change in the output price.

¹⁷⁵ Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 41-67; Salop, S.C. (2005), 'Anticompetitive Overbuying by Power Buyers', *Antitrust Law Journal*, 72(2), pp. 669-715.

This is because the reduction in the monopsonist's output will be compensated by its rivals, which will expand their output up to the competitive level.¹⁷⁶

Some authors stress, however, that even when the output market is competitive and monopsony power in that case does not directly harm consumers, it will harm them indirectly.¹⁷⁷ This may for instance occur when the monopsonist's rivals are less efficient. As explained above, the exercise of monopsony power by a firm that is a (perfect) competitor in its output market will cause the monopsonist's downstream rivals to compensate for the reduction in output until the competitive level is reached. However, when input markets have an upward sloping supply curve, the monopsonist's rivals will increase their output using less productive inputs (e.g. less productive land or employees). That is, the decrease in the monopsonist's output might be compensated for by rivals that will purchase from less efficient suppliers. Since the increase in output by the monopsonist's rivals in that scenario requires the use of less productive inputs or firms, the price for consumers will be (slightly) higher than in the absence of monopsony power.¹⁷⁸ Alternatively, the exercise of monopsony power may also indirectly harm consumers when not one but all (or a sufficient amount of) rivals in the output market have monopsony power in their input markets. This may, for instance, occur when monopsony power is exercised in distinct local markets, which are used to sell products or services in the same (perfectly) competitive regional or national output markets. Here, each individual monopsonist's reduction of output below the competitive level does not affect market conditions in the output market. However, because each local monopsonist follows this strategy, total output from each local input market may fall and total output in the final good market may also decline. In this situation, the exercise of monopsony power causes an increase in output prices and thus harms consumers.

The conclusion that monopsony power does not directly harm consumers but may indirectly harm them only applies when output markets are (perfectly) competitive. However, the situation in which a firm has monopsony power generally implies that also its output market is not (perfectly) competitive. A firm with monopsony power will typically also have developed some degree of market power on its output market. To illustrate, consider the extreme situation in which a firm is both the single purchaser

¹⁷⁶ Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078, pp. 8-13.

¹⁷⁷ See Noll, R.G. (2005), "'Buyer Power" and Economic Policy', *Antitrust Law Journal*, 72(2), pp. 596-600.

¹⁷⁸ See Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 45-48.

in its input market (monopsonist) and the single seller in its output market (monopolist); the firm is a so-called *monemporist*.¹⁷⁹ In contrast to perfect competition (on both the input and the output market), the ‘monemporist’ scenario involves a firm that affects market outcomes in the input market as well as in the output market. When price discrimination is impossible, the (profit-maximising) monemporist thus needs to take into account that any increase in its overall production causes (i) an increase in its input price and (ii) a decrease in its output price (for all units). In the monemporist scenario the monopsonist will therefore even further reduce its output than in the ‘simple monopsony’ scenario, thereby causing additional allocative inefficiency. This is concisely discussed in Box 18.¹⁸⁰

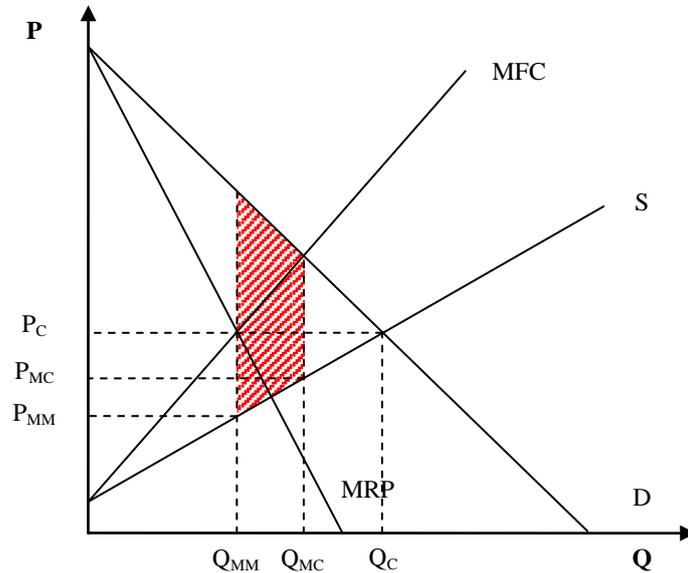
Box 18: Monemporist

In the situation where a monopsonist is also a monopolist in its output market, it needs to recognise that an increase in its output not only increases its input price but also causes a decrease in its output price (for all units). This is illustrated by the addition of the Marginal Revenue Product (MRP) curve, which accompanies the downward sloping derived demand curve.

In this extreme situation where a firm is a so-called monemporist, its profit-maximising input quantity is indicated by the intersection of its MRP and its Marginal Factor Cost (MFC) curves. The corresponding input price and quantity purchased of the monemporist in the input market are P_{MM} and Q_{MM} , whereas without seller power the monopsonist’s profit-maximising behaviour would have resulted in the input price P_{MC} and quantity Q_{MC} . The situation where a monopsonist has also monopoly power thus causes an additional allocative inefficiency. This additional deadweight loss is illustrated by the red shaded area.

¹⁷⁹ This term has been introduced by Nichol, A.J. (1943), ‘Review of *A Theoretical Analysis of Imperfect Competition with Special Application to the Agricultural Industries* by W.H. Nicholls’, *Journal of Political Economy*, 51, pp. 82-84.

¹⁸⁰ Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078, pp. 9-10.



3.3.2 – Countervailing Buyer Power

When buyer power is exercised in the relation with suppliers that have seller power, the buyer power is referred to as countervailing buyer power or bargaining power. That is, countervailing buyer power is exercised vis-à-vis sellers that – in the absence of buyer power – would have been able to exercise monopoly power. Countervailing buyer power can therefore only be exercised in the scenario of ‘bilateral market power’, a situation in which there is market power on both the selling and the purchasing side of the market. Under bilateral market power, and in marked contrast with ‘perfect competition’, both sellers and buyers are able to affect market outcomes. More precisely, in the bilateral market power scenario sellers’ effort to restrict output and raise the input price is confronted by buyers’ effort to restrict output and lower the input price. Although it might, intuitively, seem possible for firms to ignore the presence of their trading partners’ market power, Blair and Harrison explain that this is very unlikely to happen.¹⁸¹ After all, if a firm has market power, there is no reason why it should behave as a (perfect) competitor. As a result, in the relation with suppliers that have seller power, buyer power is not exercised by simply posting a low input price

¹⁸¹ Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 126-127.

and wait for sellers to arrive.¹⁸² When there is bilateral market power, buyers and sellers will mutually recognise their market power and acknowledge that none of them can simply impose a price and let the others respond by choosing a certain quantity of the input product. Instead of assuming that its trading partner will behave as a (perfect) competitor, both buyers and sellers will typically mutually recognise their market power and engage in bilateral cooperation in the bargaining process.

Whereas it is important to note that bilateral market power may involve many different degrees of buyer and seller power and also many different bargaining scenarios, this subsection only distinguishes two very simplified scenarios. First, efficiency effects of countervailing buyer power are assessed in a *market interface*. In a market interface, firms on both sides of the market interact to set a market (input) price, a price that in the absence of price discrimination all buyers pay and all sellers receive.¹⁸³ In this simplified context, the effects of countervailing buyer power are most easily explained within the extreme scenario of a so-called ‘bilateral monopoly’.¹⁸⁴ Under bilateral monopoly, a single seller (monopolist) trades with a single purchaser (monopsonist). For analytical convenience, it is moreover assumed that the monopsonist is also the single seller (monopolist) in its output market (i.e. it is a monemporist). Due to their market power, neither the buyer nor the seller can be expected to behave as a (perfect) competitor. In the bilateral monopoly scenario, the buyer and the seller recognise that negotiating over input price and quantity allows them to maximise their joint profit. In this context, Blair and Harrison show that the bargaining process (assuming that bargaining does not involve inefficiencies) will lead to the same (profit-maximising) quantity of inputs as a vertically integrated firm would choose.¹⁸⁵ It can therefore be expected that both parties agree to set the quantity at a level that maximises their joint profit and subsequently negotiate an input price that divides the corresponding profit between them. It is important to note that, in contrast to the analysis of monopoly and monopsony power, the input price therefore does not function as a rationing device

¹⁸² Noll, R.G. (2005), ‘“Buyer Power” and Economic Policy’, *Antitrust Law Journal*, 72(2), pp. 602-603.

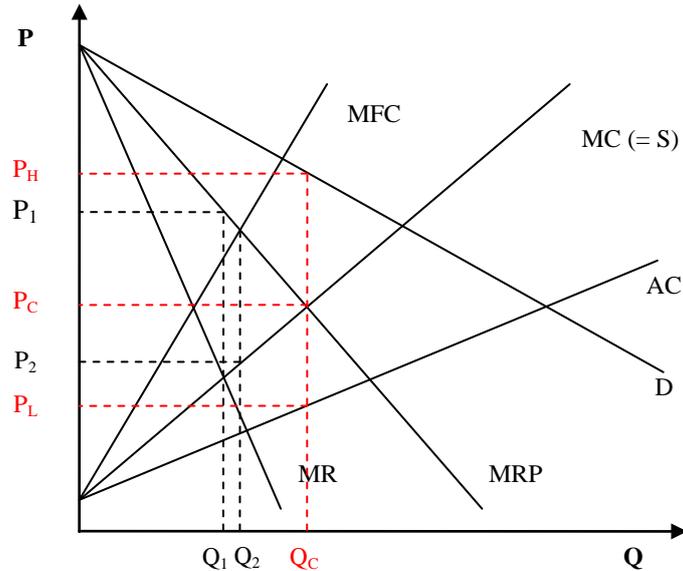
¹⁸³ Church, J. (2008), ‘Monopsony and Buyer Power’, Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, p. 25.

¹⁸⁴ See especially Blair, R.D. and DePasquale, C. (2011), ‘Considerations of Countervailing Power’, *Review of Industrial Organisation*, 39, pp. 137-143; Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 127-131; Noll, R.G. (2005), ‘“Buyer Power” and Economic Policy’, *Antitrust Law Journal*, 72(2), pp. 602-606; Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078, pp. 14-17.

¹⁸⁵ See Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 127-131, making reference to Bowley, A.L. (1928), ‘Bilateral Monopoly’, *Economic Journal*, 38, pp. 651-659.

because the quantity is already agreed upon. Instead, in the bargaining process, the input price merely serves as a means to distribute the corresponding surplus. The resulting allocation of surplus ultimately depends on the extent of bargaining power of both parties. This conclusion is concisely explained in Box 19.¹⁸⁶

Box 19: Bilateral Monopoly



In the figure above, D represents the demand faced by the retailer on its output market, on which it sells to (final) consumers. D would therefore reflect marginal revenue for the retailer if it had no monopoly power. However, since the retailer is a monopolist and enjoys monopoly power, the additional revenue reflected by employing one additional unit of the input product is marginal revenue product (MRP). Moreover, the marginal revenue curve (MR) represents the situation where both the seller and the buyer have monopoly power but where the buyer has no buyer power, i.e. the ‘double marginalisation’ scenario. As to the cost curves, AC denotes the supplier’s average cost of producing the input. MC reflects the marginal cost curve of the supplier and would, in the scenario that the supplier would have no monopoly power, correspond to the supplier’s supply curve.¹⁸⁷ Finally, MFC denotes the marginal factor cost for the buyer in the situation in which the seller would have no seller power.

¹⁸⁶ Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 127-131; Blair, R.D. and DePasquale, C. (2011), ‘Considerations of Countervailing Power’, *Review of Industrial Organisation*, 39, pp. 137-143.

¹⁸⁷ Since the supplier is, however, a monopolist, it has no supply curve.

Since the figure incorporates different scenarios, the efficiency effects of bilateral monopoly can be assessed step by step.

Single (downstream) monopoly: In the situation in which neither the seller nor the buyer has market power on the input market (but where the buyer is a monopolist on its output market), derived demand for the input (MRP) would equal marginal cost (MC, which would then represent the supply curve). As a result, the market outcome is where the output is Q_C and the input price is P_C .¹⁸⁸

Double marginalisation: The double marginalisation scenario applies when both the seller and the buyer have monopoly power, but where the buyer has no buyer power. In this scenario, the input market outcome is where the marginal revenue obtained by increasing the number of input products produced (MR) equals its marginal costs (MC), resulting in Q_1 number of inputs at input price P_1 .¹⁸⁹

Monemporist: In the monemporist scenario, the seller has no market power but the buyer has both monopsony power on its input market and monopoly power on its output market. This situation will induce the monopsonist to purchase up to the point where MRP equals MFC, resulting in Q_2 , and the corresponding monopsony price P_2 .¹⁹⁰

Bilateral monopoly: In the bilateral monopoly scenario, it is assumed that the supplier is a monopolist and the buyer a monemporist. In this situation, neither the buyer nor the seller can reasonably assume that its trading partner will behave as a ‘perfect’ competitor and respond as a price taker. Instead, in the bilateral monopoly scenario, it can be expected that both firms agree on the quantity that maximises their joint profit, Q_C , where the marginal cost of producing the input (MC) equals the marginal revenue of employing one additional unit of the input (MRP). When it comes to the input price, however, the interests of the seller and buyer contrast, and the outcome is determined by parties’ bargaining strength. There are, however, limits to the outcome of the bargaining process. The theoretical maximum and minimum input price are determined by the scenario in which either the seller or the buyer can make a so-called all-or-none offer, in which a credible threat is made that the alternative of the offer is to sell/buy nothing at all.¹⁹¹ At quantity Q_C , an all-or-none offer

¹⁸⁸ See Subsection 2.2.2.

¹⁸⁹ See Subsection 2.2.2.

¹⁹⁰ See Subsection 3.3.1.

¹⁹¹ As a result, when the buyer would be able to make an all-or-none offer, the supplier breaks even on the total volume (i.e. price equals average costs), unlike under a normal supply curve where

by the buyer would result in price P_L , where the supplier's entire surplus is captured. Alternatively, when the supplier would be able to make an all-or-none offer, the resulting price is P_H , at which the entire buyer's surplus is captured. The input price that is reached through the bargaining process will be somewhere between the extremes of P_L and P_H and ultimately depends on parties' bargaining strength.

Box 19 indicates that bilateral monopoly leads to a higher degree of economic efficiency than the situation in which only the buyer or only the seller would have market power (i.e. bilateral monopoly is preferable to the single monopoly or single monopsony scenario). Although this concerns a highly simplified example, the analysis indicates that countervailing buyer power, in contrast to monopoly or monopsony power, is typically based upon the threat of reducing output but has the objective of maintaining or increasing purchases.¹⁹² As a result, countervailing buyer power may mitigate the harmful effects of monopoly power and tends to promote economic efficiency. However, it is important to stress that the simplified bilateral monopoly scenario discussed above assumes that the buyer has monopoly power in the output market (i.e. it is assumed that the buyer is a monopolist). The beneficial effects of countervailing buyer power on the input market may therefore possibly be offset by harm to economic efficiency on the output market. As Dobson explains, this is different when the buyer has no monopoly power on its output market. Since countervailing buyer power is in this scenario not accompanied with additional allocative inefficiency on the output market, this suggests that the bilateral monopoly scenario is more preferable than the situation in which only the seller or only the buyer has market power.¹⁹³

In practice, countervailing buyer power (or bargaining power) will typically be exercised in the scenario with multiple buyers and sellers, such as the scenario with a relatively small number of buyers and sellers: so-called 'bilateral oligopoly'. In this context, countervailing buyer power is not exercised with a view to affect the (uniform)

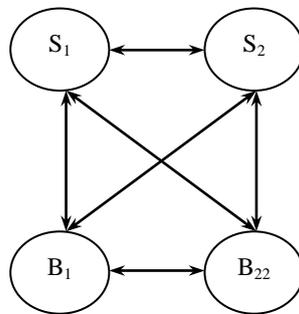
the supplier breaks even on the margin (i.e. price equals marginal costs). Under the all-or-none supply curve, rents made on the firstly produced units are therefore used to subsidise other units, on which the supplier loses money on. See Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 83-85; Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, p. 32.

¹⁹² Chen, Z. (2008), 'Defining buyer power', *Antitrust Bulletin*, 53(2), p. 244; Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, p. 37.

¹⁹³ Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078, pp. 16-17.

market price because any effort by a buyer to reduce its input price would then also benefit its rivals. Instead, countervailing buyer power is most commonly exercised in bilateral negotiations between a buyer and a seller, with a view to obtain an individual discount.¹⁹⁴ In this context, it is more common to analyse the effects of countervailing buyer power in a so-called *bargaining framework*. In a bargaining framework, buyers' ability to obtain more favourable terms of trade depends on their relative bargaining power, relative to suppliers and relative to rival buyers. Because the relative bargaining power may vary substantially across firms, there may be considerable variations in the input price paid by different buyers. This is illustrated in Box 20.

Box 20: Countervailing buyer power in a bargaining framework



In the market scenario depicted above, bilateral oligopoly is depicted in terms of 'bilateral duopoly'. Here, two sellers (S_1 and S_2) sell an input product to two buyers (B_1 and B_2). Moreover, consider that each firm on the market has some degree of market (or bargaining) power. When exercising countervailing buyer power, a buyer engages in bilateral bargaining with a supplier in order to obtain an individual discount.

A buyer's ability to negotiate an individual discount depends on its relative bargaining power, relative to its suppliers (i.e. in a vertical sense) and relative to its rival buyers (i.e. in a horizontal sense).¹⁹⁵ Bargaining

¹⁹⁴ See especially Doyle, C. and Inderst, R. (2007), 'Some Economics on the Treatment of Buyer Power in Antitrust', *European Competition Law Review*, 28(3), pp. 210-219; Inderst, R. and Mazzarotto, N. (2008), 'Buyer Power in Distribution', in: Collins, W.D. (ed.), *Issues in Competition Law and Policy*, Chicago: American Bar Association, pp. 1953-1978; Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, pp. 42-54.

¹⁹⁵ Dobson, P.W. and Inderst, R. (2007), 'Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers?', *European Competition Law Review*, 28(7), pp. 393-400. See also Steiner, R.L. (2008), 'Vertical competition, horizontal competition, and market power', *Antitrust Bulletin*, 53(2), pp. 251-270.

power is affected by a variety of factors. An important source for bargaining power is formed by the buyer's 'outside options'. For instance, if a buyer can easily switch to another supplier (or market), it may be in a better position to obtain a discount. Similarly, a buyer's bargaining power may be limited due to the supplier's outside options. Another decisive factor for bargaining power is a buyer's bargaining effectiveness. A buyer that has, for example, more patience than its rivals is more likely to have an advantage.

Generally, the exercise of countervailing buyer power (or bargaining power) by a buyer involves a negotiation for individual discounts and therefore does not affect the terms of trade for other buyers. It should be noted, however, that recent contributions in the economic literature on the bargaining process suggest that the exercise of countervailing buyer power might affect other buyers' trading conditions. On the one hand, it has been alleged that substantial differences in bargaining power amongst buyers (i.e. differential buyer power) could cause a so-called 'waterbed effect'.¹⁹⁶ In the presence of a waterbed effect, charging low prices to a powerful buyer forces suppliers to raise their prices to smaller buyers. More generally, the waterbed effect implies that the ability of a very large buyer to obtain more advantageous terms of trade would disadvantage its rivals – not only in a relative but also in an absolute sense. This adverse effect on the smaller rivals reduces their bargaining power, which would further enhance the large buyer's relative bargaining power; a process that might continue even further. That is, the presence of a waterbed effect would thus imply that the exercise of countervailing buyer power could lead to a process in which the number of buyers (and perhaps the intensity of competition) gradually decreases.

In the literature, a number of theories have been put forward to explain the possible presence of a waterbed effect. An explanation for a waterbed effect that might seem intuitively straightforward is that the large buyer's discount would reduce the supplier's profitability for which the other buyers will have to compensate if the supplier wants to break even (or cover its fixed costs). Dobson and Inderst discuss, however, that this explanation is unsatisfactory since it does not explain why the supplier should now be able to charge higher prices to the other buyers. After all, if the supplier would be able to (profitably) raise its prices after the discount to the large

¹⁹⁶ See e.g. Dobson, P.W. (2005), 'Exploiting Buyer Power: Lessons from the British Grocery Trade', *Antitrust Law Journal*, 72(2), pp. 529-562; Dobson, P.W. and Inderst, R. (2007), 'Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers?', *European Competition Law Review*, 28(7), pp. 393-400; Dobson, P.W. and Inderst, R. (2008), 'The Waterbed Effect: Where Buying and Selling Power Come Together', *Wisconsin Law Review*, pp. 331-357; Inderst, R. and Valletti, T.M. (2011), 'Buyer Power and the "Waterbed Effect"', *Journal of Industrial Economics*, 59(1), pp. 1-20.

buyer, it should also have been able to do so beforehand.¹⁹⁷ Dobson and Inderst explain that a more plausible explanation for a possible waterbed effect could be that the obtained discount allows the large buyer to gain market share at the expense of its rivals, thereby reducing their demand for inputs. If the purchased volume would be a key determinant of (discounts on) input prices, for example due to the presence of economies of scale amongst suppliers, this development would make the rival buyers' businesses less attractive for suppliers. This would in turn further reduce the buyers' bargaining power vis-à-vis the suppliers, which may now charge them a higher price.¹⁹⁸ Alternatively, it has been argued that a waterbed effect could also work itself through an adjustment amongst suppliers.¹⁹⁹ It is for instance conceivable that, pursuant to the large buyer's claim for additional discounts, some suppliers may no longer find it profitable to stay in the market. In anticipation of further reduction in their profitability, some suppliers may therefore exit the market or, similarly, refrain from entering. This development would increase the bargaining power of the remaining suppliers, which may especially adversely affect the smaller buyers.²⁰⁰

On the other hand, it has also been argued that differential buyer power could instead lead to an 'anti-waterbed effect'.²⁰¹ With an anti-waterbed effect, the ability of a powerful buyer to negotiate discounts will in fact benefit its rival buyers. It is conceivable that suppliers will anticipate on developments on the retail level and will want to prevent that one buyer becomes so large that its bargaining power will adversely affect their own profitability.²⁰² As a result, suppliers may recognise that instead of raising prices to rival buyers, they may in fact be better off by offering terms of trade that are sufficiently attractive to keep the other buyers in the market. By offering a similar discount to smaller buyers, suppliers may therefore prevent reduced

¹⁹⁷ Dobson, P.W. and Inderst, R. (2007), 'Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers?', *European Competition Law Review*, 28(7), pp. 393-400; Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, pp. 42-54.

¹⁹⁸ See, for instance, Dobson, P.W. and Inderst, R. (2007), 'Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers?', *European Competition Law Review*, 28(7), pp. 393-400.

¹⁹⁹ See e.g. Dobson, P.W. and Inderst, R. (2008), 'The Waterbed Effect: Where Buying and Selling Power Come Together', *Wisconsin Law Review*, pp. 331-357.

²⁰⁰ For a critical assessment of this theory see, however, also Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, p. 51-52.

²⁰¹ Dobson, P.W. and Inderst, R. (2007), 'Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers?', *European Competition Law Review*, 28(7), pp. 393-400; Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, p. 49-50.

²⁰² See also Chen, Z. (2003), 'Dominant Retailers and the Countervailing-Power Hypothesis', *RAND Journal of Economics*, 34(4), pp. 612-625.

competition on the retail level, in order to protect their own profitability in the long run.

The effects of the exercise of countervailing buyer power, or bargaining power, on rival buyers are therefore rather ambiguous. That is, theoretical contributions are inconclusive as to whether rival buyers benefit from the exercise of countervailing buyer power through an anti-waterbed effect or whether they are adversely affected through a waterbed effect. In this context, it is interesting to note that countervailing buyer power has been subject to extensive empirical scrutiny in the United Kingdom. In 2000 and 2008, the UK Competition Commission published extensive studies on the UK groceries sector, with specific focus on supermarkets' buyer power.²⁰³ Both studies found empirical evidence that major UK retailers are able to obtain substantially lower prices and more favourable terms than their smaller rivals.²⁰⁴ However, since the differences in supplier price could largely be explained by the large retailers' cost advantage, the Competition Commission concluded that differences in supplier prices in themselves did not give rise to an adverse effect on competition. In 2008, the Competition Commission moreover found no evidence that the lower supplier prices for the four largest retailers resulted in higher prices for other grocery retailers (and wholesalers). The Competition Commission therefore did not find evidence indicating the presence of a waterbed effect in UK grocery retailing (but did however take measures to address problems related to the market power wielded by retailers).²⁰⁵

3.3.3 – Buyer Power and Dynamic Efficiency

The somewhat difficult relationship between competition, market power and innovation that has been addressed in Chapter 2 largely also applies to buyer power.²⁰⁶

²⁰³ Competition Commission (2000), *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom*; Office of Fair Trading (2006), *The grocery market: The OFT's reasons for making a reference to the Competition Commission*, OFT845. Competition Commission (2008), *The supply of groceries in the UK market investigation*.

²⁰⁴ In fact, in its 2008 study, the Competition Commission even found that large grocery retailers, particularly the four largest, generally obtain lower prices than grocery wholesalers, from which many small convenience store operators buy substantial volumes.

²⁰⁵ Competition Commission (2008), *The supply of groceries in the UK market investigation*. Concerning the 'waterbed effect', see par. 17 and 5.19-5.43. This was the first time the Competition Commission had looked into the waterbed effect. In 2006, the Office of Fair trading considered that 'there are theoretical questions that would need to be resolved before concluding that the price differentials observed are evidence of a waterbed effect', see Office of Fair Trading (2006), *The grocery market: The OFT's reasons for making a reference to the Competition Commission*, OFT845, par. 6.13. See also Inderst, R. and Valletti, T.M. (2011), 'Buyer Power and the "Waterbed Effect"', *Journal of Industrial Economics*, 59(1), pp. 1-20.

²⁰⁶ See Subsection 2.3.1.

That is, buyer power may both stimulate and distort incentives to innovate. A specific concern within the context of buyer power is that the possession of substantial buyer power amongst retailers will reduce incentives for suppliers to invest in innovation.²⁰⁷ This argument is related to the so-called ‘holdup problem’ and may be summarised as follows.²⁰⁸ Suppose that suppliers’ investment in R&D involves sunk costs, for instance because of a necessary long-run investment in capital such as a new machine that cannot be shifted easily to another productive use. In the short run, a firm that incurs sunk costs does not need to recover its investment. In the long run, however, a firm will need to recover all of its costs – including sunk costs – if it wants to stay in business. If suppliers anticipate that a large buyer will be able to extract a large share of producer surplus so that the innovation investment is unprofitable, they may choose to underinvest. Buyer power can therefore harm dynamic efficiency. Indeed, Weiss and Wittkopp have found some empirical evidence for the German market that in some cases innovation in the food sector is adversely affected due to food retailers’ buyer power.²⁰⁹

Recent contributions in the economic literature, however, explain that the presence of substantial buyer power may in fact increase suppliers’ investment incentives. In two contributions, Inderst and Wey explain that, while the exercise of buyer power will indeed reduce the profitability of suppliers, they may however have an increased incentive to invest in R&D.²¹⁰ After all, suppliers that face considerable buyer power have increased incentives invest in more cost-efficient technologies or new products and processes. This may not only increase a firm’s own profitability, but may also enhance the profitability of the large buyer’s competitors, which may indirectly mitigate the buyer power. Furthermore, Fumagalli and Motta explain that fragmentation amongst buyers might prevent entry by a more efficient supplier when

²⁰⁷ Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078, p. 14; Church, J. (2008), ‘Monopsony and Buyer Power’, Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, pp. 53-54; Van de Gronden, J.W. and Den Hertog, J.A. (2008), ‘Inkoopmacht: economische en juridische inzichten’, *Markt & Mededinging*, 4, pp. 124-135.

²⁰⁸ See e.g. Church, J. and Ware, R. (2000), *Industrial Organisation: A Strategic Approach*, Boston: McGraw-Hill, pp. 70-71; Inderst, R. (2008), ‘The Economics of Buyer Power’, speech given at the OECD Roundtable on Monopsony and Buyer Power.

²⁰⁹ Weiss, C.R. and Wittkopp, A. (2003), ‘Buyer Power and Innovation of Quality Products: Empirical Evidence from the German Food Sector’, FE Working Papers No. 307.

²¹⁰ Inderst, R. and Wey, C. (2007), ‘Buyer Power and Supplier Incentives’, *European Economic Review*, 51, pp. 647-667; Inderst, R. and Wey, C. (2011), ‘Countervailing Power and Dynamic Efficiency’, *Journal of the European Economic Association*, 9(4), pp. 702-720.

there is miscoordination amongst buyers.²¹¹ This may be the case when the supplier's entry is only profitable when a sufficiently large number of orders will be placed, so that its fixed costs can be recovered. The presence of a coordination may in this scenario induce buyers to free ride on each other's purchasing behaviour and choose not to place orders with the more efficient supplier. Consequently, the supplier may anticipate that too few orders are placed and decide not to enter the market. Here, an increase in buyer power may stimulate entry of efficient suppliers and promote dynamic efficiency.

Although the effect of buyer power on dynamic efficiency may therefore be positive or negative, it is important to note that buyer power can also be the result of firms' superior efficiency. That is, just like in the seller power context, firms that are most successful in responding to their customers' preferences will gain buyer power. For instance, the introduction of a new product or service that is very popular amongst consumers may not only allow a firm to develop seller power but will generally also result in an increase in buyer power.²¹² Similarly, investments in technologies that allow a retailer to utilise economies of scale or scope on its input and/or output market will typically promote economic efficiency, but may at the same time result in an increase in buyer power. Since both scenarios may require very costly and risky investments, firms' incentives that lead to higher productive or dynamic efficiency crucially rely on the expectation to generate economic profit that well exceed the corresponding costs. The ability to exercise buyer power may help a firm to recoup its investment costs. Economic efficiency may thus require the competitive process to develop buyer power in order to promote productive and/or dynamic efficiency.

3.3.4 – Conclusion

The effects of buyer power on economic efficiency are the mirror image of the efficiency effects of seller power. In this context, it is important to distinguish between two types of buyer power.

Monopsony power is buyer power enjoyed by a buyer in the relation with sellers that have no (seller) market power. The analysis of monopsony power is directly analogous to that of monopoly power. That is, while a firm with monopsony power will have the same desire as a firm without buyer power to purchase up until marginal benefits of doing so equals marginal costs, it has the distinctive ability to affect market outcomes

²¹¹ Fumagalli, C. and Motta, M. (2008), 'Buyers' Miscoordination, Entry and Downstream Competition', *The Economic Journal*, 118, pp. 1196-1222.

²¹² Noll, R.G. (2005), "'Buyer Power" and Economic Policy', *Antitrust Law Journal*, 72(2), p. 614.

on its input market. More specifically, under specific circumstances, a firm with monopsony power recognises that, since an increase in units bought increases the input price for all units, it has the ability to depress input prices below the competitive level, so to generate economic profit. However, since the lower input price is achieved by reducing purchases, the exercise of monopsony power typically harms economic efficiency by reducing allocative efficiency.

Countervailing buyer power (which may also be referred to as bargaining power) is buyer power in the relation with suppliers that have seller power. Countervailing buyer power can therefore only be exercised in the situation of so-called ‘bilateral market power’, a scenario in which both buyers and sellers have market power. With bilateral market power, both sellers and buyers will mutually recognise their market power and acknowledge that none of them can treat their trading partners as (perfect) competitors, for instance by simply imposing an input price. Instead, the situation of bilateral market power induces sellers and buyers to mutually recognise their market power and engage in bilateral cooperation in the bargaining process. In the bargaining process, countervailing buyer power typically is exercised in bilateral negotiations so to obtain an individual discount and may therefore result in very different outcomes for the various buyers and sellers on the market. In marked contrast with monopsony power, countervailing buyer power is based on the threat of reducing output but generally has the objective of maintaining or increasing purchases. As a result, countervailing buyer power may mitigate the harmful effects of the seller power enjoyed by the seller, which would – in the absence of buyer power – have been able to exercise monopoly power. Countervailing buyer power therefore tends to promote economic efficiency. This observation also applies to countervailing market power on the selling side of a market. Countervailing seller power, too, tends to promote economic efficiency if this prevents buyers to exercise monopsony power.

It is important to note that both monopsony and countervailing buyer power may not only affect allocative efficiency but may also have an impact on dynamic efficiency. A specific concern within the context of buyer power is that its exercise may reduce incentives for suppliers to invest in innovation. That is, the presence of buyer power may cause suppliers to anticipate that they will be unable to recoup their innovation investment, and therefore induce them to under invest in R&D. However, while buyer power may therefore harm dynamic efficiency, it may also promote dynamic efficiency. For instance, a substantial degree of buyer power may provide an important incentive for suppliers to invest in more cost-efficient technologies or new products and processes in order to gain a competitive advantage over their rivals.

3.4 – Anti-Competitive Buyer Conduct

The previous section analysed the effects of buyer power on economic efficiency and established that buyer power can harm economic efficiency in a way that is very similar to the harmful effects of seller power. This leads to the important conclusion that buyer power may form a serious concern within the context of competition policy. In fact, since it has moreover been established that the efficiency effects of buyer power are the mirror image of the efficiency effects of seller power, it can be concluded that their treatment should be symmetric.²¹³ This implies that competition policy should recognise that buyer power can be the result of a firm's superior efficiency. Instead of challenging the exercise of market power that is the result of superior efficiency, competition policy should therefore address anti-competitive behaviour by buyers.

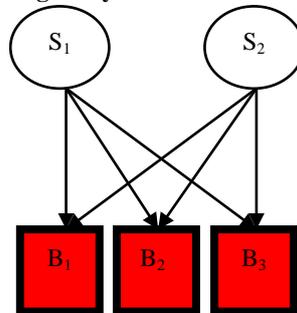
Given the need for a symmetric treatment of seller and buyer power, this section identifies the potential competition concerns by applying the economic framework in the traditional seller power context, which has been discussed in Chapter 2, analogously to the buyer power context. Accordingly, this section identifies three types of buyer conduct that may amount to anti-competitive behaviour. Subsection 3.4.1 discusses the competition concern of collusion amongst rival buyers. Subsection 3.4.2 addresses exclusionary conduct by a buyer. Subsection 3.4.3 discusses the potential competition concern of mergers involving buyer power.

3.4.1 – Collusion

Analogously to the seller power context, collusion involves the situation in which rival buyers agree on the material terms on which the competitive process induces them to compete on their input market, so to jointly exert buyer power. That is, by coordinating important purchase decisions, rival buyers can jointly exert buyer power on an input market. The competition concern of collusion amongst buyers is concisely illustrated in Box 21.

²¹³ See also Noll, R.G. (2005), "'Buyer Power" and Economic Policy', *Antitrust Law Journal*, 72(2), pp. 589-624; Schwartz, M. (2004), 'Should Antitrust Assess Buyer Market Power Differently than Seller Market Power', Paper Presented at DOJ/FTC Workshop on Merger Enforcement, Washington DC. See, however, also Jacobson, J.M. and Dorman, G.J. (1991), 'Joint purchasing, monopsony and antitrust', *Antitrust Bulletin*, 36(1), pp. 1-80.

Box 21: Collusion amongst buyers



In the figure above, rival buyers B_1 , B_2 and B_3 purchase their necessary inputs from S_1 and S_2 . The value obtained by a buyer (in terms of price, quality, specific contractual obligation, etc.) crucially depends on its market power, relative to its suppliers and relative to its rival buyers. However, the buyers may also agree on the material terms on which they compete, such as the input price, so as to jointly exert buyer power. The analysis of buyer collusion is analogous to seller collusion. Moreover, it is important to recognise that buyer collusion may also give rise to seller power (and vice versa).

As noted in the seller power context, collusion may be easier to sustain when it involves explicit agreement (i.e. a cartel) between firms than tacit agreement. A *buyer cartel* may take many forms. Rival buyers may for instance eliminate price competition on their input markets by agreeing on their input prices they are willing to pay: so-called ‘input price-fixing’. Similarly, with so-called ‘market-sharing’, firms agree on which markets they will and will not be buying their inputs. Finally, it is important to recognise that collusion between buyers may be a specific concern on so-called ‘bidding markets’, on which transactions take place through specific bidding processes such as an auction. Collusion on bidding markets is typically referred to as ‘bid rigging’.²¹⁴ With bid rigging, firms agree on a specific bid or agree not to bid against each other, so as to obtain the input product against a very low price.²¹⁵

²¹⁴ The term ‘bid rigging’ is also used when rival firms collude within the context of public procurement, see e.g. Porter, R.H. and Zona, J.D. (1993), ‘Detection of Bid Rigging in Procurement Auctions’, *Journal of Political Economy*, 101(3), pp. 518-538.

²¹⁵ Moreover, because auctions have become increasingly popular to allocate public resources, such as frequency spectrum, the risk of collusion among buyers should be a specific concern within the context of auction design. See e.g. Klemperer, P. (2004), *Auctions: Theory and Practice*, Oxford: Princeton University Press; Salmon, T. (2004), ‘Preventing collusion between firms in auctions’, in: Janssen, M.C.W. (ed.), *Auctioning Public Assets: Analysis and Alternatives*, Cambridge: Cambridge University Press, pp. 105-140.

Since collusion allows firms to jointly exert market power, collusion may inflict substantial harm to allocative efficiency. Furthermore, collusion may also harm productive and/or dynamic efficiency because it can distort firms' incentives to operate cost-effectively and to invest in more cost efficient technologies and new products and processes. However, it is important to recognise that cooperation between firms does not necessarily harm economic efficiency since it can give rise to efficiency gains. Cooperation on both input as well as output markets can allow firms to realise substantial gains in for instance productive and/or dynamic efficiency. Within the context of buyer power, efficiency gains from cooperation between rival buyers may especially be obtained when firms engage in so-called *joint purchasing*. Joint purchasing may for instance allow firms to (better) utilise economies of scale in purchasing but may also reduce transportation costs. Moreover, when suppliers have seller power, joint purchasing may allow buyers to exercise countervailing buyer power and thereby mitigate the harmful effects of suppliers' market power. The economics of joint purchasing are concisely discussed in Box 22.

Box 22: Potential efficiency gains from joint purchasing

There are several potential sources of efficiency gains from joint purchasing.²¹⁶ First, joint purchasing can allow firms to achieve a larger purchase volume in order to allow a supplier to utilise excess capacity or to realise economies of scale. Secondly, joint purchasing of inputs can also enable firms to realise efficiency gains due to reduced costs of transportation, warehousing and carrying of inventories. In both scenarios, joint purchasing typically promotes productive efficiency but also frees up resources that might be used to promote dynamic efficiency in the long term.

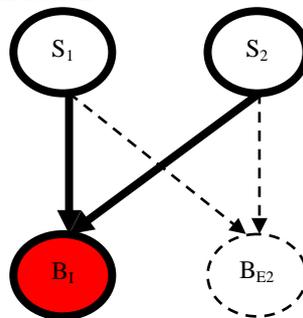
Joint purchasing can also allow rival buyers to exercise market power and thus affect allocative efficiency. Under specific circumstances, this may give rise to a third potential source of efficiency gains. When suppliers have monopoly power, joint purchasing may allow buyers to exercise countervailing buyer power and mitigate the harmful effects of suppliers' market power. However, joint purchasing typically harms economic efficiency when it allows firms to exercise monopsony power (which can occur if suppliers have no market power). Moreover, since joint purchasing may also cause the firms involved to obtain similar cost structures, joint purchasing may also facilitate collusion on the output market.

²¹⁶ See especially Jacobson, J.M. and Dorman, G.J. (1991), 'Joint purchasing, monopsony and antitrust', *Antitrust Bulletin*, 36(1), pp. 1-80. See also Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 106-122.

3.4.2 – Exclusionary Conduct

While exclusionary conduct is typically discussed in terms of behaviour by a seller on its output market, it can also be exhibited by a buyer on its input market.²¹⁷ In both cases, exclusionary conduct can take many different forms, which may all however have a similar effect. When exclusionary conduct is aimed at the exit of a rival buyer, which will be referred to as ‘horizontal exclusion’, presumably the most straightforward strategy concerns the situation in which a buyer imposes (or demands from its suppliers) *exclusivity contracts*. With an exclusive distribution arrangement, for instance, a buyer might foreclose its rivals by demanding from its suppliers the sole right to sell their products or services. De facto similar results may also be achieved by other contractual obligations, such as demanding specific selection criteria for distributors (selective distribution), contractual obligations for the supplier not to sell to another retailer at a lower price (most-favoured-customer clause) or to sell on an output market only at a minimum or fixed resale price (resale price maintenance).²¹⁸ Alternatively, a buyer might also be able to exclude a rival buyer by engaging in specific *fidelity rates* vis-à-vis its supplier(s). Furthermore, by engaging in *predation*, a buyer might induce the exit of a rival buyer through substantially increasing its own purchases of a particular input (‘anti-competitive overbuying’). Box 23 shortly discusses these practices and explains, however, that they need not be harmful and can also promote economic efficiency.

Box 23: Horizontal exclusion



Exclusivity contracts such as exclusive distribution, selective distribution, most-favoured-customer clauses or resale price maintenance might help B_1 to foreclose rival buyer B_E , though they can also promote economic

²¹⁷ This subsection has greatly benefited from valuable insights provided during the Barcelona GSE’s 2012 ‘Intensive Course on Competition Economics: Abuse of Dominance’ by Massimo Motta, Chiara Fumugalli, Jorge Padilla and Giulio Federico. Any errors fall, of course, under the responsibility of the author.

²¹⁸ See e.g. Dobson, P.W. (2008), ‘Buyer-Driven Vertical Restraints’, in: Konkurrensvetket (2008), *The Pros and Cons of Vertical Restraints*, Stockholm: Tryck AB, pp. 102-134.

efficiency. In particular, such contracts can prevent B_E from free riding on B_1 's provision of pre- or post-sale services.²¹⁹ Moreover, even if such efficiencies were absent, it is not straightforward that suppliers S_1 and S_2 would accept such an arrangement, since this would clearly reduce their output as well as their market power. Judging from recent insights in the literature on exclusive dealing, it seems however conceivable that – under very specific circumstances such as when there is a coordination failure amongst suppliers – B_1 might persuade S_1 and S_2 by compensating them and still find the strategy profitable.²²⁰

Fidelity rates may form an alternate strategy to foreclose B_E , but there are however also many explanations why they can be efficiency enhancing. Loyalty rates can for instance allow a firm to offer competitive prices, so that lower prices are offered for units with a low elasticity of supply and higher prices are offered to suppliers that are more likely to switch. Insights from economic literature indicate, however, that it is possible in very specific scenarios – most notably when a large share of a firm's business is very inelastic (the 'non-contestable share') – that a very aggressive, retroactive pricing scheme, might amount to anti-competitive behaviour, given that this is not replicable for rivals (e.g. due to scale economies).²²¹

Predation on an input market involves the overbuying of an input to cause a rival's exit.²²² However, increasing input volumes may also be a part of efficiency-enhancing sales strategies or reflect anticipation of an expected sudden increase in demand on the output market. Moreover, since successful predatory buying requires a firm to offer an input price greater than marginal revenue product, it is also a very expensive strategy. After all, the predating firm will have to increase the price for all its purchases, which tends to attract even more supply (and/or suppliers), and moreover requires costly decisions on what to do with the excessive amounts of inputs. Furthermore, it is not clear why B_E would not obtain similar credits to enable him to also increase his purchases. Analogues to

²¹⁹ Telser, L.G. (1960), 'Why Should Manufacturers Want Fair Trade?', *Journal of Law and Economics*, 3, pp. 86-105.

²²⁰ See, within the context of exclusive supply obligations, Fumagalli, C. and Motta, M. (2006), 'Exclusive Dealing and Entry, when Buyers Compete', *American Economic Review*, 96(3), pp. 785-795; Bernheim, B.D. and Whinston, M.D. (1998), 'Exclusive Dealing', *Journal of Political Economy*, 106(1), pp. 64-103.

²²¹ See e.g. O'Donoghue, R. and Padilla, A.J. (2006), *The Law and Economics of Article 82*, Oxford: Hart Publishing, pp. 374-406.

²²² See Salop, S.C. (2005), 'Anticompetitive Overbuying by Power Buyers', *Antitrust Law Journal*, 72(2), pp. 669-715; Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 70-78.

predatory pricing, predatory buying might, however, be an attractive strategy so as to create (or signal) a reputation for being 'strong' and when B_I 's enjoys financially 'deep pockets' and capital market imperfections prevent B_E to also increase his purchases.²²³

On specific markets, and under very specific circumstances, it may be conceivable that a firm with a (very) high degree of buyer power has the ability and the incentive to foreclose a firm that is not a direct rival but instead a firm that operates on a different stage in the same distribution chain or operates on another market. For such a strategy, which will be referred to as 'exclusion on adjacent markets', a firm might be able to choose between various practices. One rather exceptional scenario concerns the situation in which exclusionary conduct is targeted at a firm that operates in the same market but on a level higher in the distribution chain than the excluding firm. The most straightforward method for a firm to exclude its supplier is a *refusal to deal*. By simply refusing to buy a specific supplier's product or service, thereby reducing its demand below a certain threshold, it might be forced to exit the market. Similar results might also be achieved by only agreeing to buy the supplier's product or service under terms of trade that are de facto equivalent to a refusal to deal, for instance by offering extremely low prices, or charging very high upfront access payments (e.g. slotting allowances).²²⁴ It is important to note, however, that refusal to deal will often be motivated by reasons of efficiency and that it is only in very specific cases that it can be a viable exclusionary strategy. An alternative, and perhaps less straightforward, scenario involves the situation in which exclusionary conduct is part of a firm's strategy to leverage its buyer power onto another market.²²⁵ With *tying*, for instance, a firm with a (very) high degree of buyer power might extend its market power onto another input market by conditioning the purchase of a product or service on the agreement that the supplier also sells another product or service to that buyer. Similarly, with so-called *reciprocal dealing*, which means that a buyer will only purchase from a supplier if the supplier agrees to also purchase a product or service from the (first) buyer, a firm might under very specific circumstances leverage its

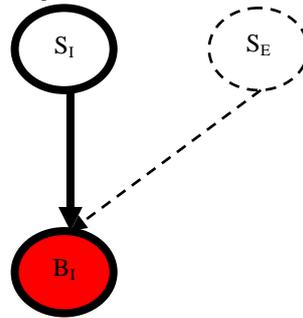
²²³ See, more generally, Bolton, P., Brodley, J.F. and Riordan, M.H. (2000), 'Predatory Pricing: Strategic Theory and Legal Policy', *Georgetown Law Journal*, 88(8), pp. 2239-2330.

²²⁴ See Dobson, P.W. (2008), 'Buyer-Driven Vertical Restraints', in: Konkurrensverket (2008), *The Pros and Cons of Vertical Restraints*, Stockholm: Tryck AB, pp. 102-134; Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078.

²²⁵ See especially Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 91-92 and pp. 179-182.

buyer power onto another output market. Box 24 shortly illustrates refusal to deal, tying and reciprocal dealing as exclusionary strategies.²²⁶

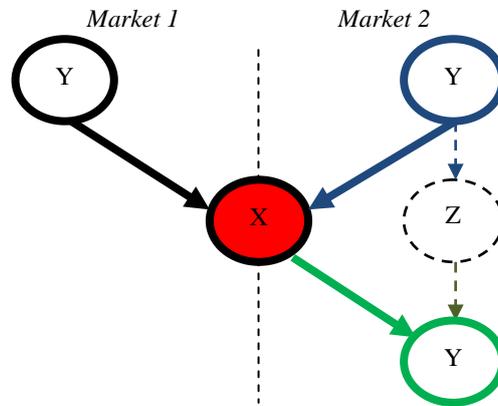
Box 24: Exclusion on adjacent markets



Refusal to deal on the buying side of a market can best be illustrated in the scenario where a vertically integrated firm, I, has a (very) high degree of buyer power vis-à-vis upstream supplier S_E . By refusing to buy or grant access to its distribution network to S_E , or only agree to deal under equivalent conditions, S_E might be forced to exit the market. However, since firm I has very much buyer power (he is depicted as a monopsonist), it is not clear why he would do so since this situation already allows him to appropriate all or most rents in the market. Firm I will therefore typically have no interest to also gain a monopoly position on the input market. On the contrary, firm I even has an incentive to promote, not distort, upstream competition. In many cases, a refusal to deal, or obligations with equivalent effects, will therefore not harm, but may promote, economic efficiency.

Economic theory suggests, however, that in very specific scenarios a refusal to deal might be a viable exclusionary strategy. This situation might for instance occur when I's position on the downstream market as a single buyer (or seller), and thus his ability to exercise market power, is not 'safe'. In this scenario, firm I might have an incentive to foreclose S_E in order to prevent S_E from forward integration and becoming a direct rival. However, since I's position on the downstream market may well be the result of costly investments in his distribution network, forcing I to deal (or grant access) could distort his investment incentives and harm economic efficiency. Competition policy should therefore be very reluctant to intervene.

²²⁶ See also Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 88-92; Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 66-68.



Tying and reciprocal dealing are illustrated in the figure above, in which two separate markets (markets 1 and 2) are displayed. On market 1, X is the single purchaser (monopsonist) from supplier Y. On market 2, however, X faces (potential) competition from direct rival (or entrant) Z. If Y is also a supplier in market 2, X might be able to foreclose Z by means of tying, which is illustrated by the blue arrow. That is, by conditioning the purchase in market 1 on the agreement that Y also sells to X in market 2, Z may have no access to input 2. Similarly, if Y is not a seller but a buyer in market 2, Z might be forced to exit by means of reciprocal dealing, which is illustrated by the green arrow. With reciprocal dealing, X conditions its purchase in market 1 on the agreement that Y buys from X on market 2 (and not from Z).

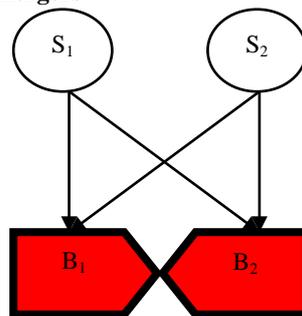
Economic theory suggests, however, that both tying and reciprocal dealing are not very straightforward as an exclusionary strategy. In both cases, forcing Y to also sell, or buy, on market 2 is equivalent to the situation in which X lowers its price even further on market 1. However, since it is possible that the packaged deal is more attractive to Y and/or there are economies (of scale or scope) to be achieved, both tying and reciprocal dealing can well promote economic efficiency. Only when tying or reciprocal dealing merely aims to create another (separate) base of market power, harm to economic efficiency might occur. However, since exclusion on market 2 is in this situation analogous to predatory buying (in the tying case) or predatory pricing (in the reciprocal dealing case), the same critical notes on predation apply and some scepticism is therefore in place.

3.4.3 – Mergers

While mergers may allow firms to create, strengthen or maintain seller power, they may also lead to a gain in buyer power. However, whether or not a merger harms economic efficiency – and thus whether it can be considered ‘anti-competitive’ – depend to a large extent on whether it involves direct competitors (horizontal merger) or firms operating in a different stage in the distribution chain (vertical mergers).

Horizontal mergers directly reduce the number of competitors on the market. As a result, horizontal mergers in principle allow the merged entity to create, strengthen or maintain market power – not only on the output market (seller power) but also on the input market (buyer power). Although most horizontal mergers increase market power at least to some extent, they are not necessarily harmful since they may result in efficiency gains. For instance, a horizontal merger may allow the merged entity to exercise countervailing market power and thus promote allocative efficiency. Furthermore, horizontal mergers may bring about substantial gains in terms of productive and/or dynamic efficiency.²²⁷ For instance, since a horizontal merger may reduce the number of necessary production plants, there can be substantial reductions in fixed costs. Similarly, horizontal mergers can also give rise to considerable marginal cost savings, for instance due to increased ability to exploit economies of scale or scope. Both cost savings promote productive efficiency but moreover free up resources that may be used for R&D investment and promote dynamic efficiency. The competition concern of mergers within the specific context of buyer power are shortly elaborated upon in Box 25.

Box 25: Horizontal mergers



Consider an input market where buyers B_1 and B_2 decide to merge. Because such a horizontal merger directly reduce the number of rival

²²⁷ See e.g. Williamson, O.E. (1968), ‘Economies as an Antitrust Defense: The Welfare Tradeoffs’, *American Economic Review*, 58, pp. 18-36.

buyers, it can – depending on inter alia barriers to entry – give rise to an increase in buyer power. On the one hand, a horizontal merger may have so-called ‘unilateral effects’, by allowing the newly merged entity to exert buyer power. On the other hand, horizontal mergers may also give rise to so-called ‘coordinated effects’ when it affects market conditions in a way that makes collusion between rival buyers easier to sustain and thus causes an indirect gain in buyer power.

While horizontal mergers may cause firms to gain buyer power and harm economic efficiency, it is important to note possible that such a merger between B_1 and B_2 allows them to exercise countervailing buyer power (or bargaining power) vis-à-vis suppliers S_1 and S_2 . In the situation that suppliers have monopoly power, mergers between rival buyers may therefore mitigate the allocative inefficiency and promote overall economic efficiency on the input market. Furthermore, horizontal mergers provide considerable scope for gains in productive and/or dynamic efficiency. Mergers between rival buyers can, for instance, give rise to considerable cost savings or allow the firms involved to achieve larger volumes and utilise economies of scale. This increases productive efficiency but may moreover free up resources for R&D investments and therefore potentially promote dynamic efficiency.

Efficiency gains typically play an even more prominent role in the context of *vertical mergers*. Since vertical mergers do not concern direct rivals, they generally do not create, strengthen or maintain market power. Vertical mergers are therefore generally less likely to form a competition concern than horizontal mergers. In fact, there are a number of reasons why vertical mergers tend to promote economic efficiency. First, just like horizontal mergers, vertical mergers tend to free up resources that can be used to invest in more cost-efficient technologies and new products and processes. Secondly, economic literature recognises that vertical mergers may mitigate non-price externalities, such as when retailers free ride on each other’s provision of services.²²⁸ Finally, as has already been noted in the seller power scenario of double marginalisation,²²⁹ vertical mergers may help the firms involved to solve a vertical (price) externality they may otherwise impose on each other and therefore often promote allocative efficiency. Also in the context of buyer power, vertical mergers may help to solve a vertical price externality. This is discussed in Box 26.

²²⁸ Telser, L.G. (1960), ‘Why Should Manufacturers Want Fair Trade?’, *Journal of Law and Economics*, 3, pp. 86-105.

²²⁹ See Subsection 2.2.2.

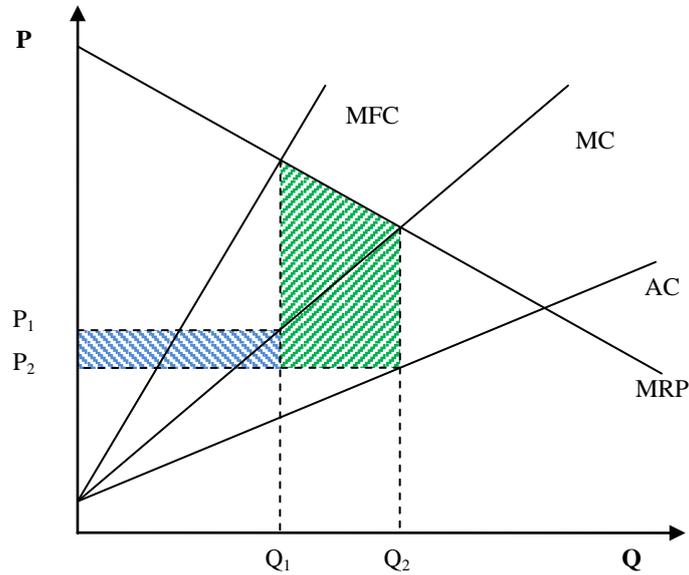
Box 26: Vertical mergers often solve a vertical price externality

A scenario in which vertical integration promotes allocative efficiency in the distribution chain involves the scenario of *bilateral market power*. When both a buyer and a seller on an input market have market power, both firms will recognise that they cannot just unilaterally impose a price and let the other firm respond by setting a quantity. With bilateral market power, firms recognise that it is in their joint interest to engage in bilateral cooperation, so as to internalise the externality they would otherwise impose on each other and thereby mitigate the corresponding allocative inefficiency. Such bilateral cooperation could take place through the bargaining process, but in order to avoid the recurring negotiation process, the buyer and seller could also decide to merge.²³⁰

Furthermore, when a firm has *monopsony power*, it has a strong incentive to engage in vertical integration. In this scenario, too, vertical integration may promote economic efficiency.²³¹ The figure below displays the monopsonist's derived demand curve (marginal revenue product, MRP), the industry's average cost curve of producing the input (AC), the industry's marginal cost curve (or supply curve, MC) and the monopsonist's marginal factor cost curve (MFC), which resembles its marginal cost of increasing purchases. As discussed above, without vertical integration, the monopsonist purchases up to the intersection of MRP and MFC, leading to employment decision Q_1 and corresponding input price P_1 . By acquiring (all) its suppliers, however, the monopsonist eliminates the loss of allocative efficiency due to underemployment of the input product. This is because the merged entity will no longer look at the marginal cost of buying the input (MFC), but will make its production decision on the basis of the marginal cost of producing the input (MC). Vertical integration therefore induces the merged entity to increase its production to Q_2 , and thus promotes allocative efficiency (illustrated by the green shaded area). Moreover, the monopsonist will also increase its profit because vertical integration allows it to capture the rest of its suppliers' rent (the blue shaded area).

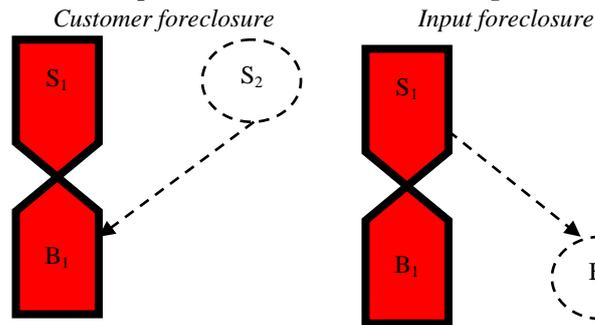
²³⁰ See Subsection 3.3.2.

²³¹ Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 96-99.



Economic theory suggests, however, that in very specific scenarios vertical mergers might under specific circumstances provide the merged entity with both the ability and the incentive to engage in exclusionary conduct.²³² Depending on inter alia market characteristics, vertical integration might allow the merged entity to engage in so-called ‘input foreclosure’ or ‘customer foreclosure’, so as to create, strengthen or maintain market power. This is shortly discussed in Box 27.

Box 27: The competition concerns of vertical mergers



²³² Furthermore, it is conceivable that, under specific circumstances, vertical mergers might make collusion easier to sustain, see for instance Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 302-410.

Pursuant to vertical integration, a merged entity with a (very) high degree of market power might choose between various exclusionary strategies. The most straightforward method is to simply refuse to deal with other firms on the market. If the strategy for instance involves the foreclosure of rival supplier S_2 , vertical integration would allow the merged entity to prevent S_2 from reaching output channels: so-called ‘customer foreclosure’. By contrast, vertical integration might also be a means to foreclose a rival buyer (B_2), that may become unable to obtain necessary input: so-called ‘input foreclosure’. However, as noted above, while these strategies might be intuitively straightforward, the same considerations that were placed in the context of exclusionary conduct apply here. It is important to recognise that it is generally not in the interest of a firm to exclude either its customers or its suppliers.

3.4.4 – Conclusion

Since the effects of buyer power on economic efficiency are the mirror image of the efficiency effects of seller power, both types of market power should be treated symmetrically. Given the need for a symmetric treatment, this section has identified three potential concerns of buyer power within the context of competition policy.

Buyer collusion involves the coordination between rival buyers on the material terms on which they compete on their input market in order to jointly exert buyer power. By means of for instance input price-fixing, market sharing and bid rigging, rival buyers can bypass the competitive process, gain buyer power and thereby potentially inflict harm to economic efficiency. It is important to note, however, that coordination amongst rival buyers can also yield efficiency gains and is therefore not necessarily harmful. In particular when firms engage in so-called joint purchasing, economic efficiency may be promoted, most notably due to gains in productive and/or dynamic efficiency. Moreover, joint purchasing may promote economic efficiency when it enables firms to exercise countervailing buyer power and thereby mitigate the harmful effects of suppliers’ market power.

Exclusionary conduct concerns the ability of a firm with a (very) high degree of buyer power to exclude a rival buyer or to deter a potential entrant from that or an adjacent market. Depending on the specific characteristics of the market(s) concerned, exclusionary buyer conduct may involve various practices that can be largely interchangeable. For instance, when foreclosure is targeted at a rival buyer, exclusionary conduct may for example involve exclusivity contracts, fidelity rates or predatory buying. Alternatively, when exclusionary conduct is aimed at a firm operating on an adjacent market, the excluding firm might for example resort to refusal to deal, tying or reciprocal dealing. Since exclusionary conduct may involve practices

that differ substantially by form, but which typically work through a very similar mechanism, it is better not to assess a particular practice by its form (form-based) but instead focus on the effects of that practice (effects-based). Furthermore, it is important to recognise that although many practices might, at least from an intuitive perspective, appear to be harmful, they may well promote economic efficiency. In the enforcement of exclusionary conduct, it is therefore crucial to ascertain that a coherent theory of harm applies.

Mergers may also give rise to buyer power concerns. Since mergers aim to bring together the ownership and management of two (or more) firms, they allow firms to take away the business of another firm at the price of the transaction. However, since the likelihood that a merger actually increases market power depends to a large extent on whether a merger involves direct rivals (horizontal mergers) or firms operating on different stages in the production chain (vertical mergers), a differentiated approach is warranted. Since horizontal mergers directly reduce the number of rival buyers on a market, they typically allow firms to gain buyer power. The resulting increase of buyer power may harm economic efficiency, in particular when exercised vis-à-vis suppliers that have no market power (monopsony power). However, horizontal mergers may allow the merged entity to exercise countervailing market power, and thus promote allocative efficiency, and moreover provide substantial scope to promote productive and/or dynamic efficiency, for instance as a result of cost savings or improved ability to utilise economies of scale or scope. Efficiency gains play an even more prominent role within the context of vertical mergers. Vertical mergers do not concern direct rivals and are therefore less likely to increase market power. In fact, vertical mergers can be an important means to solve a vertical externality between a seller and a buyer and can thus promote economic efficiency. Only in very specific situations, vertical mergers may form a competition concern, most notably when it provides the merged entity with both the ability and the incentive to engage in exclusionary conduct.

3.5 – Buyer Power and Competition Policy Design

Following the analysis on the definition and sources of buyer power, its efficiency effects and its potential concerns within the context of competition policy, this section addresses specific implications for competition policy in the buyer power context.²³³ Section 3.5.1 addresses limitations of the argument that competition policy should have a more lenient approach towards, or should even stimulate, conduct that creates, strengthens or maintains countervailing buyer (or seller power). Section 3.5.2

²³³ For a discussion of competition policy design in the traditional seller power context, see Section 2.4.

specifically assesses implications for the use of the consumer welfare standard in the buyer power context.

3.5.1 – *Countervailing Market Power Considerations*

In the above, it has been explained why buyer power may form a concern within the context of competition policy when this involves collusion, exclusionary conduct or mergers. However, it has also been noted that buyer power may in fact promote economic efficiency when exercised in the relation with suppliers that have seller power (countervailing buyer power). In fact, the (simplified) analysis on the efficiency effects of buyer power indicated that the scenario of bilateral monopoly is more efficient than the situation in which only the buyer or only the seller would have market power (i.e. bilateral monopoly is preferable to the single monopoly or single monopsony scenario). On the basis of these findings, one might conclude that competition policy should adopt a more lenient treatment of, or should even stimulate, conduct that creates, strengthens or maintains countervailing buyer (or seller power). For instance, in the situation in which a single seller (monopolist) sells to multiple rival buyers, competition policy could allow these rival buyers to collude, for instance by price fixing, or to merge in order to exercise countervailing buyer power. Similarly, the argument may also be applied to the seller power context. For example, Campbell argues that, in the situation where there is only one purchaser (monopsonist), competition policy should allow sellers to merge into a monopoly, so to create a bilateral monopoly because this would promote economic efficiency.²³⁴ This section explains, however, that there are important reasons for caution in considering the creation (or strengthening or maintenance) of countervailing market power as a defence.

First, whereas the countervailing market power defence typically relies on the premise that the creation of countervailing power promotes economic efficiency compared to the situation without countervailing power, there are various reasons why these *beneficial effects may not arise*. Blair and Harrison, for example, note in the context of bilateral monopoly that negotiations between a buyer and a seller may involve substantial transaction costs, which possibly prevents them to come to an agreement on

²³⁴ Campbell, T. (2007), 'Bilateral Monopoly in Mergers', *Antitrust Law Journal*, 74, pp. 521-536. Campbell's argument is however, heavily criticised by Baker, Farrell and Shapiro, who question the empirical relevance of Campbell's argument and stress that it is always better to promote competition than to create market power. Baker, J.B., Farrell, J. and Shapiro, C. (2008), 'Merger to Monopoly to Serve a Single Buyer: Comment', *Antitrust Law Journal*, 75, pp. 637-646. For Campbell's response to Baker, Farrell and Shapiro, see Campbell, T. (2008), 'Bilateral Monopoly: Further Comment', *Antitrust Law Journal*, 75, pp. 647-655.

the division of surplus between them.²³⁵ Accordingly, negotiations and trade may break down, causing the positive effects of countervailing market power that were intended not to occur in practice.²³⁶ Perhaps even more important is that, while the (simplified) analysis of the extreme and rather theoretical scenario of bilateral monopoly suggests that this is preferable to a ‘single monopoly’ or ‘single monopsony’, the efficiency effects are rather ambiguous when countervailing market power involves lower degrees of concentration (e.g. bilateral oligopoly). After all, and as stressed above, market power may arise on various stages in the distribution chain, can have various degrees and may moreover be confronted with various degrees of countervailing market power, thereby giving rise to many different bargaining scenarios. In these situations, the efficiency effects of countervailing market power may not be clear.

Second, it is important to note that the creation of *countervailing market power may harm economic efficiency*. The most straightforward scenario in which the creation of countervailing market power is harmful is when this leads to a spillover to another market.²³⁷ For instance, coordination between rival buyers to allow the exercise of countervailing buyer power on an input market is not necessarily limited to that input market but may in fact also increase possibilities to collude on their output market, so to exercise monopoly power. Similarly, the creation of countervailing market power may also increase the ability of firms to exercise market power on another market, for instance in another distribution chain in which they operate. The creation of countervailing market power may moreover harm economic efficiency when entry occurs. For instance, when two rival buyers are allowed to merge to a monopsony in order to exercise countervailing buyer power vis-à-vis a monopolist, any advantages that have been achieved in the short run may be lost in the long run when the monopolist faces entry, thereby allowing the newly created monopsonist to exercise its monopsony power. In this context, it is important to note that the ability to exercise market power (monopsony or monopoly power) typically attracts entry (since it implies that economic profit can be generated), whereas it may due to, for instance, technological changes not always be predictable on which markets entry may occur.²³⁸

²³⁵ Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 136-138.

²³⁶ Noll, R.G. (2005), ‘“Buyer Power” and Economic Policy’, *Antitrust Law Journal*, 72(2), pp. 606-609.

²³⁷ See Noll, R.G. (2005), ‘“Buyer Power” and Economic Policy’, *Antitrust Law Journal*, 72(2), pp. 606-609; Church, J. (2008), ‘Monopsony and Buyer Power’, Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power, pp. 36-37; Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 136-138.

²³⁸ Blair, R.D. and DePasquale, C. (2011), ‘Considerations of Countervailing Power’, *Review of Industrial Organisation*, 39, pp. 137-143.

Third, reasons for caution for accepting the countervailing market power defence also stem from *dynamic efficiency considerations*. On the one hand, the countervailing market power defence raises the question why the market power, vis-à-vis the countervailing power is created, existed in the first place.²³⁹ If this market power is the result of a firm's superior efficiency (for instance due to a better or new product or service), the creation of countervailing market power limits the more efficient firm's ability to exercise market power and thus reduce its reward for its investment. In this context, the creation of countervailing market power may therefore distort investment incentives and harm dynamic efficiency. On the other hand, as has also been noted above, the situation in which firms are confronted with trading partners that have a substantial degree of market power may provide for an important incentive to invest in more cost efficient technologies or new products or processes.²⁴⁰ By allowing them, for instance, to create countervailing market power by means of collusion or a merger, competition policy could distort those investment incentives since this may allow the firms involved to enhance their economic position in an 'easier' way.

3.5.2 – Buyer Power and the Consumer Welfare Standard

As noted above in the traditional seller power context, the enforcement of competition law can often require some degree of case-by-case analysis on the effects of firm behaviour on economic efficiency.²⁴¹ This is because conduct that may amount to anti-competitive conduct and thus harm economic efficiency, such as horizontal mergers, may also provide substantial scope for efficiency gains. A higher degree of case-by-case analysis improves a competition authorities' effectiveness in separating between conduct that is harmful and conduct that is not. This also applies to the buyer power context; the categories of conduct that have been identified as potential concerns for competition policy involve firm behaviour that may also promote economic efficiency. In the assessment of the effects of potential anti-competitive buyer conduct on static efficiency, competition authorities can make use of a welfare standard. Two welfare standards have been distinguished. Under the consumer welfare standard, firm behaviour will be taken to harm static efficiency if this leads to a reduction in the welfare of buyers. Under the total welfare standard, business conduct will be condemned if this results in a decrease in the aggregate welfare of buyers and sellers.

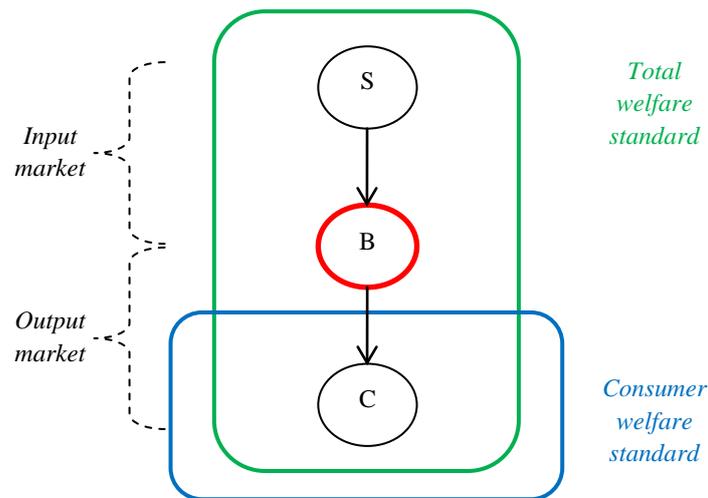
²³⁹ Noll, R.G. (2005), "'Buyer Power" and Economic Policy', *Antitrust Law Journal*, 72(2), pp. 606-609.

²⁴⁰ See Subsection 3.3.3.

²⁴¹ See Section 2.4.

In the context of anti-competitive buyer conduct, the question rises whether the consumer welfare standard is still useful in the sense that it is effective in reflecting effects on economic efficiency. After all, the consumer welfare standard focuses on buyer surplus, whereas buyer power may impose harm to economic efficiency though benefit the buyers that exercise it. Since harm to economic efficiency may not result in lower welfare of buyers, application of the consumer welfare standard could induce competition authorities to wrongly allow conduct that is harmful (i.e. Type II error). Indeed, in this context, Carlton critically notes that “if only consumers matter, then a buying cartel should be perfectly legal and indeed should be encouraged”.²⁴² However, Salop and Rosch offer a different interpretation of the consumer welfare standard that addresses this potential disadvantage of the consumer welfare standard.²⁴³ In their view, the concept of ‘consumer’ in the consumer welfare standard should not include the buyer(s) that exercise buyer power but should merely entail consumers that ultimately buy the output (i.e. consumers at the end of the distribution chain).²⁴⁴ This interpretation is illustrated and compared with the total welfare standard in Box 28.

Box 28: Welfare standards in the buyer power context



²⁴² Carlton, D.W. (2007), ‘Does Antitrust Need to Be Modernized’, *Journal of Economic Perspectives*, 21(3), pp. 155-176.

²⁴³ Salop, S.C. (2005), ‘Anticompetitive Overbuying by Power Buyers’, *Antitrust Law Journal*, 72(2), pp. 669-715; Rosch, J.T. (2007), ‘Monopsony and the Meaning of “Consumer Welfare”’: A Closer Look at *Weyerhaeuser*’, *Columbia Business Law Review*, 2, pp. 353-369.

²⁴⁴ Final consumers (or end-users) typically do not have buyer power.

Consider a distribution chain where, on the input market, suppliers (S) sell to buyers (B), whereas on the output market these buyers sell to final consumers (C). Under the total welfare standard, the analysis focuses on the aggregate welfare of all buyers and sellers (S, B and C). The total welfare standard is therefore not concerned with welfare transfers; all that matters is the net effect on aggregate (that is, total) welfare. By contrast, application of the consumer welfare standard in the treatment of (potential) anti-competitive buyer conduct by B, the concept of ‘consumer’ in the consumer welfare standard refers to all direct and indirect users of B’s product or service, in this scenario only C. Accordingly, the consumer welfare standard is sensitive to welfare transfers; it challenges transfers from buyers to sellers and favours transfers from sellers to buyers.

With the interpretation discussed in Box 28, the consumer welfare standard generally does not lead to different decisions in the buyer power context than the total welfare standard. To illustrate, consider the scenario in which a horizontal merger would allow the merged entity to exercise monopsony power and where the merger moreover would not give rise to efficiency gains that compensate for the loss of allocative efficiency. Under the total welfare standard, this merger would not pass the test since the merger would harm aggregate welfare of buyers and sellers. Under the consumer welfare standard, the focus is instead on the welfare of the customers of the merged entity (and potential buyers further down the distribution chain). While the exercise of monopsony power would allow the merged entity to obtain lower input prices, this does not benefit consumers.²⁴⁵ This is because a firm with monopsony power typically has higher marginal costs than a firm without buyer power, which induces it to reduce its level of output on the output market. If there is also market power on the output market, such as in the extreme scenario in which the merged entity is a monemporist, the market power obtained by the merged entity will therefore also harm consumer welfare. In this scenario, the consumer welfare standard will therefore also induce a competition authority to block the merger.

²⁴⁵ See Subsection 3.3.1.

However, as noted above, it is also possible that monopsony power on the input market is not accompanied with market power on the output market and that the output market is instead (perfectly) competitive. This can for instance occur when the geographic scope of the input market is narrower (e.g. local) than the output market (e.g. national or international), or when the production of rival firms' products requires different inputs that are therefore purchased on different input markets. In such a scenario, it is possible that anti-competitive buyer conduct that creates (or strengthens or maintains) monopsony power and harms economic efficiency does not directly harm consumer welfare. This may be because the reduction of purchases that is associated with monopsony power may be compensated for by rivals on the output market that expand their output up to the competitive level so that consumers are not affected.²⁴⁶ As a result, anti-competitive buyer conduct, such as the fixing of input prices, may not be noticed under the consumer welfare standard. That is, when there is no market power on the output market, the consumer welfare standard may lead to underenforcement of anti-competitive buyer conduct (i.e. Type II error).

3.5.3 – Conclusion

Economic theory explains that the effects of buyer power on economic efficiency are the mirror image of the efficiency effects of seller power. Similar to monopoly power, monopsony power typically harms economic efficiency because of a reduction in allocative efficiency. Countervailing buyer power, but also countervailing seller power, may instead promote economic efficiency. Pursuant to these conclusions, one might conclude that that competition policy should adopt a more lenient treatment of, or should even stimulate, conduct that creates, strengthens or maintains countervailing market power. For example, in the situation in which multiple buyers (or sellers) face sellers (or buyers) with substantial market power, competition policy could allow these rival buyers to collude, for instance by price fixing, or to merge in order to exercise countervailing buyer power. There are, however, a number of reasons for caution in considering the creation (or strengthening or maintenance) of countervailing market power as a defence. For instance, while the simplified analysis of bilateral monopoly suggests that this scenario is preferable to either a monopoly or a monopsony, it may be rather ambiguous whether efficiency effects are also positive with lower degrees of concentration (e.g. bilateral oligopoly). Furthermore, the creation of countervailing market power may also harm economic efficiency when this leads to a spillover of

²⁴⁶ See also Werden, G.J. (2011), 'Consumer welfare and competition policy', in: Drexler, J., Kerber, W. and Podszun, R. (eds.), *Competition Policy and the Economic Approach: Foundations and Limitations*, Cheltenham: Edward Elgar, pp. 11-43; Werden, G.J. (2007), 'Monopsony and the Sherman Act: Consumer Welfare in a New Light', *Antitrust Law Journal*, 74, pp. 707-737.

market power onto another market or when due to entry the newly created market power is monopoly or monopsony power and not countervailing power. Finally, the creation of countervailing market power may also harm dynamic efficiency. The creation of countervailing market power may for instance reduce the reward for firms that have acquired market power due to superior efficiency. Alternatively, a more lenient treatment towards countervailing market power may distort the incentives of firms to acquire through the competitive process, for example due to investing in new products or technologies.

The analysis of the efficiency effects of buyer power has also pointed out another disadvantage of the consumer welfare standard, which competition authorities may use in the enforcement of competition law to establish effects on static efficiency. Within the buyer power context, application of the consumer welfare standard implies that buyer conduct is taken to harm economic efficiency if it reduces the welfare of the customers of the firm(s) with buyer power (i.e. intermediate customers or final consumers). In general, the consumer welfare standard does not lead to different decision making than the total welfare standard, which focuses on the aggregate welfare of all buyers and sellers. This is because the exercise of monopsony power never benefits consumers and will in fact often harm consumer welfare since it induces firms to lower the level of output on the output market. However, when monopsony power is not accompanied with market power on the output market, for instance because the geographic scope of the input market is narrower than that of the output market or when firms compete on their output markets using different technologies, consumers may not be affected directly. As a result, anti-competitive buyer conduct, such as the fixing of input prices, may not be noticed under the consumer welfare standard. That is, when there is no market power on the output market, the consumer welfare standard may lead to underenforcement of anti-competitive buyer conduct (i.e. Type II error).

3.6 – Conclusions

This chapter has analysed the economic literature on buyer power and its effects on economic efficiency in order to establish whether buyer power should, at all, be a concern within the context of competition policy. Furthermore, using the economic framework of Chapter 2 concerning the traditional seller power context, this chapter has identified the (potential) competition concerns of buyer power and moreover assessed implications for competition policy design. The analysis leads to the following four conclusions.

Buyer power is market power on the input market and allows a firm to obtain from its supplier(s) more favourable terms of trade than in the absence of buyer power.

Buyer power is market power on the input market, that is the market on which firms purchase from their suppliers the necessary inputs for selling their products or services on their output markets. Essentially, buyer power concerns the ability of a buyer to obtain more favourable terms of trade from its supplier(s). As a result, the exercise of buyer power exercise can reduce suppliers' profitability. This does not mean, however that suppliers' difficulty to generate economic profit is necessarily caused by buyer power because this can well be the result of effective competition. The inability to generate economic profit, or when suppliers suffer losses, may for instance be the result of excess production capacity in the market. In this situation, the perceived 'market failure' by suppliers is not market power but is in fact the result of effective competition.

Buyer power may also be present in the absence of excess production capacity. The ability of a firm to exercise buyer power concerns a specific ability to obtain more favourable terms of trade than a supplier's terms in the absence of buyer power. Buyer power typically requires some kind of economic rent amongst suppliers, a condition that may be satisfied in three scenarios. The most straightforward scenario is when suppliers have seller power. When buyer power is exercised in the relation with suppliers that enjoy seller power, the buyer power is usually referred to as countervailing buyer power. Buyer power may, however, also arise when suppliers have no market power, a scenario in which it is referred to as monopsony power. The economic rent that is necessary for the exercise of buyer power may for instance arise when there is an upward sloping supply curve. The presence of an upward sloping supply curve essentially reflects the presence of so-called decreasing returns to scale, which means that, as output increases, it becomes more costly to produce one additional unit of output. Alternatively, economic rent may also be present when suppliers face sunk costs, which concern firm expenditure that cannot be recovered in the short run.

The effects of buyer power on economic efficiency are the mirror image of the efficiency effects of seller power. Monopsony power allows a firm to depress input prices below the competitive level by reducing purchases and therefore typically harms economic efficiency. By contrast, countervailing buyer power (or bargaining power) may mitigate the harmful effects of seller power and therefore tends to promote economic efficiency.

Monopsony power is buyer power enjoyed by a buyer in relation with sellers that have no (seller) market power. The analysis of monopsony power is directly analogous to that of monopoly power. That is a firm with monopsony power may recognise that, since an increase in units bought increases the input price for all units, it has the ability

to depress input prices below the competitive level, so to generate economic profit. However, since the lower input price is achieved by reducing purchases, the exercise of monopsony power typically harms economic efficiency by reducing allocative efficiency.

Countervailing buyer power (which is also referred to as bargaining power) is buyer power in relation with suppliers that have seller power. Countervailing buyer power can therefore only be exercised in the situation of so-called 'bilateral market power', a scenario in which both buyers and sellers have market power. With bilateral market power, sellers and buyers will mutually recognise their market power and acknowledge that none of them can treat their trading partners as (perfect) competitors. Instead, countervailing buyer power is typically exercised in bilateral negotiations so as to obtain an individual discount and may therefore result in very different outcomes for the various buyers and sellers on the market. In marked contrast with monopsony (and monopoly) power, countervailing buyer power is based on the threat of reducing output but generally has the objective of maintaining or increasing purchases. As a result, countervailing buyer power may mitigate the harmful effects of seller power and therefore tends to promote economic efficiency. This observation also applies to countervailing market power on the selling side of a market. Countervailing seller power, too, tends to promote economic efficiency if this prevents buyers to exercise monopsony power.

Both monopsony and countervailing buyer power may also have an impact on dynamic efficiency. A specific concern within the context of buyer power is that its exercise may reduce incentives for suppliers to invest in innovation. That is, the presence of buyer power may cause suppliers to anticipate that they will be unable to recoup their innovation investment, and therefore induce them to underinvest in R&D. However, while buyer power may therefore harm dynamic efficiency, it may also promote dynamic efficiency. For instance, a substantial degree of buyer power may provide an important incentive for suppliers to invest in more cost-efficient technologies or new products and processes in order to gain a competitive advantage over their rivals.

Since the effects of buyer power on economic efficiency are the mirror image of the efficiency effects of seller power, a symmetric treatment is warranted. Accordingly, instead of challenging the exercise of buyer power that is the result of superior efficiency, competition policy should focus on collusion, exclusionary conduct and mergers. There are reasons for caution in considering the creation of countervailing market power as a defence.

Buyer collusion involves the coordination between rival buyers on the material terms on which they compete on their input market in order to jointly exert buyer power. By means of for instance input price fixing, market sharing and bid rigging, rival buyers

can bypass the competitive process, gain buyer power and thereby potentially inflict harm to economic efficiency. It is important to note, however, that coordination amongst rival buyers is not necessarily harmful since it can also yield efficiency gains. In particular when firms engage in so-called joint purchasing, economic efficiency may be promoted, most notably due to gains in productive and/or dynamic efficiency. Moreover, joint purchasing may promote economic efficiency when it enables firms to exercise countervailing buyer power and mitigate the harmful effects of suppliers' market power.

Exclusionary conduct concerns the ability of a firm with a (very) high degree of buyer power to exclude a rival buyer or to deter a potential entrant from that or an adjacent market. Depending on the specific characteristics of the market(s) concerned, exclusionary buyer conduct may involve various practices that can be largely interchangeable. For instance, when foreclosure is targeted at a rival buyer, exclusionary conduct may for example involve exclusivity contracts, fidelity rates or predatory buying. Alternatively, when exclusionary conduct is aimed at a firm operating on an adjacent market, the excluding firm might for example resort to refusal to deal, tying or reciprocal dealing. Since many practices that might intuitively seem harmful may instead promote economic efficiency, it is important in the enforcement of exclusionary conduct to ascertain that a coherent theory of harm applies.

Mergers may also give rise to buyer power concerns. Since horizontal mergers directly reduce the number of rival buyers on a market, they typically allow firms to gain buyer power. The resulting increase of buyer power may harm economic efficiency but may also realise efficiency gains, for instance because it allows the merged entity to exercise countervailing buyer power, realise cost savings or improve the ability to utilise economies of scale or scope, which may promote productive and/or dynamic efficiency. Efficiency gains play an even more prominent role within the context of vertical mergers, which do not concern direct rivals and are therefore less likely to increase market power. In fact, vertical mergers can be an important means to solve a vertical externality between a seller and a buyer and thereby promote economic efficiency. Only in very specific situations, vertical mergers may form a competition concern, most notably when it provides the merged entity with both the ability and the incentive to engage in exclusionary conduct.

While economic theory suggests that the creation of countervailing market power may promote economic efficiency, there are reasons for caution in considering the creation of countervailing market power as a defence. For instance, while the simplified analysis of bilateral monopoly suggests that this scenario is preferable to either a monopoly or a monopsony, it may be rather ambiguous whether efficiency effects are also positive with lower degrees of concentration (e.g. bilateral oligopoly).

Furthermore, the creation of countervailing market power may also harm economic efficiency when this leads to a spillover of market power onto another market or when due to entry the newly created market power is monopoly or monopsony power and not countervailing power. Finally, the creation of countervailing market power may also harm dynamic efficiency. The creation of countervailing market power may for instance reduce the reward for firms that have acquired market power due to superior efficiency. Alternatively, a more lenient treatment towards countervailing market power may distort the incentives of firms to acquire through the competitive process, for example due to investing in new products or technologies.

When monopsony power is not accompanied with market power on the output market, the consumer welfare standard may lead to underenforcement of anti-competitive buyer conduct (Type II error).

Within the buyer power context, application of the consumer welfare standard implies that buyer conduct is taken to harm economic efficiency if it reduces the welfare of the customers of the firm(s) with buyer power (i.e. intermediate customers or final consumers). In general, the consumer welfare standard does not lead to different decision making than the total welfare standard, which focuses on the aggregate welfare of all buyers and sellers. This is because the exercise of monopsony power never benefits consumers and will in fact often harm consumer welfare since it induces firms to lower the level of output and charge higher prices on the output market. It is, however, also possible that monopsony power is not accompanied with market power on the output market, for instance because the geographic scope of the input market is narrower (e.g. local) than that of the output market (e.g. national or international), or when the production of rival firms' products requires different inputs that are therefore purchased on different input markets. In such a scenario, it is possible that anti-competitive buyer conduct that creates (or strengthens or maintains) monopsony power and harms economic efficiency does not directly affect consumer welfare. This may be because the reduction of purchases that is associated with monopsony power may be compensated for by rivals on the output market that expand their output up to the competitive level so that consumers are not directly affected. As a result, anti-competitive buyer conduct, such as the fixing of input prices, may not be noticed under the consumer welfare standard. That is, when there is no market power on the output market, the consumer welfare standard may lead to underenforcement of anti-competitive buyer conduct (i.e. Type II error).

4. BUYER POWER IN EU COMPETITION LAW

4.1 – Introduction

Pursuant to the economic literature on competition policy in the traditional seller power context and the literature on buyer power and its effects on economic efficiency, the previous chapters have identified the potential concerns of buyer power in the context of competition policy. It has been concluded that since the effects of buyer power on economic efficiency are the mirror image of the efficiency effects of seller power, a symmetric treatment is warranted. Accordingly, competition policy should not challenge the exercise of buyer power that is the result of superior efficiency but instead address anti-competitive behaviour, which allows the firm(s) involved to create, strengthen or maintain buyer power not through but by harming the competitive process. Anti-competitive behaviour can be exhibited on both input and output markets and, since these are generally linked, will typically allow a firm to acquire both buyer and seller power. While focusing on the competition concerns of buyer power (i.e. on the input market), three categories of buying conduct that may amount to anti-competitive buyer conduct have been identified: collusion amongst rival buyers, exclusionary conduct by a buyer and mergers involving buyer power.

Depending on the formulation of the competition rules and corresponding need for case-by-case analysis, the enforcement of competition law may require the application of a welfare standard as a proxy for static efficiency. In this context, Chapters 2 and 3 have explained that the consumer welfare standard, which only focuses on the welfare of consumers, generally does not lead to different decisions than the total welfare standard, which takes into account the aggregate welfare of buyers and sellers. Moreover, it has been explained that the consumer welfare standard may be preferable because it may involve less regulation costs. However, it has also been explained that the consumer welfare standard may have two important drawbacks that are particularly relevant in the context of this research. One important drawback is that the consumer welfare standard may induce a competition authority to wrongfully ignore overriding efficiency gains because they do not directly and sufficiently benefit consumers in that market. Consequently, the application of the consumer welfare standard may cause the overenforcement of buyer conduct (i.e. Type I error). Secondly, since monopsony power does not necessarily directly affect consumer welfare, anti-competitive buyer conduct (e.g. input price-fixing), may not be noticed when the consumer welfare standard is applied. That is, when there is no market power on the output market, the consumer welfare standard may lead to underenforcement of anti-competitive buyer conduct (i.e. Type II error).

This chapter will apply the economic framework that has been established in Chapters 2 and 3 to the current substantive legal framework of EU competition law. The analysis therefore aims to establish whether the substantive competition rules, as laid down in the Treaty of the Functioning of the European Union (TFEU), the EU Merger Regulation and various notices and guidelines issued by the European Commission, provide for a legal basis to address the competition concerns of buyer power in order to prevent the underenforcement of anti-competitive behaviour (Type II error). However, since the various types of buyer conduct that have been identified as potential competition concerns are not necessarily harmful but may instead also promote economic efficiency, this chapter will also discuss whether the legal framework allows for taking into account potential efficiency gains of buyer conduct, so to mitigate the risk of overenforcement (Type I error). Furthermore, this chapter will reflect on the role of regulation costs of competition policy (set-up costs, information and assessment costs and legal uncertainty) and discuss the potential relevant trade-offs with error costs (i.e. the costs associated with Type I and Type II errors).

This chapter is structured as follows. Section 4.2 will concisely introduce the general substantive legal framework of EU competition law, and will moreover assess in general whether and how it can be applied to buyer conduct. Then, Sections 4.3 through 4.5 will subsequently aim to establish whether the current substantive legal framework of EU competition law provides for a legal basis to address the competition concerns of buyer power that have been identified. To that end, Section 4.3 will address buyer collusion, Section 4.4 will discuss the treatment of exclusionary conduct by a buyer and Section 4.5 will analyse the treatment of buyer power in EU merger control. Moreover, in light of the important conclusions reached on inter alia the drawbacks of the consumer welfare standard, Sections 4.3 through 4.5 will analyse the role of case-by-case analysis and the welfare standard that is applied. Next, Section 4.6 will concisely reflect on other potential public interests that are related to the exercise of buyer power and which may form a motive for the requests for amendments of EU competition law. Finally, Section 4.7 concludes with a summary of this chapter's main findings.

4.2 – Buyer Conduct in EU Competition Law

The legal framework of EU competition law consists of various legal provisions in the Treaty of the Functioning of the European Union (TFEU) and underlying legal texts such as Regulations, Notices and Guidelines, as well as judgements by the European Courts: the General Court (GC) and the European Court of Justice (ECJ). The

competition rules in principle apply to all areas of the economy although it should be noted that specific rules hold for certain sectors.²⁴⁷

This section concisely introduces the general substantive legal framework of EU competition law, which essentially consists of three pillars: Article 101 TFEU, Article 102 TFEU and the EU Merger Regulation. Subsection 4.2.1 entails a basic introduction of the main framework with a discussion on the key legal elements of Articles 101 TFEU and 102 TFEU and EU merger control. Subsection 4.2.2 will assess from a general perspective whether and, if so, how the legal framework of EU competition law can be applied to the context of buyer power.

4.2.1 – Introducing the Substantive Legal Framework

Article 101 TFEU applies to joint behaviour by two or more firms (i.e. undertakings)²⁴⁸ and addresses both cooperation between rivals (horizontal agreements) and vertical restraints (agreements or contractual obligations between supplying and purchasing customers).²⁴⁹ Article 101 contains three subsections. Article 101(1) sets out the general prohibition for agreements between undertakings (or decisions by associations of undertakings or concerted practices) which have as their object or effect the prevention, restriction or distortion of competition within the common market and which may affect trade between Member States. For conduct to fall under the scope of Article 101(1) five conditions must be satisfied: (i) the existence of undertakings (or associations of undertakings), (ii) an agreement between undertakings (or a decision by an association of undertakings or a concerted practice), (iii) the object or effect to prevent, restrict or distort competition,²⁵⁰ and (v) an appreciable effect on trade between Member States. Pursuant to Article 101(2), agreements (or decisions) prohibited by Article 101 are automatically void.

²⁴⁷ See e.g. Council Regulation 1184/2006 of 24 July 2006 applying certain rules of competition to the production of and trade in certain agricultural products [2006] OJ L214/7; Council Regulation 1308/2013 of the European Parliament and of the Council of 17 December 2013 establishing a common organisation of the markets in agricultural products (Common Market Organisation (CMO) Regulation) OJ L347/671.

²⁴⁸ For the EU competition rules to apply, the actor(s) involved need to amount to an ‘undertaking’, see Subsection 4.2.2.

²⁴⁹ Cases 56/64 and 58/64, *Consten & Grundig v. Commission* [1966] ECR 299.

²⁵⁰ This condition does not directly follow from the text of Article 101 but has been formulated in the jurisprudence of the Court of Justice, see Case e.g. Case 5-69 *Völk v. Vervaecke* [1969] ECR 295.

Within the context of this research, it is important to note that the third condition, the object or effect to restriction competition, is to be read disjunctively.²⁵¹ That is, Article 101 makes a distinction between cooperation that can, by its very nature, be regarded as a restriction of competition (restrictive by object) and cooperation that can be held restrictive after their effects on competition have been examined (restrictive by effect). Whether cooperation is placed in the ‘object category’ does not depend on its (subjective) intent but rather on the (objective) meaning and purpose of the agreement considered in its economic context.²⁵² The distinction is important since once it has been established that the object is to restrict competition, anti-competitive effects have been established and there is thus no need for further case-specific analysis under Article 101(1).²⁵³ If an agreement is not restrictive by object, it can still fall under Article 101(1) but only after extensive case-specific analysis of concrete effects.

Conduct that satisfies the criteria of Article 101(1) falls within the scope of the general prohibition of Article 101. However, pursuant to Article 101(3), Article 101(1) is inapplicable if the conduct satisfies four cumulative criteria: (a) it leads to an improvement of the production or distribution of goods or a promotion of technical or economic progress, (b) it allows consumers a fair share of the resulting benefit, (c) the restrictions of competition are indispensable for the benefit and (d) the restrictions of competition must not afford firms the possibility of eliminating competition. While the burden of proving that all conditions of Article 101(3) are satisfied rests on those claiming its benefit,²⁵⁴ it is also possible that specific conduct is automatically exempted from the general prohibition if it satisfies the conditions of a so-called ‘block exemption’, such as the block exemption for certain vertical agreements.²⁵⁵ Article 101(3) does not exclude a priori certain types of agreements from its scope and can therefore also be applied to the ‘object category’. However, conduct that is placed in the ‘object category’ typically corresponds with a list of so-called ‘hardcore restraints’, identified by the European Commission in its notices, guidelines and block exemptions and of which the Commission moreover presumes that they do not satisfy the criteria of Article 101(3) TFEU.²⁵⁶

²⁵¹ See Case 56/65, *Société La Technique Minière v. Maschinenbau* [1966] ECR 234.

²⁵² See e.g. Whish, R. (2009), *Competition Law*, Oxford: Oxford University Press, p. 119.

²⁵³ Cases 56/64 and 58/64, *Etablissements Consten SA & Grundig-Verkaufs-GmbH v. Commission* [1966] ECR 299, p. 342.

²⁵⁴ Article 2 Regulation 1/2003.

²⁵⁵ See Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (hereafter Verticals Regulation) [2010] OJ L 102/1.

²⁵⁶ Jones, A. and Sufin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, p. 216.

Besides the text in the Treaty, the block exemptions and the case law of the European courts, the legal framework of Article 101 TFEU also includes (informal) guidance provided by the European Commission. The Commission has issued various notices and guidelines concerning its interpretation and application of the substantive concepts within Article 101, as well as on procedural matters regarding its enforcement. Important examples within the context of this research are the Commission's guidelines on the application of Article 101(3), as well as the guidelines on both horizontal and vertical agreements.²⁵⁷

Article 102 TFEU applies to unilateral behaviour by firms. It prohibits undertakings that hold a dominant position in the internal market (or a substantial part of it) from abusing that position insofar it may affect trade between Member States. In order to establish an infringement of Article 102, the following needs to be proven: (i) the existence of one or more undertakings, (ii) the presence of a dominant position, (iii) the dominant position must be located within the internal market (or a substantial part of it), (iv) the dominant position is abused and (v) there is an appreciable effect on trade between Member States.

One of the key challenges for the European Commission in the enforcement of Article 102 TFEU is formed by the need to establish the presence of a 'dominant position' and moreover that this position is abused. The formulation of Article 102 TFEU leaves, however, considerable room for interpretation of these notions. Since Article 102 does not explain what comprises a 'dominant position', the concept has been developed in European case law. According to the ECJ, the concept of a dominant position refers to "a position of economic strength 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".²⁵⁸

As is clear from the wordings of Article 102 TFEU, firms are allowed to have a dominant position though should refrain from 'abusing' that position. Although the finding of 'abuse' is crucial in determining legality, it is not clearly defined. Moreover, while Article 102 sets out certain practices what abuse 'may, in particular, consist in', it should be recognised that this list is illustrative, not exhaustive. In *Hoffmann-La Roche*, the ECJ introduced a rather broad formulation, stating that "[t]he concept of

²⁵⁷ Guidelines on the application of Article 101(3); Guidelines on Vertical Restraints [2010] OJ C 130/1; Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal cooperation agreements (hereafter Guidelines on horizontal agreements) [2011] OJ C 11/1.

²⁵⁸ See e.g. Case 85/76, *Hoffmann-La Roche & CO AG v. Commission* [1979] ECR 461, par. 38.

abuse is an objective concept relating to behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition”.²⁵⁹

Similar to the context of Article 101, the legal framework of Article 102 includes, besides the text of the Article and the case law, informal guidance by the Commission. However, the Commission’s guidance on Article 102 is less elaborate than its information on the application of Article 101. While the Commission distinguishes between so-called ‘exploitative’ and ‘exclusionary’ abuses,²⁶⁰ it has as of yet only offered guidance on the latter category. Moreover, instead of issuing a ‘notice’ or ‘guidelines’, the Commission explains its application of Article 102 in a ‘guidance’ paper on the Commission’s enforcement priorities.²⁶¹

The EU Merger Regulation (EUMR), that is Council Regulation 139/2004, provides the main regulatory framework for merger control at the European level.²⁶² Essentially, the EU Merger Regulation declares (i) concentrations (ii) with a Community dimension and (iii) which would significantly impede effective competition in the common market (or a substantial part of it), in particular as a result of the creation or strengthening of a dominant position, to be incompatible with the common market.

The concept of a ‘concentration’ is defined in Article 3 EUMR. Pursuant to Article 3(1) EUMR, a concentration arises where a change of control on a lasting basis results from: (a) the merger of two or more previously independent undertakings or parts of undertakings or (b) the acquisition by one or more persons already controlling at least one undertaking or by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of the whole or parts of one or more other undertakings. Whether or not a concentration has a ‘Community dimension’ is determined by a quantitative assessment on the basis of the turnover thresholds in Article 2 EUMR. Concentrations with a Community dimension must be notified to the Commission prior to completion and are suspended pending the Commission’s substantive investigation on the compatibility with the internal market.

²⁵⁹ Case 85/76, *Hoffmann-La Roche & CO AG v. Commission* [1979] ECR 461, par. 91.

²⁶⁰ As to ‘exploitative’ abuse, see Subsection 4.6.1.

²⁶¹ Guidance Paper on Article 102.

²⁶² Council Regulation 139/2004 of 20 January 2004 on the control of concentrations between undertakings (hereafter Merger Regulation) [2004] OJ L124/1.

Pursuant to its investigation, the Commission can declare a concentration either compatible or incompatible with the common market. Moreover, it is possible for parties to propose modifications to the concentration and offer commitments in order to induce the Commission to declare the transaction compatible with the common market.

In order to provide guidance on its merger control, the Commission has issued various notices and guidelines concerning its interpretations and its application of the EU Merger Regulation. Presumably most relevant for the (substantive) appraisal of cases involving buyer power are the Commission's Guidelines on the assessment of horizontal mergers and its Guidelines on the assessment of non-horizontal mergers.²⁶³

4.2.2 – Application to Buyer Conduct

At first sight, the legal framework of EU competition law appears readily applicable to buyer conduct in order to address the identified competition concerns of buyer power. Collusion is addressed under Article 101 TFEU, exclusionary conduct falls under the scope of Article 102 (concerning unilateral behaviour) and Article 101 (concerning vertical agreements),²⁶⁴ whereas mergers are addressed under the EU Merger Regulation. This subsection, however, makes two remarks concerning the application of the competition rules to buyer conduct. First, it is important to note that, in order for EU competition law to apply, the conduct concerned is exhibited by an actor that qualifies as an 'undertaking'. Secondly, since the application of the competition rules in individual cases typically requires a definition of the 'relevant market', it is important to take into account how this exercise can be applied to the buyer power context.

A necessary requirement for the competition rules to apply is that the actor(s) involved can be considered as an *undertaking*. Pursuant to the case law of the Court, an undertaking is defined as "every entity engaged in an economic activity, regardless of the legal status of the entity or the way in which it is financed".²⁶⁵ Whether or not a firm is, in the context of EU competition law, an 'undertaking' therefore depends on whether it is engaged in 'economic activity'. Pursuant to the case law of the Court, it can be concluded that the characteristic features of an 'economic activity' are "(i) the

²⁶³ Guidelines on the assessment of under the Council Regulation on the control of horizontal concentrations between undertakings (hereafter Horizontal Merger Guidelines) [2004] OJ C31/5; Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (hereafter Non-Horizontal Merger Guidelines) [2008] OJ C 265/6.

²⁶⁴ See also Section 4.4.

²⁶⁵ Case C-41/90, *Höfner and Elser v. Macroton GmbH* [1991] ECR I-1979, par. 21.

offering of goods or services or services on the market, (ii) where that activity could, at least in principle, be carried on by a private undertaking in order to make profits”.²⁶⁶ Since economic activity thus requires the *offering* of goods or services, the question raises whether the *purchasing* of goods or services can amount to economic activity, and thus whether firms involved in buying conduct can thus legally be characterised as an undertakings. As discussed in Box 29, this issue was addressed in the case law of the European Courts.²⁶⁷

Box 29: Purchasing and the concept of ‘undertaking’

In *FENIN*, the issue involved pricing practices by SNS, the public body responsible for the management of the Spanish health care system. The General Court pointed out that SNS supplied under the principle of solidarity was funded by social security and State contributions and provided its services free of charge. According to the General Court, it was not the purchasing function but the supply function that determined whether economic activity was carried out, even though “an entity may wield very considerable economic power, even giving rise to a monopsony”.²⁶⁸

In the opinion of AG Maduro, the GC’s conclusion was “consistent with the economic theory according to which the existence of a monopsony does not pose a serious threat to competition since it does not necessarily have any effect on the downstream market”.²⁶⁹ In this context, it should be noted that economic theory explains that this argument is at least incomplete and possibly incorrect. After all, as discussed above, (the creation, strengthening or maintenance of) monopsony power can pose a serious concern in the context of competition policy, since it can harm economic efficiency, regardless of whether there are downstream effects.²⁷⁰ On the appeal case, however, the European Court of Justice did not address the economics of a monopsony but merely confirmed the GC’s approach that it is the supply function that determined whether economic activity was carried out.²⁷¹

²⁶⁶ Jones, A. and Sufrin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, pp. 124-125. They refer to Case C-97/96, *Albany International BV v. Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751, Jacobs AG, par. 311; Cases C-180-184/98, *Pavlov v. Stichting Pensioenfonds Medische Specialisten* [2000] ECR I-6451, par. 201.

²⁶⁷ See Lindberg, R. (2011), ‘Buying Exclusion in EU Competition Rules – Assessing Reasons and Consequences’, *European Competition Journal*, 7(3), pp. 433-454; Jones, A. and Sufrin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, pp. 125-134.

²⁶⁸ Case T-319/99, *FENIN v. Commission* [2003] ECR II-351, par. 37.

²⁶⁹ Case C-205/03 P, *FENIN v. Commission* [2006] ECR I-6295, Maduro AG, par. 66.

²⁷⁰ See Subsection 3.3.1.

²⁷¹ Case C-205/03 P, *FENIN v. Commission* [2006] ECR I-6295.

In *Selex*, the Courts addressed the creation and collection of route charges from users of air navigation services by the European Organisation for the Safety of Air Navigation (Eurocontrol). Both the GC and the ECJ stressed, while referring to the judgement in *FENIN*, “that it would be incorrect, when determining whether or not a given activity is economic, to dissociate the activity of purchasing goods from the subsequent use to which they are put and that the nature of the purchasing activity must therefore be determined according to whether or not the subsequent use of the purchased goods amounts to an economic activity”.²⁷² However, in contrast to the GC, which had concluded that in some activities Eurocontrol was operating as an undertaking, the ECJ held that Eurocontrol’s activity was connected with (and inseparable from) the exercise of public powers so that the organisation was not acting as an undertaking.

From the case law, it can be concluded that purchasing of goods or services only amounts to ‘economic activity’, if its subsequent use amounts to economic activity. Since purchasing may, in itself, have substantial effects on economic efficiency, this interpretation is not straightforward from a mere economic perspective. It is conceivable, however, that the interpretation of the concept of ‘undertaking’ is motivated by more pragmatic and political reasons.²⁷³ Indeed, the interpretation by the Courts appears to have the mere effect of excluding from the scope of EU competition law purchasing by final consumers (which typically have no buyer power) and State purchasing (for which specific rules on public procurement may apply). With the exception of purchasing by final consumers and State purchasing, however, all other purchasing activities will typically amount to ‘economic activity’, because their subsequent use typically involves economic activity and may therefore be addressed under EU competition law as far as this condition is concerned.

Application of EU competition law generally requires the definition of the so-called *relevant market*. The definition of the relevant market is an exercise that aims to determine the set of products and geographical areas to which firms’ products (or

²⁷² Case C-113/07, *Selex Sistemi Integrati SpA v. Commission* [2009] ECR I-2207, par. 102. For the GC judgement, see Case T-155/04 ECR II-4797.

²⁷³ Lindberg, R. (2011), ‘Buying Exclusion in EU Competition Rules – Assessing Reasons and Consequences’, *European Competition Journal*, 7(3), pp. 433-454; Jones, A. and Sufrin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, p. 132. Indeed, in *FENIN*, AG Maduro noted that there must be ‘a balance between the need to protect undistorted competition on the common market and respect for the power of the Member States’, see Case C-205/03 P, *FENIN v. Commission* [2006] ECR I-6295, Maduro AG, par. 26.

services) belong.²⁷⁴ This is important since it in effect determines the market(s) on which market power may form a concern. As explained by the Commission in its explanatory notice, the definition of the relevant market involves an assessment of the substitutability of a product (or service) along two lines: a product dimension and a geographical dimension.²⁷⁵ In the context of seller power, the central question in the definition of the relevant market is whether buyers would switch to purchasing other products (or services) when suppliers would permanently raise their prices by a relatively small percentage. Similarly, in defining the relevant geographic market, the question is whether buyers would switch to purchasing their goods in another geographic area. When there is sufficient data, the relevant market can be defined using econometric techniques such as the so-called Small but Significant Non-transitory Increase in Price (SSNIP) test.

In order to address anti-competitive behaviour by a buyer, it may be necessary to determine the relevant market from the perspective of buyers (i.e. the relevant input market). In this exercise, similar techniques can be used but with some small adjustments.²⁷⁶ The crucial difference is that in the definition of the relevant input market, the starting point is the seller and not the buyer. More specifically, to determine the relevant product market from the perspective from buyers, it needs to be assessed whether suppliers, when facing a permanent price cut, would refuse to sell to their buyers and instead switch to selling their products (or services) to other buyers (which use the input for a different use). Similarly, for the geographical dimension, the question is whether sellers would respond to a permanent price cut to selling to other buyers in different geographic areas (which use the input for a similar use). In this exercise, econometric techniques such as the Small but Significant Non-transitory Decrease in Price (SSNDP) test can prove helpful.²⁷⁷

²⁷⁴ See Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 101-136.

²⁷⁵ Commission Notice on the definition of relevant market for the purposes of Community competition law [1997] OJ C372/03.

²⁷⁶ See more extensively Dobson Consulting (1999), *Buying Power and Its Impact on Competition in the Food Retail Distribution Sector of the European Union*, Prepared for the European Commission – DGIV, Study Contract No. IV/98/ETD/078, pp. 28-31; Kokkoris, I. (2006), 'Buyer Power Assessment in Competition Law: A Boon or a Menace', *World Competition*, 29(1), pp. 139-164; Church, J. (2008), 'Monopsony and Buyer Power', Background note for the OECD 2008 Roundtable on Monopsony and Buyer Power.

²⁷⁷ This is recognised by the European Commission in its Guidelines on horizontal agreements, par. 197-199.

4.2.3 – Conclusion

On first sight, the legal framework of EU competition law appears readily applicable to buyer conduct in order to address the competition concerns that have been identified. That is, collusion can be addressed under Article 101 TFEU, exclusionary conduct falls under the scope of Article 102 (concerning unilateral behaviour) and Article 101 (concerning vertical agreements), whereas mergers can be addressed under the EU Merger Regulation.

It is important to note, however, that in order for the competition rules to apply, the actor(s) involved must amount to an ‘undertaking’, which requires the presence of ‘economic activity’. A peculiar characteristic of EU competition law is that purchasing, in and by itself, is no economic activity. That is, pursuant to the case law of the European Court of Justice purchasing only amounts to economic activity, if its subsequent use amounts to economic activity, for instance because it is used as an input for products or services and/or distribution on an output market. This interpretation by the Courts merely appears to have the effect of excluding from the scope of EU competition law purchasing by final consumers (which typically have no buyer power) and State purchasing (for which specific rules on public procurement may apply). That is, with the exception of purchasing by final consumers and State purchasing, purchasing activities will typically amount to ‘economic activity’, because their subsequent use typically involves economic activity and may therefore be addressed under EU competition law as far as this condition is concerned.

Moreover, in order to address anti-competitive behaviour by a buyer, it may be necessary to determine the relevant market from the perspective of buyers (i.e. the relevant input market). The definition of the relevant market concerns the determination of the set of products and geographical areas to which firms’ products (or services) belong. To determine the relevant product market from the perspective of buyers, the definition of the relevant market involves an assessment of whether suppliers, when facing a permanent price cut, would refuse to sell to their buyers and instead switch to selling their products (or services) to other buyers (which use the input for a different use). Similarly, for the geographical dimension, the question is whether sellers would respond to a permanent price cut to selling to other buyers in different geographic areas (which use the input for a similar use). In this exercise, the Small but Significant Non-transitory Decrease in Price (SSNDP) test can prove helpful.

4.3 – Buyer Collusion

The first category of buyer conduct that has been identified as a potential competition concern is collusion. Buyer collusion involves the coordination between rival buyers

on the material terms on which they compete on their input market in order to jointly exert buyer power, for instance by price fixing, market sharing or bid rigging. However, coordination amongst rival buyers can also yield substantial efficiency gains. Efficiency gains may especially arise when buyer cooperation amounts to joint purchasing.²⁷⁸

In the legal framework of EU competition law, collusion falls under the scope of Article 101 TFEU. This section analyses whether the potential harmful effects, as well as the potential for efficiency gains, can be treated under Article 101 TFEU. Subsection 4.3.1 concisely discusses the treatment of various forms of buyer collusion in EU competition law. Subsection 4.3.2 concerns a more detailed analysis on the welfare standard that is applied in the context of Article 101 TFEU and discusses its implications for the treatment of buyer collusion.

4.3.1 – Addressing Buyer Collusion

As noted above, collusion between rival buyers falls under the scope of the cartel prohibition of Article 101 TFEU. Indeed, Article 101(1)(a) expressly identifies the direct or indirect fixing of purchase prices or any other trading conditions as conduct that may in particular restrict competition within the common market. In its Guidelines on horizontal agreements, the European Commission stresses that coordination between rival buyers may lead to restrictive effects on competition on the purchasing and/or downstream selling market or markets, such as increased prices, reduced output, product quality or variety or innovation, market allocation, or anti-competitive foreclosure of other possible purchasers.²⁷⁹ In particular, the Commission is concerned that an agreement between rival buyers may result in a significant degree of buyer power which may force suppliers to reduce the range or quality of products they produce, which may bring about restrictive effects on competition such as quality reductions, lessening of innovation efforts or ultimately sub-optimal supply.²⁸⁰ Furthermore, the Commission is concerned that agreements between rival buyers could be used to foreclose competing purchasers by limiting their access to efficient suppliers.²⁸¹

Perhaps due to its explicit reference in Article 101, the most straightforward example of collusion amongst buyers – the fixing of input prices – has been typically held to

²⁷⁸ See Subsection 3.4.1.

²⁷⁹ Guidelines on horizontal agreements, par. 200.

²⁸⁰ Guidelines on horizontal agreements, par. 202.

²⁸¹ Guidelines on horizontal agreements, par. 203.

have the *object* of restricting competition.²⁸² As noted above, when conduct is placed in the ‘object category’ of Article 101(1), it is unnecessary to assess its concrete competitive effects in that stage of the analysis. In its Guidelines on horizontal agreements, the Commission explains that cooperation agreements between rival buyers restrict competition by object if they serve as a tool to engage in a disguised cartel, that is to say, otherwise prohibited price fixing, output limitation or market allocation.²⁸³ Indeed, on multiple occasions, both the Commission and the Court have condemned agreements involving input price fixing because it had as its object of restricting competition.²⁸⁴ In *French Beef*, for instance, both the Commission and the General Court found an agreement involving the fixing of slaughterhouse entry prices to restrict competition by object and established an infringement of Article 101.²⁸⁵ Similarly, in the *Raw Tobacco Spain* and *Raw Tobacco Italy* cases, which are concisely discussed in Box 30, an input price-fixing agreement amongst tobacco processors was found to have as its object the restriction of competition.²⁸⁶

Box 30: The Spanish and Italian raw tobacco cases

In 2004, the European Commission fined five companies for participation in a cartel on the Spanish raw tobacco market. The Commission had found that, between 1996 and 2001, these companies had agreed to fix the prices to be paid to tobacco growers, and moreover shared the quantities of raw tobacco that each of them would buy at the time of delivery. Similarly, in 2005, the Commission fined the leading raw tobacco processors in Italy for colluding between 1995 and 2002 on their overall purchasing strategy, agreeing between purchasing prices, allocating suppliers, as well as bid rigging on public auctions organised by public authorities.

Both the Spanish and Italian cases were somewhat controversial since they formed, together with the *French Beef* case, the first Commission decisions with fines in the agricultural sector. While pointing out that the competition rules also applied to the agricultural sector, the Commission noted that agreements on prices are amongst the most serious

²⁸² See e.g. the opinion of AG Jacobs in Joined Cases, C-246/01, C-354/01 and C-355/01, *AOK Bundesverband* [2004] ECR I-2493, par. 69.

²⁸³ Guidelines on horizontal agreements, par. 205.

²⁸⁴ For an overview, see e.g. Kokkoris, I. (2007), ‘Purchase Price Fixing: a Per Se Infringement?’, *European Competition Law Review*, 9, pp. 473-487; Ezrachi, A. (2012), ‘Buying Alliances and Input Price Fixing: In Search of a European Enforcement Standard’, *Journal of Competition Law & Economics*, 8(1), pp. 47-71.

²⁸⁵ Joined Cases T-217/03 and T-245/03, *French Beef* [2006] ECR II-4987.

²⁸⁶ See Case COMP/C.38.238/B.2 and Case T-37/05, *Raw Tobacco Spain* [2011] ECR II-41, as well as Case COMP/C.38.281/B.2 and Case T-12/06, *Raw Tobacco Italy* [2011] ECR II-5639.

infringements of competition law. Furthermore, the Commission stressed that “the purchase price is a fundamental aspect of the competitive conduct of any undertaking operating in a processing business and is also, by definition, capable of affecting the behaviour of the same companies in any other market in which they compete, including downstream markets”.²⁸⁷ On appeal, the GC upheld both decisions (though reduced the fines).

Besides input price fixing, other types of buyer cartels have also been held to infringe Article 101. On various occasions, parties to an agreement involving the fixing of purchase prices had also agreed on, for instance, market-sharing or production quotas. In *Zinc Producer Group*, for instance, the Commission found that the cartel members had also agreed to refrain from building new production capacity.²⁸⁸ The Spanish and Italian tobacco cases moreover illustrate that Article 101 is also applied to bid rigging.²⁸⁹ Agreements between rival buyers that do not have as their object the restriction of competition, may still fall under Article 101(1) but must be analysed in their legal and economic context with regard to their actual and likely effects on competition. The Commission explains in its Guidelines on horizontal agreements that the analysis of the restrictive effects on competition generated by such arrangements must cover the negative effects on both the purchasing and the selling markets.²⁹⁰

Besides possible concerns for competition, the European Commission also acknowledges that agreements between rival buyers can also give rise to efficiency gains. In its Guidelines on horizontal agreements, the Commission explains that such arrangements may in particular lead to cost savings such as lower purchase prices or reduced transaction, transportation and storage costs, thereby facilitating economies of scale. Moreover, the Commission stresses that joint purchasing arrangements may give rise to qualitative efficiency gains by leading suppliers to innovate and introduce new or improved products on the markets.²⁹¹ Presumably for these reasons, the Commission considers it generally unlikely that market power exists if the combined market share of the parties does not exceed 15 percent of the purchasing market as well as 15 percent of the selling market. That is, the Commission is unlikely to target joint purchasing arrangements between firms with a market share lower than 15 percent on

²⁸⁷ Case COMP/C.38.281/B.2, *Raw Tobacco Italy*, par. 280.

²⁸⁸ *Zinc Producer Group* [1984] OJ L220/27.

²⁸⁹ See also *Re The European Sugar Cartel* [1973] OJ L140/17, Case COMP/E-1/38.823, *PO/Elevators and Escalators*.

²⁹⁰ Guidelines on horizontal agreements, par. 207.

²⁹¹ Guidelines on horizontal agreements, par. 217.

both input and output markets.²⁹² An important case concerning the treatment of joint purchasing is *Gøttrup-Klim*, which is concisely discussed in Box 31.²⁹³

Box 31: Joint purchasing in *Gøttrup-Klim*

The *Gøttrup-Klim* case involved a Danish cooperation association that engaged in the joint purchasing of farming supplies such as fertilizers. Although the case did not specifically focus on the joint purchasing arrangement, it did induce the ECJ to address the compatibility with Article 101 with the cooperation's internal rules that prohibited the members of the cooperative to participate in other forms of organised cooperation which were in direct competition with it. The ECJ held that the rules did not infringe Article 101(1) because they were "necessary to ensure that the cooperative functions properly and maintains its contractual power in relation to producers". The Court therefore appeared to recognise that a main objective of the cooperative was to enable their members to exercise countervailing buyer power vis-à-vis their suppliers.

It is important to note that all types of cooperation amongst rival buyers that fall under the scope of Article 101(1) are in principle eligible for the legal exception of Article 101(3). The Commission considers the conditions of Article 101(3) likely to be fulfilled in the context of joint purchasing arrangements between parties the combined market shares of which do not exceed 15 % on both the purchasing and the selling market or markets, provided that they do not have as their object of restricting competition.²⁹⁴ It is important to note, however, that even conduct that falls in the 'object category' of Article 101(1) might be eligible for the legal exception of Article 101(3). In *European Council of Manufacturers of Domestic Appliances*, for instance, the exception of Article 101(3) was applied to an agreement that restricted the import (and manufacturing) of less energy-efficient washing machines.²⁹⁵ Although the conduct was found to fall within the general prohibition of Article 101(1), the Commission concluded the competitive restrictions would increase energy efficiency and lessen pollution were indispensable to the agreement and would not substantially eliminate competition. The Commission therefore concluded that the criteria of Article 101(3) were satisfied.

²⁹² Guidelines on horizontal agreements, par. 208.

²⁹³ Case C-250/92, *Gøttrup-Klim* [1994] ECR I-5641. See Jones, A. and Sufrin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, pp. 817-818; Kokkoris, I. (2007), 'Purchase Price Fixing: a Per Se Infringement?', *European Competition Law Review* 9, pp. 486.

²⁹⁴ Guidelines on horizontal agreements, par. 208.

²⁹⁵ *European Council of Manufacturers of Domestic Appliances* [2000] OJ L 187/47. See Jones, A. and Sufrin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, pp. 817-818.

4.3.2 – Article 101 TFEU and the Consumer Welfare Standard

As noted above, the role of welfare standards depends to a large extent on the nature and degree of case-by-case analysis that is required in the enforcement of the competition rules. With respect to the welfare standard that is applied in the treatment of buyer collusion, it is therefore important to look at the formulation of Article 101 TFEU. As noted above, Article 101 TFEU requires a number of conditions to be satisfied for conduct to fall under the general prohibition of Article 101(1), whereas the legal exception of Article 101(3) also stipulates four criteria.²⁹⁶

Article 101(1) does not stipulate which welfare standard is to be applied but instead requires five conditions to be satisfied for conduct to fall under its scope: (i) the existence of undertakings (or associations of undertakings), (ii) an agreement between undertakings (or a decision by an association of undertakings or a concerted practice), (iii) the object or effect to prevent, restrict or distort competition, (iv) an appreciable effect on competition and (v) an appreciable effect on trade between Member States. With regard to the welfare standard that is applied under Article 101(1), especially the third condition, which requires that firm conduct has the object or effect to restrict competition, is of importance. As noted above, this distinction is important since once it has been established that conduct has as its object the restriction of competition, there is no need to assess its concrete effects in that stage of the analysis, whereas it requires extensive case-specific analysis whether conduct has as its effect the restriction of competition. In its case law, the ECJ has held that certain types of coordination reveal a sufficient degree of harm to competition that it may be found that there is no need to examine their effects.²⁹⁷ This presumption of anti-competitive effects is based on *inter alia* experience showing that restrictions of competition by object are likely to produce negative effects on the market, such as price fixing and market sharing.²⁹⁸

This does not imply, however, that the exercise of establishing that conduct restricts competition by object does not involve any case-by-case analysis at all. Pursuant to the recent judgement by the ECJ on September 11th 2014 in *Cartes Bancaires*, the concept of restriction of competition by object must not be interpreted restrictively.²⁹⁹

²⁹⁶ See Section 4.2.1.

²⁹⁷ See Case 56/65, *Société La Technique Minière (STM) v. Maschinenbau Ulm GmbH*, [1966] ECR 235, par. 359-360; Case C-209/07, *Beef Industry Development Society and Barry Brothers* [2008] ECR I-08637.

²⁹⁸ Case C-8/08, *T-Mobile Netherlands BV, KPN Mobile NV, Orange Nederland NV and Vodafone Libertel NV v. Raad van Bestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR I-45290. See also Guidelines on the application of Article 101(3), par. 21.

²⁹⁹ Case C-67/13 P, *Groupement des cartes bancaires (CB) v. European Commission*, not yet published.

According to the ECJ, “[t]he concept of restriction of competition ‘by object’ can be applied only to certain types of coordination between undertakings which reveal a sufficient degree of harm to competition that it may be found that there is no need to examine their effects, otherwise the Commission would be exempted from the obligation to prove the actual effects on the market of agreements which are in no way established to be, by their very nature, harmful to the proper functioning of normal competition”.³⁰⁰ This judgement indicates that establishing that conduct has as its object the restriction of competition does require some case-specific analysis as to the effects on competition.

While Article 101(1) therefore does not prescribe the application of a specific welfare standard, it is important to note that the European Commission appears to apply the consumer welfare standard in its enforcement practice. Indeed, in its decision-making practice, the Commission motivates its strict treatment of buyer cartels by the likelihood of harmful effects on the downstream market. In *Italian Raw Tobacco*, for instance, the Commission stressed that “the processors’ purchasing cartel had the potential to affect the producers’ willingness to generate output and thus reduce global tobacco production to the *ultimate detriment of consumers* [emphasis added]”.³⁰¹ However, it has been noted above that although buyer cartels typically harm consumer welfare, this is not necessarily always the case.³⁰² Since consumers are not necessarily directly affected by monopsony power, in particular when there is no market power on the output market, a requirement of consumer harm might lead to the failure to prohibit specific buyer cartels that may however inflict substantial harm to economic efficiency. That is, if application of the consumer welfare standard implies that firm cooperation can only fall under Article 101(1) if harm to consumer welfare is established, this approach might lead to underenforcement of anti-competitive buyer cooperation when there is no market power on the output market (Type II error).

In this context, it is however important to note the judgement by the European Court of Justice in *T-Mobile*. In this case, which specifically involved input price fixing, the ECJ specifically held that harm to consumer welfare is not a necessary requirement for establishing that conduct has as its object the restriction of competition.³⁰³ The *T-Mobile* case is shortly elaborated upon in Box 32.

³⁰⁰ Case C-67/13 P, *Groupement des cartes bancaires (CB) v. European Commission*, not yet published, par. 58.

³⁰¹ Case COMP/C.38.281/B.2, *Raw Tobacco Italy*, par. 282.

³⁰² See Subsection 3.3.1.

³⁰³ Case C-8/08, *T-Mobile Netherlands BV, KPN Mobile NV, Orange Nederland NV and Vodafone Libertel NV v. Raad van Bestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR I-45290. See also Gerbrandy, A. (2010), ‘Case Note, Case C-8/08’, *Common Market Law*

Box 32: Input price fixing and harm to consumers

In *T-Mobile*, the ECJ was asked to give a preliminary ruling on a concerted practice amongst mobile operators concerning the fixing of the remunerations they paid for the services supplied to them by dealers. Here, the referring court inquired whether the concerted practice may be considered to have as its object the restriction of competition, since it related neither to consumer prices nor to subscription tariffs paid by consumers and was therefore unlikely to affect consumers.

The ECJ, however, emphasised that “it is apparent from Article [101(1)a TFEU] that concerted practice may have an anti-competitive object if they ‘directly or indirectly fix purchase or selling prices or any other trading conditions’”, and that “in order to find that a concerted practice has an anti-competitive object, there does not need to be a direct link between that practice and consumer prices”.³⁰⁴ The approach that for conduct to be placed in the ‘object category’ it is not necessary to consider harm to final consumers was moreover confirmed by the ECJ in *GlaxoSmithKline*.³⁰⁵

The *T-Mobile* judgement indicates that it is not necessary to establish a link between a certain practice and consumer welfare in order to establish that conduct has as its object the restriction of competition. This mitigates the concern for underenforcement of anti-competitive cooperation that may specifically arise in the scenario in which there is no market power on the output market.

A possible explanation for focus on consumer welfare under Article 101(1) stems from the formulation of Article 101(3), which does make an explicit reference to consumer welfare. That is, the legal exception of Article 101(3) only applies to conduct (which falls under the scope of Article 101(3) and) that satisfies four cumulative criteria: (a) it leads to an improvement of the production or distribution of goods or a promotion of technical or economic progress, (b) it allows consumers a fair share of the resulting benefit, (c) the restrictions of competition are indispensable for the benefit and (d) the restrictions of competition must not afford firms the possibility of eliminating competition. Although the requirement that consumers obtain a ‘fair share’ of the benefit leaves some room for interpretation, the Commission expresses the view that

Review, 47, pp. 1199-1220; Ezrachi, A. (2012), ‘Buying Alliances and Input Price Fixing: In Search of a European Enforcement Standard’, *Journal of Competition Law & Economics*, 8(1), pp. 47-71.

³⁰⁴ Case C-8/08, *T-Mobile Netherlands BV, KPN Mobile NV, Orange Nederland NV and Vodafone Libertel NV v. Raad van Bestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR I-4529, par. 36-39.

³⁰⁵ Case C-501/06 P, *GlaxoSmithKline v. Commission* [2009] ECR I-9291.

efficiency gains should be passed on to (intermediate or final) consumers. More specifically, in its Guidelines on the application of Article 101(3) and Guidelines on horizontal agreements, the Commission stresses that efficiency gains of agreements that fall under Article 101(1) must result in a net benefit to consumers. The relevant sections on the Commission's interpretation of Article 101(3) and its application to agreements between rival buyers are discussed in Box 33.

Box 33: Treatment of efficiency gains under Article 101(3) TFEU

“The concept of ‘fair share’ implies that the pass-on of benefits must at least compensate consumers for any actual or likely negative impact caused to them by the restriction of competition found under Article [101(1)]. In line with the overall objective of Article [101] to prevent anti-competitive agreements, the net effect of the agreement must at least be neutral from the point of view of those consumers directly or likely affected by the agreement. If such consumers are worse off following the agreement, the second condition of Article [101(3)] is not fulfilled. The positive effects of an agreement must be balanced against and compensate for its negative effects on consumers. When that is the case consumers are not harmed by the agreement. Moreover, society as a whole benefits where the efficiencies lead either to fewer resources being used to produce the output consumed or to the production of more valuable products and thus to a more efficient allocation of resources.”³⁰⁶

“Efficiency gains, such as cost efficiencies or qualitative efficiencies in the form of the introduction of new or improved products on the market, attained by indispensable restrictions must be passed on to consumers to an extent that outweighs the restrictive effects of competition caused by the joint purchasing arrangement. Hence, cost savings or other efficiencies that only benefit the parties to the joint purchasing arrangement will not suffice. Cost savings need to be passed on to consumers, that is to say, the parties’ customers. To take a notable example, this pass on may occur through lower prices on the selling markets. Lower purchasing prices resulting from the mere exercise of buying power are not likely to be passed on to consumers if the purchasers together have market power on the selling markets and thus do not meet the criteria of Article 101(3). Moreover, the higher the market power of the parties on the selling market or markets, the less likely they will pass on the efficiency gains to consumers to an extent that would outweigh the restrictive effects on competition.”³⁰⁷

³⁰⁶ Guidelines on the application of Article 101(3), par. 85.

³⁰⁷ Guidelines on horizontal agreements, par. 219.

Box 33 indicates that the reference in Article 101(3) to consumers is typically interpreted, at least by the Commission,³⁰⁸ as a prescription to use the consumer welfare standard in the treatment of efficiency gains. This implies that any potential efficiency gains of agreements (which fall under the scope of Article 101(1)) must at least also benefit consumers. As noted above, the application of the consumer welfare standard generally does not lead to different results than the total welfare standard and can moreover have important advantages, such as the reduction of enforcement costs. However, the requirement of Article 101(3) that efficiency gains (e.g. cost savings) benefit consumers might induce the European Commission to ignore efficiency gains that are not passed on. This might especially be an obstacle for agreements between rival buyers that realise mostly fixed cost savings, which may for instance arise due to a reduction in the number of production plants. The prescription of the consumer welfare standard in Article 101(3) might therefore result in the wrongful prohibition of conduct that does not harm economic efficiency, and hence induce overenforcement (Type I error).

4.3.3 – Conclusion

The competition concern of collusion amongst rival buyers can be addressed under Article 101 TFEU. On various occasions, the European Commission and the Court have recognised the potential harmful effects of agreements amongst rival buyers and found cooperation between rival buyers to be incompatible with Article 101 TFEU. The Commission and the Court, however, also recognise that cooperation amongst buyers can also promote economic efficiency. Presumably for these reasons, the European Commission has indicated that it is unlikely to target joint purchasing arrangements between firms with a market share lower than 15 percent on both input and output markets (but only if they do not have as their object the restriction of competition), thereby mitigating regulation costs, most notably enforcement costs and legal uncertainty.

While Article 101 TFEU provides a legal basis for addressing the potential competition concern of buyer collusion, a critical comment is in place concerning the welfare standard that is applied. Whereas Article 101(1) does not prescribe a specific welfare standard, the European Commission appears to apply the consumer welfare standard in its enforcement practice. However, since anti-competitive buyer cooperation does not necessarily directly harm consumers, in particular when there is no market power on

³⁰⁸ See, however, Gerbrandy, A. (2013), ‘Duurzaamheidsbelangen in het mededingingsrecht’, *Nederlands tijdschrift voor Europees recht*, 9, pp. 326-332, who stresses inter alia that the Commission’s interpretation need not imply that other interpretations are incorrect.

the output market, the application of the consumer welfare standard under Article 101(1) might lead to underenforcement of anti-competitive buyer cooperation (Type II error) if this implies that harm to consumers is considered a necessary requirement for conduct to fall under Article 101(1). In this context, it is therefore important to note that the European Court of Justice has specifically held in its *T-Mobile* judgement that it is not necessary to establish a link between a certain practice and consumer welfare in order to establish that conduct has as its object the restriction of competition.

Application of the consumer welfare standard under Article 101(1) may be motivated by the formulation of article 101(3), which does appear to stipulate the consumer welfare standard with regard to the treatment of efficiency gains. That is, Article 101(3) requires that any potential efficiency gains of agreements that fall under the scope of Article 101(1)) must at least also benefit consumers. This implies that efficiency gains that are not passed on, a scenario that may for instance arise when buyer collusion realises mere fixed cost savings, will be ignored under Article 101(3). The consumer welfare prescription of Article 101(3) TFEU might therefore result in the prohibition of conduct that does not harm economic efficiency (i.e. a Type I error).

4.4 – Exclusionary Buyer Conduct

The second category of anti-competitive buyer conduct that has been identified is exclusionary conduct. Exclusionary conduct concerns the ability of a firm with a (very) high degree of buyer power to exclude a rival buyer or to deter a potential entrant from that or an adjacent market. Exclusionary conduct by a buyer may involve various practices that are largely interchangeable. For instance, when foreclosure is targeted at a rival buyer, a firm may choose between a variety of strategies such as exclusivity contracts, fidelity rates or predatory buying. Alternatively, when exclusionary conduct is aimed at a firm operating on an adjacent market, the excluding firm might for example resort to refusal to deal, tying or reciprocal dealing. However, many practices that might, at least from an intuitive perspective, appear to be anti-competitive are often in fact not harmful and may well promote economic efficiency.³⁰⁹

The treatment of exclusionary conduct in EU competition law is dispersed. Exclusionary conduct falls under the scope of Article 102 TFEU if it concerns unilateral behaviour. Vertical restraints (or agreements) are however generally addressed under Article 101 TFEU. This section analyses whether exclusionary conduct by a buyer can be addressed in EU competition law. Subsection 4.4.1 shortly discusses the treatment of exclusionary conduct in EU competition law. Subsection

³⁰⁹ See Subsection 3.4.2.

4.4.2 entails a more elaborate analysis on the welfare standard that is applied and discusses its implications.

4.4.1 – Addressing Exclusionary Buyer Conduct

The treatment of exclusionary conduct in EU competition law is dispersed. This is because Article 102 TFEU typically addresses unitary conduct, whereas the application of Article 101 TFEU requires an agreement between multiple firms, that is, a concurrence of wills between at least two parties.³¹⁰ As a result, vertical restraints such as exclusive dealing or similar arrangements are typically dealt with within the framework of Article 101. It should, however, be noted that the application of Article 101 to vertical restraints – including the legal exception of Article 101(3) – is without prejudice to the application of Article 102.³¹¹

Article 101 TFEU can apply to exclusionary conduct if this involves an agreement between undertakings (or a decision by an association of undertakings or a concerted practice). Article 101 may therefore specifically apply to exclusivity contracts such as exclusive distribution, selective distribution, most-favoured-customer clauses and resale price maintenance.³¹² In its Guidelines on Vertical Restraints, the European Commission specifically recognises that these practices may lead to competition problems that have been identified within the context of buyer power. For instance, the Commission notes its concern that these practices might under specific circumstances lead to the anti-competitive foreclosure of other distributors. This also holds for obligations concerning exclusive supply (sell only to one buyer), upfront access payments (fees to obtain access to the distribution network, e.g. ‘slotting allowances’) and exclusive customer allocation (sell to only one distributor for resale to a particular group of customers).³¹³ However, the Commission also stresses that these vertical restraints typically promote economic efficiency when the parties involved have

³¹⁰ Case T-41/96, *Bayer AG v. Commission* [2000] ECR II-3383, par. 69. This was confirmed on appeal in Cases C-2/01 P and C-3/01 P, *Bundesverband der Arzneimittel-Importeure eV and Commission v. Bayer AG* [2004] ECR I-23.

³¹¹ Joined Cases C-395/96 P and C-396/96 P, *Compagnie Maritime Belge* [2000] ECR I-1365, par. 130.

³¹² However, in its Guidance Paper on Article 102, the Commission stresses that its treatment of ‘exclusive dealing’ also applies to situations in which a dominant undertaking tries to foreclose its competitors by hindering them from purchasing from suppliers (so-called ‘input foreclosure’). See Guidance Paper on Article 102, par. 32 ff.

³¹³ See Guidelines on Vertical Restraints, par. 151, 168, 193, 204, 224. See also European Commission (2009), *Competition in the food supply chain*, Commission staff document SEC(2009)1449 accompanying the Communication *A better functioning food supply chain in Europe*, COM(2009)591 final, pp. 23-25.

relatively little market power. Accordingly, as a general rule, the Verticals Regulation exempts all vertical restraints from the scope of Article 101(1), when both the supplier's and the buyer's market share do not exceed the 30% threshold.³¹⁴ This exception does, however, not apply to so-called 'hardcore restrictions' such as resale price maintenance, for which the Commission applies the presumption that they infringe Article 101(1) and moreover do not qualify for the criteria of Article 101(3).³¹⁵

Most forms of exclusionary conduct are, however, typically addressed under Article 102 TFEU. A peculiar characteristic of Article 102 is, however, that it requires that there is a so-called 'dominant' position. Although the finding of 'dominance' is therefore a key factor in the enforcement of Article 102, the concept itself has no clear economic meaning.³¹⁶ That is, although settled case law has made it clear that 'dominance' refers to market power ('economic strength'),³¹⁷ it is not clear what makes a dominant position special from the ability to exercise (a degree of) market power. The explanation that 'dominance' allows a firm to act 'independently' from 'its competitors, its customers and ultimately of the consumers' (though only to 'an appreciable extent') is neither concrete nor very meaningful since it is not clear why a firm would have an economic interest to act independently of its suppliers and customers (of which it purchases necessary inputs from and to which it sells its output to). The Court's interpretation that 'dominance' involves the ability to 'prevent effective competition from being maintained' provides a more substantive economic meaning since it may (and may be specifically meant to) refer to that specific degree of market power, on that specific market, that allows a firm to engage in exclusionary conduct. However, since this would imply that 'dominance' simply means the ability to engage in exclusionary conduct ('abuse'), it has been argued that there is no substantive need for a separate assessment of 'dominance' and 'abuse'.³¹⁸

³¹⁴ See Article 2 and 3 of the Verticals Regulation.

³¹⁵ Since the treatment of resale price maintenance in U.S. antitrust law is, since 2007, much more lenient, this listing as 'hardcore restriction' is relatively controversial. For a discussion, see e.g. Peeperkorn, L. (2009), 'Resale Price Maintenance and its Alleged Efficiencies', *European Competition Journal*, 4(1), pp. 201-212.

³¹⁶ See also Azevedo, J.P. and Walker, M. (2002), 'Dominance: Meaning and Measurement', *European Competition Law Review*, 23(7), pp. 363-367. The lack of a clear economic meaning of 'dominance' moreover raises the question of what is meant by the term 'super-dominance', a term that has been introduced so to describe a level of market power that goes above and beyond that of a position of 'dominance'. See e.g. Cases C-395 and 396/96 P, *Compagnie Maritime Belge Transports SA v. Commission* [2000] ECR I-1365, Opinion of Fennelly AG, par. 137.

³¹⁷ See e.g. Case 85/76, *Hoffmann-La Roche & CO AG v. Commission* [1979] ECR 461, par. 38.

³¹⁸ Gual, J., Hellwig, M., Perrot, A., Polo, M., Rey, P., Schmidt, K. and Stenbacka, R. (2005), *An economic approach to Article 82*, Report by the Economic Advisory Group for Competition Policy (EAGCP).

However, although the concept of dominance may not have clear separate economic meaning, the requirement of separately assessing ‘dominance’ does also have its benefits. This is because the ability to engage in exclusionary conduct typically requires very specific market characteristics, such as substantial barriers to entry, which allow the firm that is concerned a (very) high degree of market power.³¹⁹ Moreover, exclusionary conduct typically requires incurring a short term sacrifice in the form of an economic loss (or lower profit), so that firms may often not have an incentive to engage in such practices. The separate requirement of ‘dominance’ therefore has important advantages in the context of regulation costs. As noted by Werden, the dominance requirement functions as an important screen that filters cases in which harm to economic efficiency is unlikely, such as when firms have relatively low market shares.³²⁰ The dominance requirement therefore provides legal certainty to the majority of firms that operate on markets on which exclusionary conduct is unfeasible and moreover reduces assessment costs in the enforcement of Article 102.

As noted above, Article 102 may apply to various practices that, as noted above, may from an economic perspective be largely interchangeable. After all, whereas Article 102 sets out certain practices what abuse ‘may, in particular, consist in’, this list is illustrative, not exhaustive. Within the specific context of buyer conduct (on an input market), exclusionary conduct may concern practices that are analogues to exclusionary conduct by a seller (on an output market).³²¹ Box 34 discusses the treatment of various buyer practices within the context of Article 102.

Box 34: Exclusionary buyer conduct under Article 102 TFEU

Fidelity rates usually involve a firm granting customers whose purchases exceed a certain threshold a rebate on additional purchases (incremental rebates) or on all purchases (retroactive rebates). The Commission emphasises that fidelity rates can promote economic efficiency, though it can in specific situations also lead to foreclosure of a rival.³²² The Commission moreover recognises that fidelity rates can have similar effects on an input market. In *British Airways*, for instance, the Commission held a bonus scheme applied in the purchase of travel agents services to have exclusionary effects and established an infringement of

³¹⁹ See Subsection 3.4.2.

³²⁰ Werden, G.J. (2006), ‘Competition Policy on Exclusionary Conduct: Toward an Effects-Based Analysis’, *European Competition Journal*, 2, pp. 53-67.

³²¹ See Section 3.4.2.

³²² Guidance Paper on Article 102.

Article 102 on the input market.³²³ The Commission decision was upheld by the GC and the ECJ.

Predation is also addressed under Article 102. In its Guidance Paper on Article 102, the Commission explains that it will intervene where there is evidence showing that a dominant undertaking engages in predatory conduct, since this will lead to foreclose of actual or potential rivals.³²⁴ While the case law on predation has mainly involved predation on the output market, in the form of predatory pricing,³²⁵ it is conceivable that an analogous application of Article 102 can be expected within the context of predation on an input market: predatory buying. Indeed, in Annex 1 to the Staff Working Document accompanying its White Paper on Sport, the Commission points out within the context of buying sports media rights that in cases where dominance exists at the acquisition market, under certain circumstances the acquisition and use of exclusive sports media rights could constitute an abuse of dominance by the buyer within the meaning of Article 102.³²⁶

Refusal to deal on the buying side of a market has been sparsely dealt with within the context of Article 102. One leading case – which concerns a landmark case in the development of the so-called ‘essential facilities’ concept in EU competition law – is the *Bronner* case.³²⁷ In this case, the ECJ assessed access to a distribution network for newspaper delivery and set out four factors that would have to be present before refusal to the distribution network could amount to an abuse. According to the ECJ, the refusal should (i) be likely to eliminate all downstream competition, (ii) be incapable of objective justification, whereas (iii) access to the network must be indispensable and (iv) there must be no actual or potential substitute to it.³²⁸ These criteria were not satisfied in *Bronner*. Besides refusal to deal (or refuse to grant access), it seems conceivable that EU competition law can also challenge conduct that has an equivalent effect. Indeed, in its Guidelines on Vertical Restraints, as well as in its 2009

³²³ *Virgin/British Airways* [2000] OJ L30/1; Case T-219/99, *British Airways v. Commission* [2003] ECR II-5917; Case C-95/04 P, *British Airways v. Commission* [2007] ECR I-2331. See Subsection 4.4.2.

³²⁴ Guidance Paper on Article 102, par. 63.

³²⁵ See e.g. Case C-62/86, *AKZO Chemie BV v. Commission* [1991] ECR I-3359.

³²⁶ European Commission (2007), *The EU and Sport: Background and Context*, Commission Staff Working Document SEC(2007)935 accompanying the White Paper on Sport, COM(2007)391 final.

³²⁷ Case C-7/97, *Oscar Bronner GmbH & Co KG v. Mediaprint* [1998] ECR I-7791.

³²⁸ Case C-7/97, *Oscar Bronner GmbH & Co KG v. Mediaprint* [1998] ECR I-7791, par. 41. For a discussion, see e.g. Jones, A. and Sufrin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, pp. 491-495.

publication on competition in the food supply chain,³²⁹ the Commission specifically notes that it is aware that upfront access payments (e.g. slotting allowances) might result in foreclosure of other suppliers.³³⁰

Tying (and bundling) is typically addressed under Article 102.³³¹ In its Guidance Paper on Article 102, the Commission discusses the competition concern of tying (and bundling). While acknowledging that tying (and bundling) are common practices that can well promote economic efficiency, the Commission also recognises that these practices might also allow a dominant undertaking to foreclose its competitors. The Commission discusses that it will intervene when a dominant undertaking's tying practice (i) involves distinct products and (ii) is likely to lead to anti-competitive foreclosure. An example in the case law, though in the context of seller power, is the *Microsoft* case, which involved the tying of Windows Media Player to the operating system Windows.³³² While reciprocal dealing is not specifically discussed by the Commission in its Guidance Paper, it is conceivable that the Commission's approach will be similar.

It is perhaps remarkable to note that *British Airways* is one of very few cases (if not the only one) that has been explicitly recognised as a case involving abusive behaviour by a dominant *buyer* on an *input market*.³³³ However, as noted above, the identification of a 'buyer' or 'seller' (and hence buyer or seller power) requires a distinction between 'input' and 'output' markets, which may be very difficult in practice. Indeed, in *British Airways*, the market on which British Airways was found to have a dominant position as a buyer – the purchase of airline travel agency services – is relatively easily conceptually reframed as a market in which British Airways is a seller of tickets to downstream retailers, which act as an intermediary for final consumers. The potential difficulties in distinguishing between seller and buyer power (of course together with

³²⁹ European Commission (2009), *Competition in the food supply chain*, Commission staff document SEC(2009)1449 accompanying the Communication *A better functioning food supply chain in Europe*, COM(2009)591 final, p. 24.

³³⁰ Guidelines on Vertical Restraints, par. 205. As noted above, vertical restraints including upfront access payments are generally exempted under the Verticals Regulation from the scope of Article 101(1), when both the supplier's and the buyer's market share does not exceed the 30% threshold.

³³¹ According to the Commission, bundling usually refers to the way products are offered and priced by the dominant undertaking, which can have similar effects as tying. See Guidance Paper on Article 102, par. 47-62.

³³² See Case T-201/04 *Microsoft v. Commission* [2007] ECR II-3601.

³³³ *Virgin/British Airways* [2000] OJ L30/1; Case T-219/99, *British Airways v. Commission* [2003] ECR II-5917; Case C-95/04 P, *British Airways v. Commission* [2007] ECR I-2331. See O'Donoghue, R. and Padilla, A.J. (2006), *The Law and Economics of Article 82*, Oxford: Hart Publishing, pp. 165-166.

the conclusion that the effects of buyer power on economic efficiency are the mirror image of the efficiency effects of seller power) form important arguments for a symmetric treatment of exclusionary conduct on input and output markets.³³⁴ This implies that legal concepts and principles that are used in the seller power context to assess whether conduct by a firm with a dominant firm amounts to ‘abusive’ behaviour, may be applied analogously in the buyer power context.

However, it should be noted that an analogous interpretation of legal concepts in the seller power context to the buyer power context may lead to confusion that may give rise to imperfect decision making. An illustrative and relatively recent example from U.S. antitrust law concerns the controversial *Weyerhaeuser* case.³³⁵ In *Weyerhaeuser*, the U.S. Supreme Court extended its settled price-cost test for predation on an output market (predatory pricing) to the buyer side of a market and found aggressive buying of an input to violate Subsection 2 of the Sherman Act, since this allowed foreclosure of a rival buyer in order to obtain a monopsony on the input market (predatory buying). The case has been subject to substantial criticism that states that the Supreme Court failed to correctly assess the specific context of exclusionary conduct by a buyer on an input market.³³⁶ The case is shortly discussed in Box 35.

Box 35: Predatory buying in *Weyerhaeuser*

In *Weyerhaeuser*, two firms (*Weyerhaeuser* and *Ross-Simmons*) purchased alder logs on the spot market as raw material for their lumber processing business, the output of which was sold on the market for hardwood finished lumber. While *Weyerhaeuser* enjoyed considerable buyer power on the (local) input market, it did not have any seller power on its (national) output market. *Weyerhaeuser* was held to infringe Subsection 2 of the Sherman Act by bidding up the prices of alder logs as part of a plan to drive *Ross-Simmons* out of the market and to gain a monopsony.

³³⁴ Schwartz, M. (2004), ‘Should Antitrust Assess Buyer Market Power Differently than Seller Market Power’, Paper Presented at DOJ/FTC Workshop on Merger Enforcement, Washington DC.

³³⁵ *Weyerhaeuser v. Ross-Simmons Hardwood Lumber Co.* 127 S. Ct. 1069 (2007).

³³⁶ For a discussion, see e.g. Hylton, K.N. (2008), ‘Weyerhaeuser, predatory bidding and error costs’, *The Antitrust Bulletin*, 53(1), pp. 51-73; Kirkwood, J.B. (2008), ‘Controlling Above-Cost Predation: An Alternative to Weyerhaeuser and Brooke Group’, *The Antitrust Bulletin*, 53(2), pp. 369-410; Haglund, M.E. (2008), ‘Weyerhaeuser’s aftermath: increased vulnerability of resource-based input markets to monopsony’, *The Antitrust Bulletin*, 53(2), pp. 411-453; Blair, R.D. and Harrison, J.L. (2010), *Monopsony in Law and Economics*, Cambridge: Cambridge University Press, pp. 76-78.

In its judgement, the Supreme Court noted the parallel between predatory pricing and predatory buying. That is, the Supreme Court noted that in both the predatory pricing and predatory bidding contexts there are two stages of the predation strategy: a predation period, in which the dominant predator suffers losses, and then a recoupment phase, in which the gains from exclusion are reaped. In its decision, the Supreme Court applied the settled two-prong standard (the so-called *Brooke Group* standard) for predatory pricing – below-cost pricing (predation) and the exercise of monopoly power (recoupment) – to predatory buying.

An analogous application of this standard to the buying context would require the demonstration of purchasing in input for a price above marginal revenue product (predation) followed by a period of exercising monopsony power (recoupment). However, the Supreme Court instead focused its assessment of the predation period on the output market; the Court required proof that the alleged predatory bidding led to *below-cost pricing of the predator's outputs*. This standard is, however, underinclusive. After all, a firm that pays in excess of the marginal product for an input may be able to sell its output at above-cost pricing, for instance when it has monopoly power on its output market.

4.4.2 – Article 102 TFEU and the Consumer Welfare Standard

The role of welfare standards in the enforcement of exclusionary conduct largely depends on the nature and degree of case-by-case analysis that is required in EU competition law. Compared to Article 101 TFEU, which is already assessed above and will therefore not be analysed in this section,³³⁷ Article 102 TFEU requires a relatively high degree of case-specific analysis in order to establish an infringement. As noted above, Article 102 contains the following elements: (i) the existence of one or more undertakings, (ii) the presence of a dominant position, (iii) the dominant position must be located within the internal market (or a substantial part of it), (iv) the dominant position is abused and (v) there is an appreciable effect on trade between Member States. Especially the establishment of ‘dominance’ and ‘abuse’ require substantial case-specific analysis.

With respect to the welfare standard that is applied under Article 102 TFEU, the condition that requires the ‘abuse’ of a dominant position is of particular importance. Whereas the formulation of the provision does not prescribe the application of a specific welfare standard, the European Commission seems to focus in its enforcement of Article 102 on the effects of specific practices on consumer welfare. Indeed, in its

³³⁷ See Section 4.3.2.

Guidance Paper on Article 102 TFEU, the European Commission states that its enforcement practice focuses on situations “where effective access of actual or potential competitors to supplies or markets is hampered or eliminated as a result of the conduct of the dominant undertaking whereby the dominant undertaking is likely to be in a position to profitably increase prices *to the detriment of consumers* [emphasis added]. The identification of likely consumer harm can rely on qualitative and, where possible and appropriate, quantitative evidence”.³³⁸

The general approach outlined by the Commission in its Guidance Paper indicates that it applies the consumer welfare standard in the enforcement of Article 102 TFEU. However, as noted above, the application of the consumer welfare standard may have an important disadvantage in the context of exclusionary conduct by a buyer. This is because the monopsony power that may be created (or strengthened or maintained) by exclusionary buyer conduct never benefits consumers but does not necessarily impose direct harm to consumer welfare. More specifically, when there is no market power on the output market, the exercise of monopsony power on an input market does not directly affect consumers in the output market.³³⁹ Consequently, a requirement under Article 102 to establish consumer harm might therefore lead to the failure to prohibit exclusionary conduct by a buyer (i.e. Type II error).

However, it is important to note that the *British Airways* case that has been concisely discussed above provides for an important indication that the European Commission does not take the position that consumer harm is a necessary requirement for a violation of Article 102 TFEU. That is, the Commission specifically held in *British Airways* that proof of consumer harm is no necessary requirement in the enforcement of Article 102. The decision by the European Commission was moreover upheld by the General Court and the European Court of Justice. The European Courts moreover explicitly stressed that “Article [102 TFEU] is aimed not only at practices which may cause prejudice to consumers directly, but also at those which are detrimental to them through their impact on an effective competition structure”.³⁴⁰

The position taken by the European Commission, the General Court and the European Court of Justice in *British Airways* indicate that harm to consumer welfare is not a necessary requirement for establishing a violation of Article 102 TFEU. This mitigates

³³⁸ Guidance Paper on Article 102 TFEU, par. 19.

³³⁹ See Subsection 3.3.1.

³⁴⁰ Case C-95/04 P, *British Airways v. Commission* [2007] ECR I-2331, par. 106. It should be noted, however, that the Commission decision in *British Airways* has been subject to substantial criticism, inter alia because there was no clear evidence of exclusionary effects (competitors had even gained market share).

the above-mentioned concern of underenforcement of exclusionary conduct by a buyer on an input market. The rulings in *British Airways* concerning the requirement of consumer harm have moreover been recently reiterated by the General Court in its decision on June 12th 2014 in *Intel*.³⁴¹ Although the judgement by the General Court in *Intel* concerns practices that may be interpreted as ‘seller conduct’, it is important since it moreover provides an important indication of the limits of the (relatively high) degree of case-specific analysis that is required under Article 102.³⁴² That is, although the text of Article 102 TFEU does not mention a dichotomy between ‘object’ or ‘effect’ that can be found in Article 101 TFEU, the judgement indicates that a distinction should be made between certain types of ‘abuse’ where a negative effect can be presumed (e.g. exclusivity rebates) and types of ‘abuse’ where such effects have to be proven (e.g. price abuses).³⁴³ The case is concisely discussed in Box 36.

Box 36: The *Intel* judgement by the General Court

In *Intel*, the European Commission considered that Intel abused its dominant position on the worldwide market for x86 CPUs from October 2002 to October 2007, by implementing a strategy aimed at foreclosing from the market its only serious competitor, Advanced Micro Devices, Inc. (AMD). According to the Commission, Intel had abused its dominant position in particular because of granting rebates to four major computer manufacturers (Dell, Lenovo, HP and NEC) on the condition that they purchased from Intel all or almost all of their x86 CPUs. Similarly, Intel awarded payments to Media-Saturn, which were conditioned on its selling exclusively computers containing Intel’s x86 CPUs. The Commission considered that Intel’s conduct resulted in a reduction of consumer choice and in lower incentives to innovate and imposed a fine of €1.06 billion. Intel brought an action against the Commission’s decision before the General Court, seeking the annulment of that decision or, at least, a substantial reduction of the fine.

In its judgement, the General Court has upheld the Commission’s decision and considered that none of the arguments raised by Intel supports the conclusion that the fine imposed is disproportionate. According to the GC, the rebates granted by Intel amount to ‘exclusivity rebates’, which involve

³⁴¹ Case T-286/09, *Intel v. European Commission*, not yet published.

³⁴² For a discussion, see e.g. Wils, W.P.J. (2014), ‘The judgment of the EU General Court in *Intel* and the so-called “more economic approach” to abuse of dominance’, *World Competition*, 37(4), pp. 405-434.

³⁴³ See also Italianer, A. (2014), ‘The Object of Effects’, speech delivered on the CRA Annual Brussels Conference – Economic Developments in Competition Policy, December 10th 2014. Available on: http://ec.europa.eu/competition/speeches/text/sp2014_07_en.pdf (last visited January 31st 2015).

“rebates the grant of which is conditional on the customer’s obtaining all or most of its requirements from the undertaking in a dominant position”.³⁴⁴ Moreover, the GC stated that “exclusivity rebates granted by an undertaking in a dominant position are by their very nature capable of restricting competition”.³⁴⁵ Accordingly, the GC held that the Commission is “not required to prove a causal link between the practices complained of and actual effects on the market” and moreover that “the Commission is *not required to prove either direct damage to consumers or a causal link between such damage and the practices at issue in the contested decision [emphasis added]*”.³⁴⁶ Intel has appealed to the GC judgement.³⁴⁷

The *Intel* judgement indicates that the need for case-by-case assessment under Article 102 TFEU is limited (although this appears to vary per type of ‘abuse’). Although this may mitigate regulation costs, such as information and assessment costs, this may also increase the risk that conduct is caught under Article 102 even though it does not harm economic efficiency (Type I error). However, it is important to note that, although Article 102 does not contain a legal exception similar to Article 101(3), the Court has developed the concept of ‘objective justification’ pursuant to which otherwise abusive conduct may escape a violation of Article 102.³⁴⁸ In the case law on Article 102, the possible grounds for objective justification include the protection of an undertaking’s own commercial interests (the ‘meeting competition defence’),³⁴⁹ when the conduct concerned is necessary to protect legitimate public interest objectives (such as health or safety)³⁵⁰ and because the conduct creates efficiency gains that outweigh the anti-competitive effects.³⁵¹

With regard to the treatment of potential efficiency gains, the European Commission explains in its Guidance Paper on Article 102 TFEU that it follows a similar approach as it does under Article 101 TFEU. That is, the dominant undertaking will need to demonstrate with a sufficient degree of probability and on the basis of verifiable evidence that the conduct (i) creates efficiency gains, such as technical improvements in the quality of goods or a reduction in the cost of production or distribution, (ii) is

³⁴⁴ Case T-286/09, *Intel v. European Commission*, not yet published, par. 76.

³⁴⁵ Case T-286/09, *Intel v. European Commission*, not yet published, par. 85.

³⁴⁶ Case T-286/09, *Intel v. European Commission*, not yet published, par. 104-105.

³⁴⁷ Case C-413/14 P, *Intel v. European Commission*, not yet decided.

³⁴⁸ See e.g. Jones, A. and Sufrin, B. (2011), *EU Competition Law*, Oxford: Oxford University Press, pp. 376-382.

³⁴⁹ Case 27/76, *United Brands v. Commission* [1978] ECR 207, par. 184.

³⁵⁰ Case T-83/91 *Tetra Pak International v. Commission (Tetra Pak II)* [1994] ECR II-755, par. 83-84 and 138.

³⁵¹ Case C-95/04 P, *British Airways v. Commission* [2007] ECR I-2331.

indispensable to the realisation of those efficiencies, (iii) realises efficiencies that outweigh any likely negative effects on competition and consumer welfare in the affected markets and (iv) does not eliminate effective competition, by removing all or most existing sources of actual or potential competition.³⁵² The condition that potential efficiencies must outweigh any likely effect on competition and consumer welfare suggests that the Commission applies the consumer welfare standard in the assessment of efficiency gains, similar to its approach under Article 101 TFEU. The *British Airways* case moreover suggests that the European Court of Justice also applies this approach because it ruled that assessment of objective justification (for a system of discounts or bonuses) involves the determination of “whether the exclusionary effect arising from such a system, which is disadvantageous for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency *which also benefit the consumer* [emphasis added]”.³⁵³

4.4.3 – Conclusion

The competition concern of exclusionary conduct by buyers can be addressed under Article 102 TFEU (concerning unilateral behaviour) and Article 101 TFEU (concerning vertical agreements). Indeed, in its Guidance Paper on Article 102 TFEU, as well as in its Guidelines on Vertical Restraints, the European Commission recognises its concerns for potential anti-competitive behaviour by a buyer on an input market. An interesting observation is that *British Airways* is one of very few cases (if not the only one) that has been explicitly recognised as a case involving abusive behaviour by a dominant buyer on an input market. This does not necessarily imply that the legal framework is difficult to apply to the buyer power context. Because of the need for a symmetric treatment of exclusionary conduct on input and output markets, legal concepts and principles that are used in the seller power context may be applied analogously in the buyer power context in order to assess whether conduct by a dominant buyer is considered ‘abusive’.

In its enforcement of Article 102 TFEU, the European Commission focuses on the effects of specific practices on consumer welfare. The European Commission therefore appears to apply the consumer welfare standard in its treatment of exclusionary conduct under Article 102 TFEU. However, since economic theory suggests that the monopsony power that may be created (or strengthened or maintained) by exclusionary buyer conduct does not necessarily directly harm consumer welfare, the application of the consumer welfare might lead to the failure to prohibit exclusionary conduct by a

³⁵² Guidance paper on Article 102, par. 30.

³⁵³ Case C-95/04 P, *British Airways v. Commission* [2007] ECR I-2331, par. 86.

buyer (i.e. Type II error). However, in *British Airways*, the European Commission, the General Court and the European Courts of Justice held that it is not necessary to establish harm to consumer welfare in order for conduct to violate Article 102 TFEU. This mitigates the concern of underenforcement of exclusionary conduct by a buyer on an input market.

Although Article 102 TFEU does not contain a legal exception similar to Article 101(3) TFEU, the Court has developed the concept of ‘objective justification’ pursuant to which otherwise abusive conduct may escape a violation of Article 102. One important ground for potential objective justification is when the conduct creates efficiency gains. The approach towards potential efficiency gains under Article 102 TFEU is similar as under Article 101(3) TFEU. That is, in order to potentially qualify as an ‘objective justification’, the efficiency gains must at least also benefit consumers. Since this implies that efficiency gains should be ignored if they do not (directly) benefit consumers, this approach might therefore result in the prohibition of conduct that does not harm economic efficiency (i.e. a Type I error).

4.5 – Mergers That Involve Buyer Power

The third type of business conduct that may amount to anti-competitive behaviour are mergers. Mergers allow firms to take away the business of another firm at the price of a transaction and can also give rise to buyer power concerns. However, the likelihood that a merger actually increases market power depends to a large extent on whether a merger involves direct rivals (horizontal mergers) or firms operating on different stages in the production chain (vertical mergers). Horizontal mergers are typically much more likely to be harmful than vertical mergers. Both horizontal and vertical mergers can, however, provide scope for substantial efficiency gains.³⁵⁴

Mergers are addressed under the EU Merger Regulation. This section analyses whether the potential harmful effects of mergers that involve buyer power can be addressed under the current legal framework. Subsection 4.5.1 shortly discusses the treatment of horizontal and vertical mergers that involve buyer power. Subsection 4.5.2 discusses the welfare standard that is applied in the context of EU merger control and analyses its implications.

³⁵⁴ See Subsection 3.4.3.

4.5.1 – Addressing Mergers That Involve Buyer Power

Both horizontal and vertical mergers are addressed under the EU Merger Regulation (Council Regulation 139/2004).³⁵⁵ Article 2(1) EUMR stipulates various factors that the European Commission must take into account in its enforcement of the EU Merger Regulation, including the market position of the undertakings concerned, barriers to entry and potential efficiency gains. Article 2(3) of the EU Merger Regulation declares concentrations with a Community dimension which would significantly impede effective competition in the common market (or a substantial part of it), in particular as a result of the creation or strengthening of a dominant position, to be incompatible with the common market. The European Commission explains its approach towards horizontal and vertical mergers in its Horizontal Merger Guidelines and its Non-Horizontal Merger Guidelines, respectively.

The formulation of Article 2(3) suggests that there is a legal basis for the Commission to take into account both potential harmful effects and potential efficiencies of mergers. A peculiar characteristic of Article 2(3), however, is its specific reference to the creation or strengthening of a ‘dominant position’. Due to the relatively unclear meaning of the concept of ‘dominance’, the question arises whether all potential harmful effects are taken into account. After all, whether or not a merger harms economic efficiency depends on whether it increases market power and whether the corresponding (potential) harmful effects are not compensated for by overriding efficiency gains. It is from an economic efficiency perspective not relevant whether a merger creates or strengthens to the presence of ‘dominance’.³⁵⁶ That is, if only mergers would be assessed when they create or strengthen ‘dominance’, there is a risk of underenforcement of harmful mergers (Type II error). However, the formulation in Article 2(3) that the creation or strengthening of a dominant position may ‘in particular’ provide for evidence of a significant impediment of effective competition implies that also mergers that do not create or strengthen ‘dominance’ may be assessed, thereby mitigating the risk of underenforcement. Indeed, in its Guidelines on Horizontal Mergers, for instance, the European Commission notes that the presence of a dominant position is a primary form of competitive harm but that the relevant factors taken into account are not a ‘checklist’ that is to be mechanically applied in each and every case.³⁵⁷ Instead, the Commission stresses that the competitive analysis in a particular case will be based on an overall assessment of the foreseeable impact of the merger in the light of the relevant factors and conditions, which may inter alia involve

³⁵⁵ Council Regulation 139/2004 of 20 January 2004 on the control of concentrations between undertakings (hereafter Merger Regulation) [2004] OJ L124/1.

³⁵⁶ See Subsection 4.4.2.

³⁵⁷ See e.g. the Horizontal Merger Guidelines, par. 2 and 13.

an assessment of market shares and concentration thresholds, the likelihood of anti-competitive effects, possible countervailing market power, the likelihood of entry and the likelihood of efficiency gains.³⁵⁸

With regard to horizontal mergers, the European Commission specifically mentions in its Horizontal Merger Guidelines that not only seller power but buyer power, too, may form a specific concern.³⁵⁹ According to the Commission, a merger that creates or strengthens the market power of a buyer may significantly impede effective competition, in particular by creating or strengthening a dominant position. The Commission stresses that the merged firm may be in a position to obtain lower prices by reducing its purchase of inputs. The Commission therefore explicitly recognises the risk that the merged entity may enjoy monopsony power. However, the Commission also recognises that mergers can promote economic efficiency, for instance because it can allow firms to lower input costs without restricting downstream competition or total output (i.e. countervailing buyer power).³⁶⁰ For the Commission to take account of efficiency claims in its assessment of a merger and be in a position to reach the conclusion that as a consequence of efficiencies there are no grounds for declaring the merger to be incompatible with the common market, the efficiencies have to benefit consumers, be merger-specific and be verifiable. These conditions are cumulative.³⁶¹ The Commission has assessed various mergers in which increased buyer power was an important concern. Box 37 shortly discusses three of these cases.³⁶²

Box 37: Leading European retail merger cases involving buyer power

In *Kesko/Tuko*, the Finnish Office of Free Competition had requested the Commission to assess the acquisition of Tuko Oy by Kesko Oy, two leading Finnish supermarket chains.³⁶³ Following this acquisition, the Commission found that Kesko would hold a market share of at least 55 %

³⁵⁸ See e.g. the Horizontal Merger Guidelines, par. 11 ff.

³⁵⁹ Horizontal Merger Guidelines, par. 61-63.

³⁶⁰ See e.g. Case IV/M.1225, *Enso/Stora* [1999] OJ L254/9; Case IV/M.833, *The Coca-Cola Company/Carlsberg A/S* [1998] OJ L145/41.

³⁶¹ Horizontal Merger Guidelines, par. 78.

³⁶² For a more thorough discussion, see also e.g. Mazzarotto, N. (2001), 'Competition Policy Towards Retailers: Size, Seller Market Power and Buyer Power', CCR Working Paper CCR 01-4; Ware, R. and Blakney, J.F. (2006), 'Efficiencies analysis for Retail Sector Mergers', *European Competition Journal*, 2(2), pp. 285-310; Doyle, C. and Inderst, R. (2007), 'Some Economics on the Treatment of Buyer Power in Antitrust', *European Competition Law Review*, 28(3), pp. 210-219; Ezrachi, A. (2010), 'Unchallenged Market Power? The Tale of Supermarkets, Private Labels and Competition Law', *World Competition*, 33(2), pp. 257-274; Pera, A. and Bonfitto, V. (2011), 'Buyer Power in anti-trust investigations: a review', *European Competition Law Review*, 32(8), pp. 414-425.

³⁶³ Case IV/M.784, *Kesko/Tuko* [1997] OJ L10/53.

of the Finnish market for retail of daily consumer goods (the output market). The Commission considered that this market share would moreover result in a very high degree of buyer power in the corresponding input market. As an indication of the magnitude of the merged entity's buyer power, the Commission stressed that the majority of the suppliers had indicated that they depend on Kesko and Tuko for approximately 50 to 75% of their total sales in Finland. While it was for many suppliers of vital interest to maintain sales through Kesko, the Commission pointed out that Kesko will not be dependent on any individual supplier to the same extent. Since there was no remedy available to allow the transaction to take place, the Commission declared the acquisition incompatible with the common market.

In *Rewe/Meinl*, the Commission examined the merger of Austrian food retailers Rewe and Meinl.³⁶⁴ In this case, the Commission stressed that retail trade has a close interdependence between the input and the output market. According to the Commission, retailers' shares of the distribution market determine their procurement volume: the bigger the retailer's share of the distribution volume, the larger the procurement volume. The Commission identified 19 product categories and that in at least 10 of those markets the merger would give rise to a state of 'dependence', which the Commission identified as a situation in which 22% of suppliers' turnover volume depended on a single buyer. While final consumers may benefit from the process in the short run, the Commission argued that this could give rise to a spiral effect up until a dominant position would arise in the distribution market, thereby reducing the intensity of competition. The deal was eventually approved after it was agreed that the transaction were limited to 162 out of Meinl's 341 outlets.

In *Carrefour/Promodès*, the Commission assessed a merger between French retailers Carrefour and Promodès.³⁶⁵ Although the merger would result in a post-merger market share on the distribution market of 30%, the Commission was specifically concerned about the buyer power the merger would create and that suppliers may be put in a position of economic dependence (meaning that a supplier's business with the merged entity accounted for more than 22% of revenues). The Commission asserted that economic dependency would arise in four out of 23 markets. Pursuant to the proposed divestiture of Carrefour's 40% shareholdings in Cora (another retailer operating in France), the Commission declared the merger compatible with the common market.

³⁶⁴ Case IV/M.1221, *Rewe/Meinl* [1999] OJ L274/1.

³⁶⁵ Case COMP/M.1684, *Carrefour/Promodès* [2000] OJ C164/5.

The cases discussed above indicate that the competition concerns of horizontal mergers that involve buyer power can be addressed under EU competition law and that the European Commission recognises that mergers between rivals may not only give rise to seller power concerns but also to buyer power concerns. While the above-mentioned cases are all in the EU supermarket sector, it should be noted that these concerns may also arise in other sectors. An example concerns the decision by the European Commission on October 19th 2014 in *Liberty Global/Ziggo*.³⁶⁶ Here, the Commission had concerns that the proposed acquisition of Dutch cable TV operator Ziggo by Liberty Global would hinder competition in the Dutch market for the wholesale of premium Pay TV film channels but was also worried about the increased buyer power by Liberty Global vis-à-vis TV channel broadcasters. Regarding the latter concern, the Commission was specifically concerned that the acquisition would hinder innovation in the delivery of audiovisual content over the Internet (so-called over-the-top or ‘OTT’ services). The acquisition was eventually approved after Liberty Global’s offering to sell Film1, its premium Pay TV film channel and to terminate clauses in channel carriage agreements that limit broadcasters’ ability to offer their channels and content over the Internet.

With regard to vertical mergers, the European Commission explains its approach in its Non-Horizontal Merger Guidelines. In its Guidelines, the Commission stresses that vertical mergers are less likely to significantly impede effective competition than horizontal mergers.³⁶⁷ More specifically, the Commission explicitly acknowledges, firstly, that vertical mergers do not entail the loss of direct competition and therefore are less likely to have anti-competitive effects and, secondly, that vertical mergers can provide substantial scope for efficiencies. Nevertheless, the Commission also recognises that vertical mergers can harm economic efficiency and explicitly refers to both input foreclosure and customer foreclosure as the main competition concerns.³⁶⁸ The Commission explains that it will consider both the possible anti-competitive effects arising from the merger and the possible pro-competitive effects stemming from efficiency gains. With regard to potential (input or customer) foreclosure, the Commission explains that it will examine, first, whether the merged entity would have, post-merger, the ability to foreclose, second, whether it would have the incentive to do so and, third, whether a foreclosure strategy would have significant detrimental effect

³⁶⁶ Case COMP/M.7000, *Liberty Global/Ziggo*, not yet published. For the press release, see http://europa.eu/rapid/press-release_IP-14-1123_en.htm (visited on January 11th 2015).

³⁶⁷ Non-Horizontal Merger Guidelines, par. 11-14 and par. 52-57.

³⁶⁸ The Commission also considers that vertical integration might make it easier for firms on the market to reach collusive outcomes, see Non-Horizontal Merger Guidelines, par. 79 ff. For an economic perspective, see e.g. Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 359-362.

on competition, while taking into account efficiencies substantiated by the merging parties. When assessing efficiencies, the Commission has the same approach as it has in its treatment of horizontal mergers.³⁶⁹ Box 38 discusses an example from the Commission's practice concerning vertical integration.

Box 38: Vertical integration in *TomTom/Tele Atlas*

In *TomTom/Tele Atlas*, the Commission examined a proposed acquisition by TomTom, the market leader in the provision of navigable digital maps and production of navigation devices, of Tele Atlas, one of two providers of navigable digital maps offering a complete coverage of Europe and North America.³⁷⁰ The Commission considered that navigable digital maps are essential inputs for production navigation devices. In light of the duopoly market for navigable digital maps and TomTom's strong position in the market for production navigation devices, the Commission engaged in an in-depth investigation to assess whether the merger would lead to a significant impediment to effective competition.

In its assessment, the Commission analysed whether the merged entity had the ability and the incentive to increase the cost for other producers of production navigation devices (input foreclosure). The Commission found that the merged entity would be unlikely to pursue this strategy. First, the merged entity's ability to restrict access to digital maps would be limited by the presence of an upstream competitor (Navteq). Second, the Commission found that the merged entity would moreover had no incentive to restrict access to the input because the corresponding loss in (input) sales would not be compensated by additional (output) sales of production navigation devices. As a result, the Commission concluded that the proposed concentration would not raise competition concerns and therefore cleared the merger.

4.5.2 – The EU Merger Regulation and the Consumer Welfare Standard

Since the role of welfare standards largely depends on the nature and degree of case-by-case analysis that is required in the enforcement of mergers, it is important to look at the formulation of the substantive provisions in the EU Merger Regulation. With respect to the welfare standard in the assessment of mergers, especially Article 2 EUMR is of importance. Article 2(3) EUMR states that “[a] concentration which would significantly impede effective competition, in the common market or in a

³⁶⁹ Non-Horizontal Merger Guidelines, par. 52-57.

³⁷⁰ Case COMP/M.4854, *TomTom/Tele Atlas* [2008] C237/8.

substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market”.

Although Article 2 EUMR contains no prescription of a specific welfare standard for assessing anti-competitive effects, the European Commission appears to focus in its enforcement practice on the effects on consumer welfare. In its *Kesko/Tuko*, *Rewe/Meinl* and *Carrefour/Promodès* decisions that are discussed above, the European Commission stressed that due to the interconnection between input and output markets, the increase in buyer power could reinforce market power on the output market and thus harm consumer welfare.³⁷¹ This approach corresponds with the finding in economic theory that mergers that involve buyer power and that harm economic efficiency will generally also adversely affect consumers. However, it also raises the question whether the Commission will also assess potential anti-competitive effects in the absence of consumer harm. After all, as noted above, economic theory also suggests that the harmful effects of monopsony power that may be created (or strengthened or maintained) by mergers may not have a direct impact on consumers, in particular when there is no market power on the output market. Consequently, if the application of the consumer welfare standard under the EUMR implies that harm to consumer welfare is considered a necessary requirement in order to establish a significant impediment of competition, this approach could induce the underenforcement of mergers that create, strengthen or maintain monopsony power (Type II error).

While the European Commission explicitly recognises in its Horizontal Merger Guidelines that mergers may also give rise to buyer power concerns, it does not conclusively answer whether it considers consumer harm a necessary requirement for establishing a significant impediment to effective competition. According to the Commission, pursuant to a horizontal merger, “[t]he merged firm may be in a position to obtain lower prices by reducing its purchase of inputs. This may, in turn, lead it also to lower its level of output in the final product market, and thus harm consumer welfare”.³⁷² This text suggests that while the Commission explicitly recognises the risk that a merger may create (or strengthen or maintain) monopsony power, its most prominent concern appears to be that this leads to a lower level of output in the final product market, thereby adversely affecting consumer welfare.

³⁷¹ Case IV/M.784, *Kesko/Tuko* [1997] OJ L10/53; Case IV/M.1221, *Rewe/Meinl* [1999] OJ L274/1; Case COMP/M.1684, *Carrefour/Promodès* [2000] OJ C164/5.

³⁷² Horizontal Merger Guidelines, par. 61.

However, it is in this context relevant to note the European Commission's contribution for the 2008 OECD Roundtable on Monopsony and Buyer Power.³⁷³ Here, the Commission stated that the "ultimate end user of any product – the consumer – should be at the centre of competition law" and that it should therefore specifically address buyer power in the presence of consumer harm.³⁷⁴ However, the Commission also explicitly noted that "[i]n some cases a firm may possess buyer power upstream vis-à-vis its suppliers but not also possess market power downstream. For example, when the geographic boundaries of the upstream and downstream markets differ, the merged entity may hold buyer power, without having any market power as a subsequent seller".³⁷⁵ Furthermore, the Commission also explained that it had handled such a case in practice: the *Sovion/Südfleisch* case.³⁷⁶ This case is concisely discussed in Box 39.

Box 39: The *Sovion/Südfleisch* merger case

In *Sovion/Südfleisch*, the Commission examined the proposed acquisition by Dutch firm Sovion of German company Südfleisch. Both firms were active in the slaughtering of pigs and cattle, the processing, production and sale of meat products. Since the Commission found that the merger did not lead to competition concerns in any of the merged entity's output markets, the Commission's assessment focused its investigation on the input markets for the slaughtering of pigs and cattle, in particular in Bavaria. More specifically, the Commission verified whether the merged entity could exercise monopsony power, that is whether it would be able to depress the price paid to farmers delivering pigs to slaughterhouses by reducing its purchases.

In its assessment of the case, the Commission analysed the possible alternatives of upstream suppliers. That is, the Commission analysed to what extent farmers (and other suppliers) could supply to other slaughterhouses in Southern Germany and Austria. The Commission found that sufficient spare capacity was available; any attempt to depress input prices below the competitive level would induce farmers to switch to alternative slaughterhouses in neighbouring parts of Austria. The Commission therefore concluded that the transaction did not allow the merged entity to exercise monopsony power and declared the merger compatible with the common market.

In its contribution for the 2008 OECD Roundtable on Monopsony and Buyer Power, as well as in its approach in the *Sovion/Südfleisch* merger, the European Commission thus

³⁷³ OECD (2008), *Roundtable on Monopsony and Buyer Power*, pp. 255-265.

³⁷⁴ OECD (2008), *Roundtable on Monopsony and Buyer Power*, pp. 255-256.

³⁷⁵ OECD (2008), *Roundtable on Monopsony and Buyer Power*, pp. 256-257.

³⁷⁶ Case COMP/M.3968, *Sovion/Südfleisch* [2006] OJ C124/33.

recognised that there may be a need to assess potential anti-competitive effects of a merger involving buyer power in the absence of harm to consumer welfare, in particular when there is no market power on the output market. This indicates that the Commission is conscious of the risk that an approach that considers consumer harm a necessary requirement for establishing a significant impediment to effective competition might induce underenforcement of anti-competitive mergers (Type II error). However, since the Commission's Horizontal Merger Guidelines do not clearly state that the Commission may analyse anti-competitive effects of mergers involving buyer power in the absence of consumer harm, there appears to be a discrepancy with the Commission's actual approach. It seems advisable to clarify the Guidelines and thereby mitigate the potential regulation costs that may arise due to for instance legal uncertainty.

In this context, an example may perhaps be taken from recent developments in the United States.³⁷⁷ In 2010, the U.S. Department of Justice and the Federal Trade Commission issued a revised version of their Horizontal Merger Guidelines in which it was (inter alia) specified that horizontal mergers that involve buyer power are not evaluated strictly, or even primarily, on the basis of the downstream effects in which the merging firms sell and that the consumer welfare is thus not applied. As Stucke notes, this is remarkable because it appears that “[...] the United States – a leading cheerleader of the consumer welfare objective – does not use consumer welfare to screen buyer-power claims”.³⁷⁸ The approach towards horizontal mergers involving buyer power under U.S. antitrust law is further elaborated upon in Box 40.

Box 40: Horizontal mergers between buyers in U.S. antitrust law

In their 1992 and 1997 Horizontal Merger Guidelines, the U.S. Department of Justice and the Federal Trade Commission explained that their approach towards mergers that may involve monopsony power essentially followed an analytical framework analogous to the framework applied to mergers involving monopoly power. The guidelines, however, did not explain what an analogous application would imply in practice, nor did it specify whether this would specifically imply whether the consumer welfare standard was always applied.

³⁷⁷ See Carstensen, P.C. (2012), ‘Buyer Power and the Horizontal Merger Guidelines: Minor Progress on an Important Issue’, *University of Pennsylvania Journal of Business Law*, 14(3), pp. 775-821; Stucke, M.E. (2013), ‘Looking at Monopsony in the Mirror’, *Emory Law Journal*, 62, pp. 1509-1562; Heyer, K. (2012), ‘Welfare Standards and Merger Analysis Revisited’, *Competition Policy International*, 8(1).

³⁷⁸ Stucke, M.E. (2013), ‘Looking at Monopsony in the Mirror’, *Emory Law Journal*, 62, p. 1546.

In the 2010 revision of the Horizontal Merger Guidelines, the Department of Justice and the Federal Trade Commission (inter alia) specifically elaborated upon its approach towards mergers involving buyer power. The new guidelines specifically state that horizontal mergers that involve buyer power are not evaluated strictly, or even primarily, on the basis of the downstream effects in which the merging firms sell and moreover provide for an example in which the consumer welfare standard is not applied.

“The Agencies do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power. Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell.

Example 24: Merging Firms A and B are the only two buyers in the relevant geographic market for an agricultural product. Their merger will enhance buyer power and depress the price paid to farmers for this product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. *These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output* [emphasis added].³⁷⁹

A final remark concerning the use of welfare standards in the EU Merger Regulation concerns the treatment of efficiency gains, which may outweigh potential anti-competitive effects and induce the Commission to conclude that a merger is compatible with the common market. While Article 2(1) of the EU Merger Regulation stipulates various factors that the Commission must take into account but which do not severely limit the Commission’s discretionary margin, such as the market position of the undertakings concerned and barriers to entry, it however also limits the extent to which efficiencies may be taken into account. That is, Article 1(b) EUMR stipulates that the Commission shall take into account “[...] the development of technical and economic progress *provided that it is to consumers’ advantage* and does not form an obstacle to competition” [emphasis added]. In correspondence with Article 101(3) TFEU, the EU Merger Regulation therefore prescribes the application of the consumer welfare standard concerning the treatment of efficiency gains. This implies that efficiency gains are only taken into account if they lead to a net benefit to consumer welfare. However, as noted above, not all efficiency gains are necessarily passed on to

³⁷⁹ U.S. Department of Justice and the Federal Trade Commission (2010), *Horizontal Merger Guidelines*, pp. 32-33.

consumers, in particular when they involve fixed cost savings. Indeed, in its Horizontal Merger Guidelines, the European Commission explains that “[i]n line with the need to ascertain whether efficiencies will lead to a net benefit to consumers, cost efficiencies that lead to reductions in variable or marginal costs are more likely to be relevant to the assessment of efficiencies than reductions in fixed costs; the former are, in principle, more likely to result in lower prices for consumers”.³⁸⁰ The consumer welfare prescription concerning the assessment of efficiency gains therefore induces the Commission to disregard efficiency gains that are not passed on and might therefore result in the wrongful prohibition of mergers that do not harm economic efficiency and thus result in overenforcement (Type I error).

4.5.3 – Conclusion

The competition concerns of both horizontal and vertical mergers can be addressed under the EU Merger Regulation. In its Horizontal Merger Guidelines and Non-Horizontal Merger Guidelines, the European Commission acknowledges that both merger types may pose competition concerns but also recognises that horizontal mergers are much more likely to cause anti-competitive effects than vertical mergers. In various horizontal merger cases in the European retail sector, such as in *Kesko/Tuko*, *Rewe/Meinl* and *Carrefour/Promodes*, the European Commission has specifically analysed the likelihood of anti-competitive effects due to an increase in buyer power. Moreover, in its Horizontal Merger Guidelines, the European Commission explicitly states its concern that horizontal mergers may allow the merged entity to exercise monopsony power, and thus depress the input price below the competitive level by reducing purchases. However, the European Commission also recognises that both horizontal and vertical mergers may bring about substantial efficiency gains and stresses that its merger appraisal involves a careful assessment on inter alia the likelihood of both potential anti-competitive effects and efficiency gains.

While the EU Merger Regulation therefore provides a legal basis for addressing the potential competition concern of mergers that involve buyer power, a critical comment is in place concerning the welfare standard that is applied. Although the EU Merger Regulation does not prescribe a specific welfare standard for the assessment of anti-competitive effects, the European Commission appears to apply the consumer welfare standard in its enforcement practice. However, since the monopsony power that is created (or strengthened or maintained) by a merger does not necessarily directly affect consumers, there is a risk of underenforcement of anti-competitive mergers (Type II error) if application of the consumer welfare standard implies that harm to consumer

³⁸⁰ Horizontal Merger Guidelines, par. 80.

welfare is considered a necessary requirement in order to establish a significant impediment to competition. Its contribution for the 2008 OECD Roundtable on Monopsony and Buyer Power, as well as its approach in the *Sovion/Südfleisch* merger, however, suggests that the European Commission is aware of this risk since it explicitly recognised that there may be a need to assess potential anti-competitive effects of a merger involving buyer power in the absence of harm to consumer welfare.

While the European Commission may therefore refrain in specific cases from the application of the consumer welfare standard in its assessment of anti-competitive effects, it is obligated to apply the consumer welfare standard in its appraisal of efficiency gains in its merger control. This is because, in correspondence with Article 101(3) TFEU, the EU Merger Regulation prescribes the application of the consumer welfare standard concerning the treatment of efficiency gains. That is, Article 1(b) of the EU Merger Regulation stipulates that efficiency gains are only to be taken into account insofar they lead to a net benefit to consumers. However, since mergers may also give rise to efficiency gains that are not necessarily passed on to consumers, in particular when they give rise to fixed cost savings, this consumer welfare prescription in the EU Merger Regulation might in specific scenarios induce the Commission to wrongfully ignore specific efficiency gains and thus cause overenforcement (Type I error).

4.6 – Buyer Power and ‘Unfair’ Business Practices

The analysis in this chapter indicates that the legal framework of EU competition law is readily applicable to the context of buyer power. Moreover, the analysis leads to the observation that the competition concerns that have been identified – buyer collusion, exclusionary buyer conduct and mergers that involve buyer power – can be addressed under the current substantive legal framework of EU competition law. It can therefore be concluded that EU competition law provides for a legal basis to address the competition concerns of buyer power. While some critical comments have been made concerning in particular the application of the consumer welfare standard, the analysis therefore does not give rise to the conclusion that the current substantive legal framework of EU competition law is unfit to address the (potential) harmful effects of buyer power.

While the analysis in this research focuses the effects of the potential presence of the market failure of market power on economic efficiency (economic welfare), it is important to note that other public interests may also warrant government

intervention.³⁸¹ Indeed, in the discussion on the treatment of buyer power, a key complaint is that the (alleged) imbalance in bargaining power between retailers and suppliers gives rise to business practices that are sometimes perceived as ‘unfair’. For this reason, this section concisely discusses the relationship between EU competition law and ‘unfair’ business practices. Section 4.6.1 concisely discusses the ability of EU competition law to take into account ‘fairness’. Section 4.6.2 concisely reflects on some considerations concerning additional policy measures.

4.6.1 – EU Competition Law and ‘Unfair’ Business Practices

This research addressed the questions of what the potential concerns of buyer power within the context of competition policy are and whether there is a legal basis in EU competition law to address these concerns. The analysis identified three categories of potential competition concerns – buyer collusion, exclusionary buyer conduct and mergers that involve buyer power – and moreover concluded that these can be addressed under the EU competition rules. While the analysis therefore does not lead to the conclusion that there is a ‘gap’ concerning the identified competition concerns, this does not imply that requests for amendments of EU competition law or other policy measures are necessarily illegitimate. While this research has limited its scope to an assessment of the effects of buyer power and the role of competition policy from the perspective of economic efficiency (economic welfare), other motives may also induce governments to intervene in markets.

Perhaps the most straightforward scenario in which additional policy measures may be called for concerns the scenario in which there is other market failure than market power. That is, while it has been explained that competition policy crucially relies on the premise that competition promotes economic efficiency and that competition policy may be warranted due to the potential presence of market power, the market mechanism may also be distorted in the presence of other market failures, such as externalities, information asymmetry or when products or services have public good characteristics.³⁸² The presence of (negative) externalities may imply, for instance, that firms’ actions adversely affect other parties (or e.g. the environment) but that the corresponding costs are not borne by these firms. Alternatively, the presence of information asymmetry may imply that sellers and buyers have different information on a specific product or service, which may for instance induce inefficient decision making. Since market failure may have the effect that competition does not necessarily

³⁸¹ See Section 1.5.

³⁸² See for example Gruber, J. (2011), *Public Finance and Public Policy*, New York: Worth Publishers.

promote economic efficiency, economic theory suggests that specific government policy instruments may be warranted in order to remedy market failure. However, since competition policy crucially relies on the premise that competition promotes economic efficiency, difficult questions may arise with respect to the role of competition policy when such remedies are not implemented. More specifically, in the absence of adequate remedies of (other) market failures, it may be important to assess the extent EU competition law is suitable to take into account these (other) market failures.³⁸³ Since this question does not appear to be the primary concern in the debate on the treatment of buyer power, this subject matter is outside the scope of this research.³⁸⁴

A scenario that is, however, particularly relevant within this research concerns the claims that the exercise of buyer power should be challenged because it allegedly amounts to ‘unfair’ conduct. In the debate on the appropriate treatment of buyer power, suppliers often complain that they are ‘exploited’ and that large retailers are ‘abusing’ their market position, for instance by demanding very low prices, demanding (retroactive) discounts or unilaterally changing contract terms.³⁸⁵ Such arguments, however, do not necessarily relate to economic efficiency. In fact, the ability of a buyer to obtain from its supplier(s) more favourable terms of trade, for instance by negotiating a lower input price or better contract terms, may well promote economic efficiency.³⁸⁶ However, requests for government intervention do not seem to be primarily based upon arguments related to economic efficiency but on a specific perception of ‘fairness’. Indeed, the concerns expressed by European Parliament often refer to practices exhibited by (large) retailers that are deemed ‘unfair’.³⁸⁷ In a 2012

³⁸³ See in this context Ottow, A.T. (2012), ‘Modernisering van het mededingingsrecht 2.0’, *Markt & Mededinging*, 1, pp. 1-3; Gerbrandy, A. (2013), ‘Duurzaamheidsbelangen in het mededingingsrecht’, *Nederlands tijdschrift voor Europees recht*, 9, pp. 326-332; Prosser, T. (2010), ‘EU competition law and public services’, in: Mossialos, E., Permanand, G., Baeten, R. and Hervey, T.K. (eds.), *Health Systems Governance in Europe*, New York: Cambridge University Press, pp. 315-336; Parlevliet, J. and Drahos, M. (2011), ‘Is mededingingsbeperking nodig voor duurzaamheid?’, *Markt & Mededinging*, 3, pp. 96-101; Bijl, P. de and Dijk, T. van (2012), ‘Mededingingsbeleid en publieke belangen: een economisch perspectief’, *Markt & Mededinging*, 4, pp. 149-156.

³⁸⁴ See Section 1.5.

³⁸⁵ See Section 1.4.

³⁸⁶ In this context, Inderst emphasises that late payments and seemingly opportunistic adjustments of terms of supply by retailers may, for instance, help to ensure that smaller suppliers satisfy the expected quality standards. Contractual restrictions would then backfire by leading to less instead of more efficiency. See Inderst, R. (2008), ‘The Economics of Buyer Power’, speech given at the OECD Roundtable on Monopsony and Buyer Power.

³⁸⁷ See e.g. European Parliament resolution of 10 March 2009 on the Reports on competition policy 2006 and 2007 (P6_TA(2009)0099); European Parliament resolution of 26 March 2009 on food prices in Europe (P6_TA(2009)0191); European Parliament resolution of 7 September 2010 on

resolution on ‘Imbalances in the food supply chain’, for instance, European Parliament makes explicit references to ‘unfair’ trading practices and specifically calls upon the Commission to address ‘unfair’ distribution of profits within the food chain, especially with regard to ‘adequate’ incomes for farmers.³⁸⁸

This raises the question whether and to what extent specific notions of ‘fairness’ may be taken into account in the application of EU competition law. Obviously, this depends on what is deemed ‘fair’ or ‘unfair’. If a specific notion of fairness merely implies that government intervention is only warranted if there is harm to economic efficiency, government actions will typically also promote that perception of ‘fairness’. That is, if the types of conduct that are perceived as ‘unfair’ would exactly match the categories of anti-competitive buyer conduct, such as buyer cartels, application of EU competition law may promote fairness. A more difficult situation may arise, however, when a specific conception of fairness calls for the prohibition of conduct that does not amount to anti-competitive conduct, and thus does not harm economic efficiency. More specifically, since the application of EU competition law typically requires that conduct leads to a ‘restriction of competition’ on the market, it is questionable that the competition rules provide for a legal basis to challenge all conduct that may at some point be perceived as ‘unfair’.

It is in this context, however, important to note that the category of ‘exploitative’ abuse that is recognised under Article 102 TFEU does make some references to ‘unfair’ conduct. From the wordings of Article 102, it appears that exploitative abuses may include: “directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions”. This suggests that Article 102 provides for a legal basis to prohibit specific types of ‘unfair’ conduct. However, conduct is only eligible to violate Article 102 when a firm is found to have a ‘dominant position’.³⁸⁹ Conduct exhibited by firms with a degree of market power that is less than what is required under the threshold of ‘dominance’ is therefore not caught under Article 102. It is moreover questionable how likely the European Commission is to intervene in cases with (alleged) ‘exploitative’ abuse. Indeed, in its enforcement practice, the Commission has

fair revenues for farmers: A better functioning food supply chain in Europe (P7_TA(2010)0302); European Parliament resolution of 17 February 2011 on rising food prices (P7_TA(2011)0071); European Parliament resolution of 19 January 2012 on the imbalances in the food supply chain (P7_TA(2012)0012).

³⁸⁸ European Parliament resolution of 19 January 2012 on the imbalances in the food supply chain (P7_TA(2012)0012).

³⁸⁹ See Kokkoris, I. (2009), *A Gap in the Enforcement of Article 82*, London: British Institute of International and Comparative Law, who argues that there is a gap concerning ‘exploitative’ abuse by non-dominant firms, such as charging ‘high’ or ‘low’ prices.

tilted the balance towards addressing exclusionary conduct.³⁹⁰ The Commission's decision-making practice concerning 'exploitative abuses' have been mainly an issue in cases involving the obligations imposed by national copyright collection societies and technology licensing agreements.³⁹¹ A very rare example in the buyer power context is the *CICCE* case. Here, the European Commission had received complaints that undertakings with exclusive broadcasting rights in France had paid unfairly low licence fees for the purchase of movies. The Commission dismissed the complaint and stated that the complainant had failed to provide sufficient evidence that the license fees that were paid amount to the abuse of a dominant position. However, the European Commission also did not deny that low prices could constitute an abuse. The case was upheld by the ECJ.³⁹²

Although Article 102 therefore appears to provide for some legal basis to address conduct that may be perceived as 'unfair', it is conceivable that the legal basis does not apply to all conduct that the complainants or (members of) European Parliament may perceive as 'unfair'. This may for instance especially apply to the concerns expressed by European Parliament with regard to 'unfair' practices exhibited by large retailers in business-to-business relations, such as late payments and other unilateral changes of contract terms. This may be because such practices may primarily affect the business-to-business relationship between seller(s) and buyer(s) but need not have an impact on the overall functioning on competition in the market.³⁹³ This corresponds with a conclusion in the 2012 report of the European Competition Network (ECN) on the EU food sector.³⁹⁴ The report provides information on recent activities carried out by both the European Commission and the national competition authorities in the EU food sector. Although national competition authorities identified the existence of certain practices linked to imbalances of market power between market players that are deemed 'unfair' by many stakeholders, the national competition authorities also found that most of these practices do not fall within the scope of competition rules at the EU level (or in most of the Member States).

³⁹⁰ European Commission (2011), 'Article 102 and Excessive Prices' in: OECD, *Excessive Prices*, DAF/COMP(2011)18, pp. 309-321.

³⁹¹ See O'Donoghue, R. and Padilla, A.J. (2006), *The Law and Economics of Article 82*, Oxford: Hart Publishing, pp. 639-658.

³⁹² Case 298/83, *Cicce v. Commission* [1985] ECR 1105.

³⁹³ See also Italianer, A. (2014), 'The Devil is in the Retail', speech delivered on the conference on the study 'The economic impact of modern retail on choice and innovation in the EU food sector', October 2nd 2014. Available on: http://ec.europa.eu/competition/speeches/text/sp2014_04_en.pdf (last visited January 25th 2015).

³⁹⁴ European Competition Network (2012), *ECN Activities in the Food Sector*, Report on competition law enforcement and market monitoring activities by European competition authorities in the food sector.

A similar difficulty in taking into account ‘fairness’ under EU competition law may arise when a specific perception of what is ‘fair’ warrants non-intervention, whereas the conduct concerns harms economic efficiency and is moreover caught under the competition rules. This in particular applies to the concern that is *inter alia* expressed by European Parliament with regard to ‘unfair’ distribution of profits in various distribution chains. While the exploitation of economies of scale and scope have been an important cause of the rise of large retailers, the resulting increased popularity amongst consumers may have also provided them with the potential ability to exercise buyer power. Although the ability to exercise buyer power may not harm but may even promote economic efficiency, in particular when it involves countervailing buyer power, this may also result in a reduction of suppliers’ profits below a level that they themselves think of as ‘fair’. In such a scenario, suppliers may want to engage in anti-competitive (seller) conduct in order to promote countervailing seller power and increase their own profits, for instance by engaging in price fixing (or merging). Such conduct, however, may typically be caught under Article 101(1) TFEU (and the EU Merger Regulation). It is moreover doubtful whether such conduct may satisfy the necessary conditions for application of the legal exception of Article 101(3) (or to consider that there efficiency gains that outweigh the harmful effects of a merger). An important reason for this is that efforts to promote ‘fair’ incomes for suppliers may not give rise to the necessary ‘efficiency gains’ (or, more precisely, ‘an improvement of the production or distribution of goods or a promotion of technical or economic progress’).³⁹⁵ Instead, supplier efforts to gain seller power by harming competition may well harm overall economic efficiency on a market, for instance because this can result in a spillover of market power onto another market or because this harms dynamic efficiency.³⁹⁶

4.6.2 – Policy Considerations

The analysis in the previous section indicates that there is a difficult relation between EU competition law and ‘fairness’ and that the competition rules may not be suitable to promote specific conceptions of ‘fairness’. That is, while Article 101, Article 102 and the EU Merger Regulation provide for a legal basis to address buyer collusion, exclusionary buyer conduct and mergers that involve buyer power, this legal basis does not necessarily extend to (all) practices that stakeholders may deem ‘unfair’. Because this might suggest that there is a ‘gap’ concerning the (potential) government motive to promote a specific perception of ‘fairness’ in a market, the EU legislator might

³⁹⁵ See Sections 4.3, 4.4 and 4.5.

³⁹⁶ With respect to countervailing market power considerations, see Section 3.5.1.

consider additional policy measures, either within or outside the context of EU competition law. This section discusses three policy considerations that may be relevant with regard to such measures.

The first consideration is related to the observation that many complaints on buyer power and requests for regulatory changes concern the exercise of buyer power, for instance by demanding low input prices or negotiating specific contractual obligations. As has been stressed above, however, the mere exercise of buyer power need not harm economic efficiency but may in fact promote economic efficiency for at least two reasons. First, the exercise of buyer power may promote economic efficiency if this involves countervailing buyer power that mitigates the harmful effects of seller power amongst suppliers. Second, the ability to exercise buyer power may also be a necessary requirement to promote dynamic efficiency. That is, firms may have gained buyer power in the competitive process because of superior efficiency, for instance because of investments aimed at utilising economies of scale or scope or in new cost-efficient technologies or products and processes. Since such investments are typically very risky and costly, they typically require firms' expectation to generate economic profit that well exceeds their costs. In both scenarios, policy measures aimed at challenging the exercise of buyer power can harm economic efficiency. Most notably, harm to economic efficiency may occur because of increased error costs associated with the prohibition of conduct that is not anti-competitive (Type I error). Moreover, additional policy measures to promote 'fairness' will presumably also increase the complexity of rules and increase regulation costs, most notably due to legal uncertainty and assessment costs. The observation that policy measures to promote 'fairness' may harm economic efficiency implies that there is a trade-off between efforts to promote 'fairness' and economic efficiency.

This criticism also specifically applies to Article 102 TFEU, which provides a legal basis to challenge dominant firms that charge prices that are 'too high' or 'too low' or use 'unfair' trading conditions.³⁹⁷ Challenging the exercise of market power can distort firms' ability to recoup – and consequently their incentives to invest in – more cost-efficient technologies and new products and processes.³⁹⁸ The prohibition of firm

³⁹⁷ See also Motta, M. (2004), *Competition Policy, Theory and Practice*, Cambridge: Cambridge University Press, pp. 69-70. See also Subsection 2.3.1.

³⁹⁸ In very specific circumstances, economic theory suggests that challenging the exercise of market power might not harm economic efficiency. This situation may occur when a market can be characterised as a 'natural monopoly' or 'natural monopsony', which generally implies that – due to for instance high and non-transitory entry barriers (or when there is a legal monopoly) – a firm's position as a single seller or buyer does not face any (potential) competitive pressure (i.e. the market is not 'contestable'). In such a scenario, the competitive process may not promote

conduct that merely involves charging prices that are for instance ‘too high’ or ‘too low’ (without there being exclusionary effects)³⁹⁹ therefore runs a risk of harming economic efficiency due to overenforcement (i.e. Type I error). Furthermore, Article 102 TFEU may increase regulation costs because of legal uncertainty and assessment costs. This is because deciding whether a price is ‘too high’ or ‘too low’ involves a substantial degree of arbitrariness. In practice, whether a price is abusive is based upon the relationship between the (marginal) cost and the ‘economic value’ of a product.⁴⁰⁰ However, it is in practice very difficult to acquire all relevant data and analyse this adequately, and even with this data available there may still be a lot of ambiguity on how the border line between reasonable and unreasonable deviations from marginal costs must be drawn (and whether marginal costs are the most appropriate measure for determining the competitive level). This border line is even less clear with respect to conduct that may fall under the, rather vague, category of ‘unfair’ trading conditions. In this context, it is interesting to note that the ability under Article 102 TFEU to challenge the mere exercise of market power stands in marked contrast with U.S. antitrust law, where the potential harm of challenging the exercise of market power has been explicitly acknowledged. This view is shortly discussed in Box 41.

Box 41: The exercise of market power in U.S. antitrust law

In antitrust law in the United States, Subsection 2 of the Sherman Act merely allows for a legal basis to challenge single-firm conduct in case of so-called ‘monopolisation’, that is exclusionary conduct. Accordingly, monopoly (or monopsony) pricing is, in itself, not illegal. The most important reason for this approach is the potential harmful effect on

economic efficiency and it might be possible to restore (some) allocative efficiency without (fully) distorting the firm’s investment incentives. Since such intervention typically requires very specific regulatory competences to be effective (e.g. the ability to impose price regulation), as well as highly detailed knowledge of a specific sector, its players and all relevant developments, economists often argue that this type of intervention is best left to specialised regulatory authorities and should therefore fall outside the scope of general competition policy. Only when there is no sector-specific regulator, challenging so-called ‘excessive’ prices within the context of competition policy might be a cost-effective alternative. See e.g. Gual, J., Hellwig, M., Perrot, A., Polo, M., Rey, P., Schmidt, K. and Stenbacka, R. (2005), *An economic approach to Article 82*, Report by the European Advisory Group on Competition Policy (EAGCP). Motta, M. (2007), ‘Excessive Pricing in Competition Law: Never say Never?’, in: *Konkurrensverket, The Pros and Cons of High Prices*, Kalmar: Lenanders Grafiska, pp. 14-46. For a discussion on targeting so-called ‘excessive’ pricing, see in particular Maier-Rigaud, F.P. (2012), *Excessive Prices*, OECD Best Practice Roundtables in Competition Policy October 2011.

³⁹⁹ It should be noted that charging very high or very low prices may also amount to exclusionary conduct, for instance because it is de facto equivalent to a refusal to deal or predatory pricing. See e.g. Case C-280/08 P, *Deutsche Telekom v. Commission* [2010] I-9555.

⁴⁰⁰ See e.g. Case 27/76, *United Brands v. Commission* [1978] ECR 207.

economic efficiency of challenging the exercise of market power. Indeed, in *Trinko*, the Supreme Court stated the following.

“The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices – at least for a short period – is what attracts ‘business acumen’ in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anti-competitive *conduct*.”⁴⁰¹

The second observation concerns the question of whether potential policy measures to address ‘unfair’ business practices should be taken inside or outside the sphere of EU competition law. As has been explained above, the enforcement of competition policy may require extensive case-by-case analysis of potential harmful and positive effects on economic efficiency. Although this may involve a careful balancing exercise between allocative, productive and dynamic efficiency, this exercise involves aspects that in effect amount to the broader concept of economic efficiency and are, for this reason, objectively comparable. That is, it should, in principle, be possible to establish objectively whether conduct is harmful to economic efficiency or not.⁴⁰² In order to ensure that EU competition rules are enforced effectively and objectively on the basis of legal and economic arguments, free from external influences such as lobbying and politics, it is generally accepted that the European Commission, as well as national competition authorities, should be independent.⁴⁰³

However, if the enforcement of EU competition law would require taking into account a specific conception of ‘fairness’, this could make the enforcement of the competition rules an exercise of a subjective (or political) nature.⁴⁰⁴ Firstly, whereas it is typically possible to assess objectively whether there is harm to economic efficiency, individuals may have very different perceptions of what is deemed ‘fair’ or ‘unfair’. Secondly, individuals may have very different valuations of a specific conception of ‘fairness’ (i.e. some individuals derive more well-being from a promotion of ‘fairness’ than

⁴⁰¹ *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004) (emphasis in original).

⁴⁰² However, because competition policy enforcement typically suffers from inter alia imperfect information, it is conceivable that absolute certainty as to the efficiency effects of firm conduct is unfeasible. This implies that competition policy is always imperfect. See also Section 2.4.

⁴⁰³ See e.g. Ottow, A.T. (2015), *Market and Competition Authorities: Good Agency Principles*, Oxford: Oxford University Press.

⁴⁰⁴ See in this context also Bijl, P. de and Dijk, T. van (2012), ‘Mededingingsbeleid en publieke belangen: een economisch perspectief’, *Markt & Mededinging*, 4, pp. 149-156.

others). Thirdly, there may be differences in individuals' willingness to sacrifice a certain degree of economic efficiency for an effort to promote fairness (e.g. there may be differences in consumers' willingness to pay for fairness). Because of this subjective (or political) nature of the trade-off with fairness, the question arises to what extent independent competition authorities have democratic legitimacy to decide what is 'fair' and how this is to be weighed against economic efficiency. Instead, it is conceivable that politicians would be of the opinion that it is not for independently institutionalised agencies such as (within) the Commission and national competition authorities to take into account 'fairness' but that such decisions should be taken at the political level.

In this context, it is interesting to note some indications that at least at the level of competition authorities there is some reluctance towards addressing 'unfair' business conduct within the sphere of competition law. In the 2012 report of the European Competition Network (ECN) on the EU food sector, various national competition authorities identified issues related to 'unfair' business practices but have proposed alternative solutions that may be more effective in addressing these than competition law, such as the application of national laws against unfair trading practices or the adoption of codes of conduct or good practices with effective enforcement mechanisms.⁴⁰⁵ Moreover, DG Competition Alexander Italianer reiterated this view in a speech and explained that such "laws are particularly designed to deal with fairness, rather than promoting competition".⁴⁰⁶ In this context, Italianer noted that the Commission is also already addressing this issue at a European level in the food supply chain. These initiatives are outside the context of EU competition law and on a voluntary, self-regulatory basis, instead of by means of binding regulation. Recent efforts at the EU level concerning 'unfair' business practices in the food supply chain are concisely discussed in Box 42.⁴⁰⁷

⁴⁰⁵ European Competition Network (2012), *ECN Activities in the Food Sector*, Report on competition law enforcement and market monitoring activities by European competition authorities in the food sector.

⁴⁰⁶ Italianer, A. (2014), 'The Devil is in the Retail', speech delivered on the conference on the study 'The economic impact of modern retail on choice and innovation in the EU food sector', October 2nd 2014. Available on: http://ec.europa.eu/competition/speeches/text/sp2014_04_en.pdf (last visited January 25th 2015).

⁴⁰⁷ See also OECD (2013), *Competition Issues in the Food Chain Industry*, pp. 107-119; European Commission (2014), *Tackling unfair trading practices in the business-to-business food supply chain*, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2014)472 final.

Box 42: Tackling ‘unfair’ business conduct in EU food supply chains

Following the concerns on alleged ‘unfair’ trading practices, an expert platform on business-to-business contractual practices was set up by the European Commission in 2010. This resulted in November 2011 in an agreement between all operators in the chain (through their European associations) on a code of good practices on the basis of principles such as predictability of changes in contract terms, responsibility for own entrepreneurial risk and justifiability of requests and charges. In September 2013, a voluntary framework for implementing the principles of good practice was launched (the Supply Chain initiative). In this initiative, individual companies may join once they comply with the principles of good practice. Individual disputes in business-to-business relations can, according to the framework and subject to certain conditions, be addressed by dispute resolution mechanisms, mediation and arbitration. Such disputes may include for instance demanding retroactive discounts, transferring unjustified or disproportionate risk to a contracting party or unilaterally terminating a commercial relationship without notice.

In July 2014, the European Commission published a Communication in which it does not foresee regulatory action at EU level but instead encourages stakeholders and Member States to tackle unfair business practices in an appropriate and proportionate manner, taking into account impact on stakeholders and consumer welfare and to engage in voluntary schemes and to promote effective redress.⁴⁰⁸ The Commission will monitor and assess the progress made by voluntary initiatives and the Member States. At the end of 2015, the Commission will present a report to the Council and the European Parliament and decide whether further action should be taken at EU level.

The third and final observation relates to the effectiveness of potential policy measures to curb ‘unfair’ business practices. In the debate on the treatment of buyer power, many complaints issued by suppliers concern specific types of behaviour that they deem ‘unfair’, such as late payments or unilateral and/or retroactive change of contract terms. Accordingly, it seems conceivable that potential policy measures will specifically address these specific ‘unfair’ business practices. Indeed, the laws on ‘abuse of economic dependency’ or ‘superior bargaining position’ that have, pursuant to the room given in Regulation 1/2003, been adopted in various Member States inter alia

⁴⁰⁸ European Commission (2014), *Tackling unfair trading practices in the business-to-business food supply chain*, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2014)472 final.

address the imposition of ‘unfair’ contract terms.⁴⁰⁹ Similarly, codes of conduct that aim for a reduction of ‘unfair’ business practices in the distribution chain on a voluntary nature, such as those at the European level, typically address specific types of conduct.

However, measures that aim to prevent specific types of firm conduct typically do not shift market power in the distribution chain. More specifically, the prohibition of (or voluntary commitment to refrain from) specific ‘unfair’ types of conduct by firms that (allegedly) enjoy substantial market power does not change the fact that the firm(s) concerned will seek to exercise that market power in order to generate profit. In this context, Inderst emphasises that banning specific practices may therefore only have as a consequence that the firm(s) concerned will extract profits through another, potentially less efficient channel.⁴¹⁰ That is, instead of extracting profits through ‘unfair’ practices, firms may have the incentive to exercise buyer power in other ways. Instead of engaging in for instance late payments or retroactively changing contract terms, buyers may therefore simply ‘fairly’ negotiate in their contract a lower input price. From the perspective of suppliers, the question may therefore rise to what extent policy will actually promote ‘fairness’.

In order to prevent any potential ‘unfair’ impact of disparities in market power in business-to-business relations in a market, policy measures might require going as far as fully banning the exercise of buyer (and seller) power. As stressed above, however, such a measure will distort the competitive process itself and may impose considerable harm to economic efficiency. After all, the expectation and possibility of firms to exercise (a substantial degree of) market power form an essential requirement for the fundamental premise that competition promotes economic efficiency. At some point, the question may therefore rise whether specific perceptions of ‘fairness’ are perhaps inherently incompatible with the economic rationale behind the protection of competition, a process that primarily generates positive effects precisely because it eliminates ‘losers’ and rewards ‘winners’.

4.6.3 – Conclusion

Although all potential competition concerns of buyer power can be addressed under EU competition law, this does not imply that requests for policy measures with respect to buyer power may not be motivated by other potentially legitimate reasons. In the

⁴⁰⁹ See Section 1.4.

⁴¹⁰ Inderst, R. (2008), ‘The Economics of Buyer Power’, speech given at the OECD Roundtable on Monopsony and Buyer Power.

debate on the treatment of buyer power, the complaints issued and concerns expressed often refer to specific types of conduct by large buyers that are deemed ‘unfair’, such as late payments or unilateral changes of contract terms. Although Article 102 TFEU appears to provide some legal basis to challenge conduct that involves ‘too high’ or ‘too low’ prices or amounts to ‘unfair’ trading conditions, this legal basis may not extend to all conduct that stakeholders may deem ‘unfair’. Article 102 TFEU, for instance, requires that the firm(s) concerned meet the threshold of ‘dominance’, though it is conceivable that also firms that are not ‘dominant’ have the ability to behave ‘unfairly’. Similarly, application of the EU competition rules typically requires that there is a restriction of competition on a market, but the practices concerned may typically affect bilateral business-to-business relations and need not have an overall impact on competition on the market.

Since this might suggest that there may be a ‘gap’ concerning the (potential) government motive to promote a specific perception of ‘fairness’ in a market, the EU legislator might consider additional policy measures. In this context, three policy considerations have been discussed. First, since potential policy measures will presumably involve mitigating the ability of firms to exercise buyer power, an ability that is essential requirement for the premise that competition promotes economic efficiency, such policy measures can harm economic efficiency. This implies that there is a trade-off between efforts to promote ‘fairness’ and economic efficiency. Secondly, whereas the enforcement of competition policy involves the difficult task of balancing allocative, productive and dynamic efficiency, this concerns an exercise that is in principle objectively comparable (conduct is either inefficient or not). However, if notions of ‘fairness’ are to be taken into account within the sphere of competition law, the enforcement of competition policy could become a more subjective (or political) exercise, for instance because individuals differ in what they perceive as ‘unfair’ and how this is to be weighed against economic efficiency. Accordingly, the question arises to what extent independent competition authorities have democratic legitimacy to make such decisions. Thirdly and finally, since policy measures that aim to prevent specific types of ‘unfair’ conduct do not change the fact that firms will seek to exercise to generate profits, it is conceivable that they will exercise buyer power through other channels. The question may therefore arise to what extent policy measures to promote ‘fairness’ would be effective to that end.

4.7 – Conclusions

This chapter has analysed the treatment of buyer power in EU competition law. More specifically, this chapter has assessed whether the legal framework of in EU competition law is suitable to address the competition concerns of buyer power that

have been identified: buyer collusion, exclusionary buyer conduct and mergers that involve buyer power. On the basis of the analysis, it is possible to derive four key conclusions.

The legal framework of EU competition law is readily applicable to apply to buyer conduct. Buying conduct by final consumers and most purchasing activities by governments are typically excluded from the scope of EU competition law.

The legal framework of EU competition law is readily applicable to buyer conduct. The potential competition concern of buyer collusion typically falls under the scope of Article 101 TFEU. The treatment of exclusionary conduct is, however, dispersed. That is, vertical restraints that qualify as an ‘agreement’ (which requires a concurrence of wills between multiple parties) fall under the scope of Article 101 TFEU, whereas (truly) unilateral behaviour can be addressed by Article 102 TFEU. It should be noted, however, that the application of Article 101 TFEU to vertical restraints – including the legal exception of Article 101(3) – is without prejudice to the application of Article 102 TFEU. Finally, concerning the potential competition concerns of mergers, both horizontal and vertical mergers fall under the scope of the EU Merger Regulation.

It is important to note, however, that in order for the competition rules to apply, the actor(s) involved must amount to an ‘undertaking’, which requires the presence of ‘economic activity’. A peculiar characteristic of EU competition law is that purchasing is, in and by itself, no economic activity. That is, pursuant to the case law of the European Court of Justice, purchasing only amounts to economic activity if its subsequent use amounts to economic activity, for instance because it is used as an input for products or services and/or distribution on an output market. This interpretation by the Courts merely appears to have the effect of excluding from the scope of EU competition law purchasing by final consumers (which typically have no buyer power) and State purchasing (for which specific rules on public procurement may apply). That is, with the exception of purchasing by final consumers and State purchasing, purchasing activities will typically amount to ‘economic activity’, because their subsequent use typically involves economic activity, and may therefore be addressed under EU competition law as far as this condition is concerned.

The competition concerns of buyer power – collusion amongst rival buyers, exclusionary conduct by a buyer and mergers involving buyer power – can be addressed under EU competition law.

Buyer collusion can be addressed under Article 101 TFEU. On various occasions, the European Commission and the Court have recognised the potential harmful effects of agreements amongst rival buyers and found cooperation between rival buyers to be incompatible with Article 101 TFEU. For instance, in the Spanish and Italian raw tobacco cases, the European Commission treated a buyer cartel similar to a seller

cartel, since parties were found to have fixed input prices, allocated suppliers and engaged in bid rigging. Both the European Commission and the European Courts acknowledge, however, that cooperation amongst rival buyers does not necessarily harm economic efficiency, and may also promote economic efficiency. In this context, the European Commission has indicated that it is unlikely to challenge joint purchasing agreements between firms with a market share lower than 15 percent on both input and output markets.

Exclusionary conduct by a buyer can be addressed under Article 102 TFEU (concerning unilateral behaviour) and/or Article 101 TFEU (concerning vertical agreements). The possibility that exclusionary conduct can also occur on input markets has been recognised by both the European Commission and the European Courts. Indeed, in its Guidance Paper on Article 102 TFEU, as well as in its Guidelines on Vertical Restraints, the European Commission recognises its concerns for potential anti-competitive behaviour by a buyer on an input market. An interesting observation is that *British Airways* is one of very few cases (if not the only one) that has been explicitly recognised as a case involving abusive behaviour by a dominant buyer on an input market. However, although most of the European Commission's guidance and the bulk of the case law involve firm conduct on output markets, it is conceivable that legal concepts and principles that are used in the seller power context may be applied analogously in the buyer power context in order to assess whether conduct by a dominant buyer is considered 'abusive'.

Mergers that involve buyer power can be addressed under the EU Merger Regulation. In its Horizontal Merger Guidelines and Non-Horizontal Merger Guidelines, the European Commission acknowledges that both merger types may pose competition concerns but also emphasises that horizontal mergers are much more likely to cause anti-competitive effects than vertical mergers. In various horizontal merger cases in the European retail sector, such as in *Kesko/Tuko*, *Rewe/Meinl* and *Carrefour/Promodes*, the European Commission has specifically analysed the likelihood of anti-competitive effects because of buyer power concerns. Moreover, in its Horizontal Merger Guidelines, the European Commission explicitly states its concern that horizontal mergers may allow the merged entity to exercise monopsony power, and thus depress the input price below the competitive level by reducing purchases. However, the European Commission also recognises that both horizontal and vertical mergers may bring about substantial efficiency gains and notes that its merger appraisal involves a careful assessment on inter alia the likelihood of both potential anti-competitive effects and efficiency gains.

EU competition law does not stipulate a specific welfare standard for establishing anti-competitive effects. With regard to the treatment of efficiency gains, however, EU competition law appears to prescribe the consumer welfare standard.

Article 101 TFEU, Article 102 TFEU and the EU Merger Regulation do not stipulate that a specific welfare standard is to be used in the assessment of potential anti-competitive effects. Judging from its decision-making practice and its guidelines, however, the European Commission primarily appears to focus on the effects of firm conduct on consumer welfare and therefore seems to apply the consumer welfare standard. However, since the monopsony power that may be created (or strengthened or maintained) by anti-competitive buyer conduct does not necessarily directly affect consumers, there is a risk of underenforcement of anti-competitive buyer conduct (Type II error) if application of the consumer welfare standard implies that harm to consumer welfare is considered a necessary requirement in order to establish anti-competitive effects. However, the contribution of the European Commission for the 2008 OECD Roundtable on Monopsony and Buyer Power and its approach in the *Sovion/Südfleisch* merger suggest that the European Commission is aware of this risk since it explicitly recognised that there may be a need to assess potential anti-competitive effects of a merger involving buyer power in the absence of harm to consumer welfare.

Although EU competition law does not stipulate that a specific welfare standard is to be used in the assessment of anti-competitive effect, the competition rules do appear to prescribe the consumer welfare standard for the assessment of efficiency gains. Both Article 101(3) TFEU and Article 1(b) of the EU Merger Regulation are typically interpreted so that efficiency gains may only be taken into account if they lead to a net benefit to consumers. A similar approach is taken with regard to the concept of ‘objective justification’ under Article 102 TFEU. However, buyer conduct may also give rise to efficiency gains that does not necessarily (directly) benefit consumers, for instance when buyer conduct realises fixed cost savings. Accordingly, the consumer welfare prescription in EU competition law with regard to the treatment of efficiency gains might therefore result in the prohibition of conduct that does not harm economic efficiency (i.e. a Type I error).

There is a difficult relationship between EU competition law and allegedly ‘unfair’ business practices.

In the debate on the treatment of buyer power, the complaints issued and concerns expressed often refer to specific types of conduct by large buyers that are deemed ‘unfair’, such as late payments or unilateral changes of contract terms. Although Article 102 TFEU appears to provide some legal basis to challenge conduct that involves ‘too high’ or ‘too low’ prices or amounts to ‘unfair’ trading conditions, this legal basis may not extend to all conduct that stakeholders may deem ‘unfair’. Article

102 TFEU, for instance, requires that the firm(s) concerned meet the threshold of ‘dominance’, though it is conceivable that also firms that are not ‘dominant’ have the ability to behave ‘unfairly’. Similarly, application of the EU competition rules typically requires that there is a restriction of competition on a market, but the practices concerned may typically affect bilateral business-to-business relations and need not have an overall impact on competition on the market.

With regard to potential policy measures in order to mitigate ‘unfair’ business practices, three policy considerations may prove relevant. First, since potential policy measures will presumably involve mitigating the ability of firms to exercise buyer power, an ability that is essential requirement for the premise that competition promotes economic efficiency, such policy measures can harm economic efficiency. Secondly, since there is thus a trade-off between efforts to promote ‘fairness’ and economic efficiency, efforts to mitigate ‘unfair’ business practices in the sphere of competition law could imply that the enforcement of competition policy involves a subjective (or political) exercise. Accordingly, the question arises whether such decisions should be taken by independently institutionalised agencies or that such a balancing exercise is instead better made at the political level in order to prevent a democratic deficit. Thirdly, since policy measures that aim to prevent specific types of ‘unfair’ conduct do not change the fact that firms will seek to exercise to generate profits, it is conceivable that they will exercise buyer power through other channels. The question may therefore arise to what extent policy measures to promote ‘fairness’ would be effective to that end.

5. CONCLUSIONS AND SUMMARY

5.1 – Introduction

Buyer power, the subject matter of this research, is an issue of increasing interest in the European Union. For a great deal, the augmented attention to this topic stems from a trend of ongoing concentration in the European retailing sector. Especially in the groceries sector, consumer preferences for a broader range of goods and services have induced retailers to implement substantial changes to their business models. As a result, large retail chains, which have exploited considerable economies of scale and scope and implemented various innovating shopping models, play an increasingly leading role in the EU retail landscape. While the emergence of large retail chains have typically come at the cost of smaller retailers, it has also raised considerable concerns amongst primary producers and intermediate suppliers, which have become dependent on fewer alternative sales channels in order to reach final consumers. Correspondingly, retail firms, either individually or through buying groups, have allegedly gained in their ability to exercise buyer power and thereby reduce suppliers' profitability and/or contractual freedom.

While the changed nature of competition has therefore caused considerable concern on producer and supplier margins in the distribution chain, this trend has not been followed-up by amendments of the regulatory framework of EU competition law, or its enforcement. Indeed, the modernisation of EU competition law, presumably the most influential change in competition policy in the European Union since its introduction, does not prescribe increased attention to the economic position of producers and suppliers. On the contrary, pursuant to the implementation of the so-called 'more economic approach', EU competition policy has increasingly relied on an economics-oriented approach in which the focus is not on the protection of producers, suppliers or retailers (competitors) but on the protection of an effective competitive process (competition) and consumer welfare. The developments of, on the one hand, increasing pressure on suppliers' margins and, on the other hand, increased focus on the position of consumers have caused concerns amongst politicians on both the national and the European level, supported by producer lobby groups, that the current legal framework of EU competition policy is too narrow and therefore unfit to address the (potential) harmful effects of buyer power.

In this discussion, reference is often made to initiatives at the national level that are specifically designed to deal with disparities in market power in business-to-business relations. In various EU Member States, such as France, Germany and Spain, national

competition authorities have the task to assess the compatibility of the exercise of buyer (and seller) power with specific prohibitions on so-called ‘abuse of economic dependency’ or ‘abuse of superior bargaining position’. Alternative methods that might mitigate the exercise of buyer power, and that have been included in the debate, include prohibitions on sales below costs, which have been implemented in Belgium, France and Germany, and measures that facilitate the organisation of countervailing seller power, such as in the Netherlands. As of yet, the European legislature has refrained from similar measures within the sphere of EU competition law but instead addresses the issue of ‘unfair’ business practice outside the context of EU competition law and on a voluntary, self-regulatory basis.

The complaints on, and requests for amendments of, EU competition law crucially rely on the hypothesis that there is a ‘gap’ in the substantive legal framework of traditional EU competition law, which causes the underenforcement of the (potential) harmful effects of buyer power. In this research, a Law and Economics approach has been used to put this hypothesis to the test. That is, by applying the conceptual apparatus of economics to the field of EU competition law, it has been assessed from an economic efficiency perspective whether the competition rules provide for a legal basis to address the potential competition concerns of buyer power. The main research question in this research is:

Is there a gap in the current substantive legal framework of EU competition law that warrants changes in order to address the (potential) harmful effects of buyer power?

This chapter entails a summary of the main findings and conclusions in this research. Section 5.2 discusses the (potential) concerns of buyer power within the context of competition policy. Next, Section 5.3 assesses whether the identified competition concerns of buyer power can be addressed under the current legal framework of EU competition law. Finally, Section 5.4 concludes and answers the main research question.

5.2 – The Competition Concerns of Buyer Power

The discussion on the appropriate treatment of buyer power in EU competition law has been primarily initiated by primary producers and intermediate suppliers that increasingly have to deal with large and influential buyers. However, in order to determine whether and, if so, to what extent buyer power should at all form a concern within the context of competition policy, it is important to address a number of questions. More specifically, it is important to determine whether the complaints

indeed concern buyer power and, if there is buyer power, what type of buyer power it is and how the firm(s) concerned may have acquired it.

Suppliers' difficulties to generate economic profit are not necessarily caused by buyer power but can be the result of a healthy and effective competitive process. Instead, buyer power is market power on an input market that allows a firm to obtain from its supplier(s) more favourable terms of trade than in the absence of buyer power.

Most commonly, complaints on buyer power, and its alleged harmful effects on economic efficiency, are issued by primary producers and intermediate suppliers. However, since it is well possible that requests for competition policy intervention are motivated by (private) motives of suppliers, and need not be in the (public) interest of economic efficiency, it is important to ascertain whether the complaints indeed concern buyer power. After all, while buyer power has the potential to harm suppliers' profitability, this does not imply that suppliers' difficulties to generate (substantial) economic profit are necessarily caused by buyer power. In fact, the pressure suppliers may encounter on their margins, and which might force them to exit the market, may well be the result of a healthy and effective competitive process. After all, competition is a dynamic process of rivalry that encourages firms to respond to the changing preferences of their customers, most notably by pricing competitively, producing cost-effectively and investing in new technologies, products and processes. By allowing the most successful firms to gain market power and by forcing the exit of unsuccessful firms, and eliminating potential excess production capacity, competition works as a selection mechanism that promotes economic efficiency. Since it is in fact precisely this mechanism that competition policy aims to protect, competition policy should refrain from the protection of inefficient or excess supply. That is, instead of protecting competitors from competition, competition policy should protect the competitive process itself.

Instead, buyer power is market power on the input market. The input market is the market on which firms purchase from their suppliers the necessary inputs for selling their products or services on an output market. Essentially, buyer power concerns the ability of a buyer to obtain from its supplier(s) more favourable terms of trade, for instance a lower input price or by negotiating specific contractual obligations. Since buyer power therefore involves a transfer of economic welfare from sellers to buyers, it requires the presence of some kind of economic rent amongst suppliers. This condition may be satisfied in three scenarios. The most straightforward scenario is when suppliers have seller power. When buyer power is exercised in the relation with suppliers that enjoy seller power, the buyer power is usually referred to as countervailing buyer power (or bargaining power). Buyer power may, however, also arise when suppliers have no market power, a scenario in which it is referred to as

monopsony power. The economic rent that is necessary for the exercise of buyer power may for instance arise when there is an upward sloping supply curve. In contrast to the scenario that is presumably most commonly discussed and in which there are constant or even increasing returns to scale (scale economies), the presence of an upward sloping supply curve essentially reflects the presence of decreasing returns to scale, which means that, as output increases, it becomes more costly to produce one additional unit of output. Alternatively, economic rent may also be present when suppliers face sunk costs, which concern costs that refer to a long-run investment in capital such as a building or machine but which cannot be shifted easily to another productive use. In the short run, a firm that incurs sunk costs does not need to recover its investment. In the long run, however, a firm will need to recover all of its costs – including sunk costs – if it wants to stay in business.

The effects of buyer power on economic efficiency are the mirror image of the efficiency effects of seller power. Monopsony power allows a firm to depress input prices below the competitive level by reducing purchases and therefore typically harms economic efficiency. By contrast, countervailing buyer power (or bargaining power) may mitigate the harmful effects of seller power and therefore tends to promote economic efficiency.

Monopsony power is buyer power enjoyed by a buyer in the relation with sellers that have no (seller) market power. The analysis of monopsony power is directly analogous to that of monopoly power. That is, while a firm with monopsony power will have the same desire as a firm without buyer power to purchase up until marginal benefits of doing so equals marginal costs, it has the distinctive ability to affect market outcomes on its input market. More specifically, a firm with monopsony power may recognise that, since an increase in units bought increases the input price for all units, it has the ability to depress input prices below the competitive level, so to generate economic profit. However, since the lower input price is achieved by reducing purchases, the exercise of monopsony power typically harms economic efficiency by reducing allocative efficiency.

Countervailing buyer power (which may also be referred to as bargaining power) is buyer power in the relation with suppliers that have seller power. Countervailing buyer power can therefore only be exercised in the situation of so-called ‘bilateral market power’, a scenario in which both buyers and sellers have market power. With bilateral market power, both sellers and buyers will mutually recognise their market power and acknowledge that none of them can treat their trading partners as (perfect) competitors, for instance by simply imposing an input price. Instead, countervailing buyer power is typically exercised in bilateral negotiations so as to obtain an individual discount and may therefore result in very different outcomes for the various buyers and sellers on the market. In marked contrast with monopsony (and monopoly) power, countervailing

buyer power is based on the threat of reducing output but generally has the objective of maintaining or increasing purchases. As a result, countervailing buyer power may mitigate the harmful effects of seller power enjoyed by the seller, which would – in the absence of buyer power – have been able to exercise monopoly power. Countervailing buyer power therefore tends to promote economic efficiency. This observation also applies to countervailing market power on the selling side of a market. Countervailing seller power, too, tends to promote economic efficiency if this prevents buyers to exercise monopsony power.

It is important to note that both monopsony and countervailing buyer power may not only affect allocative efficiency but may also have an impact on dynamic efficiency. Dynamic efficiency is the extent in which firms introduce new products and processes. A specific concern within the context of buyer power is that its exercise may reduce incentives for suppliers to invest in innovation. That is, the presence of buyer power may cause suppliers to anticipate that they will be unable to recoup their innovation investment, and therefore induce them to underinvest in R&D. However, while buyer power may therefore harm dynamic efficiency, it may also promote dynamic efficiency. That is, although buyer power may reduce the profitability and investment decisions by suppliers, it can also promote investment decisions. For instance, a substantial degree of buyer power may provide an important incentive for suppliers to invest in more cost-efficient technologies or new products and processes in order to gain a competitive advantage over their rivals.

Competition policy should recognise competition as an ongoing dynamic process of rivalry, in which the expectation and actual possibility to exercise market power form an essential requirement for the fundamental premise that competition promotes economic efficiency. Accordingly, competition policy should therefore refrain from challenging the exercise of buyer (and seller) power that is the result of superior efficiency.

Competition policy should recognise that competition is not the concept of ‘perfect competition’ that is used in traditional static equilibrium models, in which competition reflects an ideal ‘end state’ (or equilibrium). In reality, the necessary conditions for ‘perfect competition’ are extremely rarely, if ever, satisfied. Moreover, since static equilibrium models typically ignore the important role of, inter alia, scale economies and dynamic efficiency, the concept of ‘perfect competition’ is not only unfeasible but in fact inferior and undesirable. Instead of a static concept, competition policy should recognise competition as an ongoing dynamic process of rivalry in which firms constantly create and adopt new technologies, products and processes in order to gain a competitive advantage over their rivals. The recognition of competition as a dynamic process has important implications for the appropriate scope of competition policy. Competition policy should acknowledge that, due to the presence of efficiency trade-

offs, economic efficiency may require competition to develop market power, and corresponding (potential) allocative inefficiency, in order to promote productive and/or dynamic efficiency.

One important efficiency trade-off involves the potential conflict between allocative and productive efficiency that may arise when some firms are more productive than others. Such a scenario may for example occur due to the ability to utilise economies of scale or scope. In this scenario, economic efficiency typically requires productive efficiency to prevail over allocative efficiency. Another and perhaps even more important efficiency trade-off involves the relation between allocative efficiency and dynamic efficiency. Since investments in more cost-efficient technologies and new products and processes are typically very risky and costly, they require the expectation to generate economic profit that well exceeds the corresponding costs. Accordingly, the ability to exercise market power forms the necessary reward for the promotion of dynamic efficiency. That is, it is the very prospect of firms to exercise (a very high degree of) market power that encourages them to invest in new cost-efficient technologies and new products and processes. Competition policy should therefore refrain from preventing more productive and innovative firms to take away the business of their rivals. Furthermore, competition policy should refrain from challenging the corresponding ability to exercise market power that is the result of firms' superior efficiency.

Instead, competition policy should address anti-competitive behaviour, which essentially refers to the creation, strengthening or maintenance of buyer power not through but by harming the competitive process. There are three categories of conduct that may amount to anti-competitive behaviour: collusion, exclusionary conduct and mergers.

Since the effects of buyer power on economic efficiency are the mirror image of the efficiency effects of seller power, a symmetric treatment is warranted. Accordingly, instead of challenging the exercise of buyer power that is the result of superior efficiency, competition policy should focus on anti-competitive behaviour. The concept of anti-competitive behaviour refers to firm efforts to create, strengthen or maintain market power not through but by harming the competitive process. Since competition policy is based upon the principle that the competitive process itself is the best mechanism to promote economic efficiency, the concept of anti-competitive behaviour requires harm to both competition and economic efficiency. Anti-competitive behaviour typically harms economic efficiency due to a gain in market power (and corresponding allocative inefficiency) that is not compensated for by overriding gains in productive and/or dynamic efficiency. In this context, it is possible to identify three categories of buyer conduct that may amount to anti-competitive behaviour.

Buyer collusion involves the coordination between rival buyers on the material terms on which they compete on their input market in order to jointly exert buyer power. By means of for instance input price fixing, market sharing and bid rigging, rival buyers can bypass the competitive process, gain buyer power and thereby potentially inflict harm to economic efficiency. It is important to note, however, that coordination amongst rival buyers is not necessarily harmful since it can also yield efficiency gains. In particular when firms engage in so-called joint purchasing, economic efficiency may be promoted, most notably due to gains in productive and/or dynamic efficiency. Moreover, joint purchasing may promote economic efficiency when it enables firms to exercise countervailing buyer power and mitigate the harmful effects of suppliers' market power.

Exclusionary buyer conduct concerns the ability of a firm with a (very) high degree of buyer power to exclude a rival buyer or to deter a potential entrant from that or an adjacent market. Depending on the specific characteristics of the market(s) concerned, exclusionary buyer conduct may involve various practices, which can be largely interchangeable. For instance, when foreclosure is targeted at a rival buyer, exclusionary conduct may for example involve exclusivity contracts, fidelity rates or predatory buying. Alternatively, when exclusionary conduct is aimed at a firm operating on an adjacent market, the excluding firm might for example resort to refusal to deal, tying or reciprocal dealing. Since exclusionary conduct may involve practices that differ substantially by form, but which typically work through a very similar mechanism, it is better not to assess a particular practice by its form (form-based) but instead focus on the effects of that practice (effects-based). Furthermore, it is important to recognise that although many practices might, at least from an intuitive perspective, appear to be harmful, they may well promote economic efficiency. In the enforcement of exclusionary conduct, it is therefore crucial to ascertain that a coherent theory of harm applies.

Mergers may also give rise to buyer power concerns. Since horizontal mergers directly reduce the number of rival buyers on a market, they typically allow firms to gain buyer power. The resulting increase of buyer power may harm economic efficiency but may also realise efficiency gains, for instance because it allows the merged entity to exercise countervailing buyer power, realise cost savings or improve the ability to utilise economies of scale or scope, which may promote productive and/or dynamic efficiency. Efficiency gains play an even more prominent role within the context of vertical mergers, which do not concern direct rivals and are therefore less likely to increase market power. In fact, vertical mergers can be an important means to solve a vertical externality between a seller and a buyer and thereby promote economic efficiency. Only in very specific situations, vertical mergers may form a competition

concern, in particular when it provides the merged entity with both the ability and the incentive to engage in exclusionary conduct.

5.3 – Buyer Power in EU Competition Law

Having identified that buyer collusion, exclusionary buyer conduct and mergers that involve buyer power may give rise to concerns within the context of competition policy, the question arises whether these potential competition concerns can be addressed under the current substantive legal framework of EU competition law. In order to ensure that the competition rules do not systematically cause the failure to prohibit anti-competitive buyer conduct (Type II error), it is necessary that EU competition law provides for a legal basis to address the potential competition concerns of buyer power. However, since the various types of buyer conduct that are potentially harmful may also promote economic efficiency, it is also important that the competition rules are not too strict and allow for taking into account potential efficiency gains, in order to mitigate the risk of prohibiting conduct that is not anti-competitive (Type I error). Furthermore, competition policy design should also take into account that competition policy creates regulation costs (set-up costs, information and assessment costs and legal uncertainty).

The legal framework of EU competition law is readily applicable to apply to buyer conduct. Buying conduct by final consumers and most purchasing activities by governments are typically excluded from the scope of EU competition law.

The legal framework of EU competition law is readily applicable to buyer conduct. The potential competition concern of buyer collusion typically falls under the scope of Article 101 TFEU. The treatment of exclusionary conduct is, however, dispersed. That is, vertical restraints that qualify as an ‘agreement’ (which requires a concurrence of wills between multiple parties) fall under the scope of Article 101 TFEU, whereas (truly) unilateral behaviour can be addressed by Article 102 TFEU. It should be noted, however, that the application of Article 101 TFEU to vertical restraints – including the legal exception of Article 101(3) – is without prejudice to the application of Article 102 TFEU. Finally, concerning the potential competition concerns of mergers, both horizontal and vertical mergers fall under the scope of the EU Merger Regulation.

It is important to note, however, that in order for the competition rules to apply, the actor(s) involved must amount to an ‘undertaking’, which requires the presence of ‘economic activity’. A peculiar characteristic of EU competition law is that purchasing is, in and by itself, no economic activity. That is, pursuant to the case law of the European Court of Justice, purchasing only amounts to economic activity if its

subsequent use amounts to economic activity, for instance because it is used as an input for products or services and/or distribution on an output market. This interpretation by the Courts merely appears to have the effect of excluding from the scope of EU competition law purchasing by final consumers (which typically have no buyer power) and State purchasing (for which specific rules on public procurement may apply). That is, with the exception of purchasing by final consumers and State purchasing, purchasing activities will typically amount to ‘economic activity’, because their subsequent use typically involves economic activity, and may therefore be addressed under EU competition law as far as this condition is concerned.

The competition concerns of buyer power – collusion amongst rival buyers, exclusionary conduct by a buyer and mergers involving buyer power – can be addressed under EU competition law.

Buyer collusion can be addressed under Article 101 TFEU. On various occasions, the European Commission and the European Courts have recognised the potential harmful effects of agreements amongst rival buyers and found cooperation between rival buyers to be incompatible with Article 101 TFEU. For instance, in the Spanish and Italian raw tobacco cases, the European Commission treated a buyer cartel similar to a seller cartel, since parties were found to have fixed input prices, allocated suppliers and engaged in bid rigging. Both the European Commission and the European Courts acknowledge, however, that cooperation amongst rival buyers does not necessarily harm economic efficiency and may also promote economic efficiency. In this context, the European Commission has indicated that it is unlikely to challenge joint purchasing agreements between firms with a market share lower than 15 percent on both input and output markets.

Exclusionary conduct by a buyer can be addressed under Article 102 TFEU (concerning unilateral behaviour) and/or Article 101 TFEU (concerning vertical agreements). The possibility that exclusionary conduct can also occur on input markets has been recognised by both the European Commission and the European Courts. Indeed, in its Guidance Paper on Article 102 TFEU, as well as in its Guidelines on Vertical Restraints, the European Commission recognises its concerns for potential anti-competitive behaviour by a buyer on an input market. An interesting observation is that *British Airways* is one of very few cases (if not the only one) that has been explicitly recognised as a case involving abusive behaviour by a dominant buyer on an input market. However, although most of the European Commission’s guidance and the bulk of the case law involve firm conduct on output markets, it is conceivable that legal concepts and principles that are used in the seller power context may be applied analogously in the buyer power context in order to assess whether conduct by a dominant buyer is considered ‘abusive’.

Mergers that involve buyer power can be addressed under the EU Merger Regulation. In its Horizontal Merger Guidelines and Non-Horizontal Merger Guidelines, the European Commission acknowledges that both merger types may pose competition concerns but also emphasises that horizontal mergers are much more likely to cause anti-competitive effects than vertical mergers. In various horizontal merger cases in the European retail sector, such as in *Kesko/Tuko*, *Rewe/Meinl* and *Carrefour/Promodes*, the European Commission has specifically analysed the likelihood of anti-competitive effects because of buyer power concerns. Moreover, in its Horizontal Merger Guidelines, the European Commission explicitly states its concern that horizontal mergers may allow the merged entity to exercise monopsony power, and thus depress the input price below the competitive level by reducing purchases. However, the European Commission also recognises that both horizontal and vertical mergers may bring about substantial efficiency gains and notes that its merger appraisal involves a careful assessment on, inter alia, the likelihood of both potential anti-competitive effects and efficiency gains.

EU competition law does not stipulate a specific welfare standard for establishing anti-competitive effects. With regard to the treatment of efficiency gains, however, EU competition law does appear to prescribe the application of the consumer welfare standard.

Article 101 TFEU, Article 102 TFEU and the EU Merger Regulation do not stipulate that a specific welfare standard is to be used in the assessment of potential anti-competitive effects. Judging from its decision-making practice and its guidelines, however, the European Commission primarily appears to focus on the effects of firm conduct on consumer welfare and therefore seems to apply the consumer welfare standard. The application of the consumer welfare standard gives rise to a specific concern with respect to the treatment of buyer power. In general, the consumer welfare standard does not lead to different decision making than the total welfare standard, which focuses on the aggregate welfare of all buyers and sellers. This is because the exercise of monopsony power never benefits consumers and will in practice often harm consumer welfare since it induces firms to lower the level of output and charge higher prices on the output market. It is, however, also possible that monopsony power is not accompanied with market power on the output market, for instance because the geographic scope of the input market is narrower (e.g. local) than that of the output market (e.g. national or international) or when the production of rival firms' products requires different inputs that are therefore purchased on different input markets. In such a scenario, it is possible that anti-competitive buyer conduct that creates (or strengthens or maintains) monopsony power and harms economic efficiency does not directly affect consumer welfare. This may be because the reduction of purchases that is associated with monopsony power may be compensated for by rivals on the output market that expand their output up to the competitive level so that consumers are not

directly affected. Consequently, there is a risk of underenforcement (Type II error) if application of the consumer welfare implies that harm to consumer welfare is considered a necessary requirement in order to establish anti-competitive effects.

Although EU competition law does not stipulate that a specific welfare standard is to be used in the assessment of anti-competitive effect, the competition rules do appear to prescribe the consumer welfare standard for the assessment of efficiency gains. Both Article 101(3) TFEU and Article 1(b) of the EU Merger Regulation are typically interpreted so that efficiency gains may only be taken into account if they lead to a net benefit to consumers. A similar approach is taken with regard to the concept of 'objective justification' under Article 102 TFEU. However, buyer conduct may also give rise to efficiency gains that does not necessarily (directly) benefit consumers. This situation may especially occur when buyer conduct realises fixed cost savings, which typically do not affect a firm's profit-maximising output or price choice, at least in the short run. Accordingly, the consumer welfare prescription in EU competition law with regard to the treatment of efficiency gains implies that efficiency gains that are not passed on should be ignored. This may result in the wrongful prohibition of conduct that does not harm economic efficiency (Type I error).

For a great deal, complaints on buyer power appear to be based upon specific perceptions of what is 'fair' and are not necessarily related to economic efficiency. The extent into which EU competition law may take into account 'fairness' is, however, limited.

In the debate on the treatment of buyer power, the complaints issued and concerns expressed often refer to specific types of conduct by large buyers that are perceived as 'unfair'. Indeed, the concerns expressed by European Parliament often refer to practices exhibited by (large) retailers that are deemed 'unfair', such as late payments or unilateral changes of contract terms. In a 2012 resolution on 'Imbalances in the food supply chain', for instance, European Parliament makes explicit references to 'unfair' trading practices and specifically calls upon the Commission to address 'unfair' distribution of profits within the food chain, especially with regard to 'adequate' incomes for farmers. Such arguments, however, do not necessarily relate to economic efficiency. In fact, the ability of a buyer to obtain from its supplier(s) more favourable terms of trade, for instance by negotiating a lower input price or better contract terms, may well promote economic efficiency.

Although Article 102 TFEU appears to provide some legal basis to challenge conduct that involves 'too high' or 'too low' prices or amounts to 'unfair' trading conditions, this legal basis may not extend to all conduct that stakeholders may deem 'unfair'. Article 102 TFEU, for instance, requires that the firm(s) concerned meet the threshold of 'dominance', though it is conceivable that also firms that are not 'dominant' have

the ability to behave ‘unfairly’. Furthermore, application of the EU competition rules typically requires that there is a restriction of competition on a market, but the practices concerned may typically affect bilateral business-to-business relations and need not have an overall impact on competition on the market. Alternatively, it is conceivable that a specific view on what are ‘fair’ incomes may call for a more lenient treatment of (potential) anti-competitive conduct, for instance by allowing suppliers to engage in price fixing. Such conduct is, however, typically caught under the competition rules and will moreover presumably not meet the necessary requirements to qualify for ‘efficiency gains’, for instance because they do not amount to ‘an improvement of the production or distribution of goods or a promotion of technical or economic progress’. These observations imply that some might perceive a ‘gap’ in EU competition law with regard to addressing ‘unfair’ business practices.

5.4 – Conclusions

Buyer power, the ability of a buyer to obtain from its supplier(s) more favourable terms of trade, can harm economic efficiency and may therefore amount to a concern within the context of competition policy. Most notably when exercised in the relation with suppliers that have no market power, buyer power (which is then referred to as ‘monopsony power’) may harm economic efficiency, in particular by limiting total market output and potentially hampering innovation amongst suppliers. Buyer power can, however, also promote economic efficiency. When exercised vis-à-vis suppliers that enjoy market power, buyer power (which is then referred to as ‘countervailing buyer power’ or ‘bargaining power’) may mitigate the harmful effects of seller power enjoyed by the seller and therefore tends to promote economic efficiency. Furthermore, it is crucial to recognise that firms’ expectation and actual ability to exercise market (buyer or seller) power form an essential requirement for the fundamental premise that competition promotes economic efficiency. Accordingly, competition policy should refrain from challenging buyer power that is the result of superior efficiency but should instead address anti-competitive conduct, which allows firms to create, strengthen or maintain buyer power by harming the competitive process. In this context, three categories of (potential) anti-competitive buyer conduct have been identified: collusion amongst rival buyers, exclusionary conduct by a buyer and mergers involving buyer power.

EU competition law is readily applicable to buyer conduct and moreover provides for a legal basis to address the potential competition concerns that have been identified. That is, buyer collusion can be addressed under Article 101 TFEU, exclusionary buyer conduct falls under the scope of Article 102 (concerning unilateral behaviour) and/or Article 101 (concerning vertical agreements), whereas mergers that involve can be

addressed under the EU Merger Regulation. Although the bulk of the case law and the European Commission's guidance concern the context of seller power, both the European Courts and the European Commission have recognised that buyer power can also give rise to competition concerns. Buyer collusion has, for instance, been addressed in the Spanish and Italian raw tobacco cases, exclusionary buyer conduct was a primary concern in *British Airways*, whereas in *Kesko/Tuko*, *Rewe/Meinl* and *Carrefour/Promodes* the European Commission specifically analysed the likelihood of anti-competitive effects because of buyer power concerns. Since the potential competition concern that has been identified can be addressed under EU competition law, the analysis therefore does not give rise to the conclusion that the current substantive legal framework of EU competition law is unfit to address the (potential) harmful effects of buyer power.

However, a critical comment is in place with regard to the application of the consumer welfare standard. Although EU competition law does not prescribe a specific welfare standard for the assessment of potential anti-competitive effects, the European Commission seems to apply the consumer welfare standard. In general, the consumer welfare standard does not lead to different decision making than the total welfare standard, which focuses on the aggregate welfare of all buyers and sellers. Moreover, application of the consumer welfare standard might be preferable because it may mitigate regulation costs and potentially undesirable lobbying. However, the consumer welfare standard has a specific and important disadvantage in the context of buyer power. Since anti-competitive buyer conduct may create (or strengthen or maintain) monopsony power, which typically harms economic efficiency but does not necessarily directly affect consumer welfare, there is a risk of underenforcement of anti-competitive buyer conduct (Type II error) if application of the consumer welfare standard implies that harm to consumer welfare is considered a necessary requirement in order to establish anti-competitive effects. However, the contribution of the European Commission for the 2008 OECD Roundtable on Monopsony and Buyer Power and its approach in the *Sovion/Südfleisch* merger suggest that the European Commission is aware of this risk since it explicitly recognised that there may be a need to assess potential harm on an input market due to buyer power in the absence of harm to consumer welfare. Because this suggests that there is a discrepancy between the actual treatment of buyer conduct and the approach outlined in the European Commission's guidelines, it seems advisable that these guidelines are clarified. For such a clarification concerning the application of the consumer welfare standard to the buyer power context, an example may perhaps be taken from the 2010 revision of the U.S. Department of Justice and the Federal Trade Commission's Horizontal Merger Guidelines. These Guidelines explicitly state that horizontal mergers that involve buyer power are not evaluated strictly, or even primarily, on the basis of the downstream

effects in which the merging firms sell, and that the consumer welfare is thus not applied.

For a great deal, complaints on buyer power and corresponding requests for amendments of EU competition law appear to be based upon the perception that specific practices, such as late payments and retroactive changes of contract terms, are 'unfair'. Since EU competition law may not extend to all conduct that stakeholders may deem 'unfair', a 'gap' might be perceived and additional policy measures might be considered to mitigate 'unfair' business practices. In this context, three policy considerations may prove relevant. First, since potential policy measures will presumably involve mitigating the ability of firms to exercise buyer power – an essential requirement for the premise that competition promotes economic efficiency – such policy measures can harm economic efficiency. Secondly, because of this trade-off between 'fairness' and economic efficiency, efforts to mitigate 'unfair' business practices in the sphere of competition law could imply that the enforcement of competition policy involves a subjective (or political) exercise. Accordingly, the question arises whether such decisions should be taken by independently institutionalised agencies or that such a balancing exercise is instead better made at the political level in order to prevent a democratic deficit. In this context, it is interesting to note that the European Commission currently aims to address 'unfair' business practices outside the context of EU competition law and on a voluntary, self-regulatory basis. Finally, since policy measures that aim to prevent specific types of 'unfair' conduct typically do not shift market power, it is conceivable that firms will exercise their (alleged) buyer power through other channels. Instead of for instance late payments or retroactive changes of contract terms, buyers may therefore simply negotiate in their contract a lower input price. Since policy measures that prohibit specific 'unfair' practices may give rise to other practices that stakeholders may also deem 'unfair', the question may arise to what extent such policy measures would be effective. In fact, since effectiveness of such measures could require drastic intervention in firms' ability to exercise buyer power, the question may arise whether specific perceptions of 'fairness' are perhaps inherently incompatible with the economic rationale behind the protection of competition, a process that primarily generates positive effects precisely because it eliminates 'losers' and rewards 'winners'.

SUMMARY IN DUTCH

Inleiding

Inkoopmacht betreft de mogelijkheid voor een afnemer om gunstigere inkoopvoorwaarden te bedingen, bijvoorbeeld door een korting of specifieke contractuele bepalingen met zijn leverancier(s) af te spreken. Met name naar aanleiding van toenemende concentratie op het niveau van detailhandelaars zoals supermarkten bestaat er toenemende zorg onder (Europese) politici dat het juridische raamwerk van het Europese mededingingsrecht mogelijk niet geschikt is om de (potentiële) mededingingsproblemen van inkoopmacht te adresseren. Een verklaring voor deze zorg komt mogelijk voort uit de ogenschijnlijke tegenstrijdigheid die is gelegen in de constatering dat inkoopmacht met name leveranciers zoals primaire producenten kan benadelen, maar dat het Europese mededingingsrecht in toenemende mate de nadruk legt op de economische belangen van consumenten (professionele afnemers en eindgebruikers). Klachten van (lobbyorganisaties voor) primaire producenten hebben de belangstelling onder (Europese) politici doen toenemen voor aanvullende maatregelen om de (potentieel) schadelijke effecten van inkoopmacht tegen te kunnen gaan. Daarbij wordt vaak met interesse gekeken naar maatregelen die in enkele Europese lidstaten zijn genomen, waaronder met name wettelijke maatregelen die verkoop onder de kostprijs en misbruik van economische afhankelijkheid verbieden, maar ook naar maatregelen die marktmacht onder leveranciers kunnen bevorderen.

De toenemende roep om aanvullend overheidsingrijpen is gebaseerd op de veronderstelling dat in het huidige materiële juridisch kader van het Europese mededingingsrecht sprake is van een leemte aangaande inkoopmacht. Het onderhavige onderzoek toetst deze hypothese vanuit het perspectief van economische efficiëntie (economische welvaart) via een rechtseconomische analyse en beoogt daarmee bij te dragen aan het rechtswetenschappelijk onderzoek op het gebied van het mededingingsbeleid en -recht. Daartoe heeft dit onderzoek aan de hand van de economische literatuur over mededingingsbeleid en over de economische effecten van inkoopmacht een toetsingskader ontwikkeld waarin de potentiële mededingingsproblemen van inkoopmacht worden geïdentificeerd. Teneinde vast te kunnen stellen of de geïdentificeerde potentiële mededingingsproblemen van inkoopmacht daadwerkelijk kunnen worden geadresseerd is dit economische toetsingskader toegepast op het huidige materiële juridische kader van het Europese mededingingsrecht zoals dat door de Europese Commissie, nationale mededingingsautoriteiten en de Europese rechters kan worden toegepast. Op basis van de uitkomsten is ten slotte kort ingegaan op eventuele additionele maatregelen om de (potentiële)

negatieve gevolgen van inkoopmacht tegen te gaan. De uitkomsten van het onderzoek worden hieronder kort toegelicht.

De potentiële mededingingsproblemen van inkoopmacht

De roep om overheidsingrijpen is veelal afkomstig van leveranciers zoals primaire producenten, die rechtstreeks te maken hebben met steeds grotere en economisch sterkere afnemers. Deze klachten hoeven niet altijd te duiden op de aanwezigheid van inkoopmacht. Zo kan de kwetsbare economische positie waarin leveranciers verkeren het gevolg zijn van overcapaciteit op de markt die is ontstaan door bijvoorbeeld een vermindering van de consumentenvraag of een verschuiving daarvan naar andere producten of diensten. In dit geval duiden verminderde rentabiliteit en gedwongen uittreding over het algemeen niet op een mededingingsprobleem maar juist op de aanwezigheid van een effectief concurrentieproces. Mededingingsbeleid is namelijk gebaseerd op het fundamentele principe dat concurrentie economische efficiëntie bevordert omdat het concurrentieproces ondernemingen stimuleert om zoveel mogelijk aan te sluiten bij de behoeften van gebruikers. Ondernemingen die in hun dienstverlening niet goed aansluiten bij consumentenvoorkeuren zullen in een effectief concurrentieproces klanten verliezen en mogelijk worden gedwongen tot uittreding. Concurrentie bevordert economische efficiëntie, juist omdat het concurrentieproces functioneert als een selectiemechanisme dat waarborgt dat enkel die dienstverlening overblijft die aansluit op actuele consumentenvoorkeuren. Mededingingsbeleid heeft daarom niet de bescherming van concurrenten maar de bescherming van concurrentie als doel.

Inkoopmacht betreft marktmacht op de inkoopmarkt, waarop (zakelijke) afnemers producten of diensten afnemen van hun leveranciers, en heeft betrekking op de mogelijkheid om gunstigere inkoopvoorwaarden te bedingen dan in de afwezigheid van inkoopmacht. De mogelijkheid om inkoopmacht uit te oefenen kan ontstaan in drie situaties. Ten eerste kan inkoopmacht ontstaan indien leveranciers over marktmacht (verkoopmacht) beschikken en dus in de afwezigheid van inkoopmacht monopoliemacht kunnen uitoefenen. In dit geval wordt inkoopmacht compenserende inkoopmacht (of onderhandelingsmacht) genoemd. Inkoopmacht kan echter ook ontstaan indien leveranciers geen marktmacht hebben. In dat geval wordt inkoopmacht monopsoniemacht genoemd. Inkoopmacht kan zich, ook indien leveranciers geen verkoopmacht hebben, aanwezig zijn indien de markt een stijgende aanbodcurve kent. Deze situatie ontstaat indien leveranciers op een markt bij een grotere productie niet te maken hebben met gelijkblijvende of dalende (schaalvoordelen) gemiddelde kosten maar met stijgende gemiddelde kosten (schaalnadelen). Ten slotte kan inkoopmacht ontstaan indien ondernemingen te maken hebben met verzonken kosten; investeringen die vereist zijn voor het productieproces maar die vrijwel niet voor alternatieve

processen kunnen worden ingezet en niet kunnen worden terugverdiend indien de activiteit wordt stopgezet.

Voor het beoordelen van de efficiëntie-effecten van inkoopmacht is het van belang onderscheid te maken tussen twee typen inkoopmacht. Monopsoniemacht is inkoopmacht die door afnemers wordt uitgeoefend jegens leveranciers die niet beschikken over marktmacht (verkoopmacht) en daarom geen invloed hebben op markttuitkomsten. De effecten van monopsoniemacht zijn vergelijkbaar met die van monopolie-macht. Een onderneming met monopsoniemacht is in staat om een lagere inkoopprijs te bedingen dan de inkoopprijs die zou ontstaan bij volledige (of perfecte) concurrentie door minder van het desbetreffende product of de dienst af te nemen. De verminderde productie als gevolg van de uitoefening van monopsoniemacht schaadt de economische efficiëntie met name omdat dit leidt tot een inefficiënte allocatie van middelen (allocatieve inefficiëntie). Compenserende inkoopmacht (dat ook wel onderhandelingsmacht wordt genoemd) betreft inkoopmacht die wordt uitgeoefend jegens leveranciers die wel beschikken over marktmacht (verkoopmacht) en dus in de afwezigheid van inkoopmacht monopolie-macht zouden uitoefenen. Omdat in dit geval zowel afnemers als leveranciers beschikken over marktmacht komen markttuitkomsten over het algemeen tot stand via individuele onderhandelingen. Compenserende inkoopmacht kan de allocatieve inefficiëntie die monopolie-macht met zich brengt verminderen en werkt daarom over het algemeen efficiëntiebevorderend. Daarbij dient echter te worden opgemerkt dat zowel monopsoniemacht als compenserende inkoopmacht ook gevolgen kunnen hebben voor dynamische efficiëntie (innovatie). Een mogelijk negatief effect van inkoopmacht op dynamische efficiëntie kan zich bijvoorbeeld voordoen indien leveranciers door de uitoefening van inkoopmacht erop anticiperen dat zij investeringen in onderzoek en ontwikkeling niet (voldoende) terugverdienen en daarom besluiten minder te investeren. Tegelijkertijd kan inkoopmacht de prikkels voor leveranciers om te investeren in innovatie juist ook bevorderen, omdat dit kan leiden tot een concurrentievoordeel. Inkoopmacht kan daarom ook positieve effecten hebben op dynamische efficiëntie.

Indien mededingingsbeleid enkel rekening zou houden met de statische efficiëntie-effecten van inkoopmacht, zoals deze naar voren komen in traditionele economische evenwichtsmodellen, dan ligt een zeer strikte aanpak voor de hand. Inkoopmacht (en/of verkoopmacht) leidt namelijk over het algemeen tot een lager efficiëntieniveau dan op grond van traditionele evenwichtsmodellen onder volledige (of perfecte) concurrentie kan worden verwacht. In dit verband zou daarom kunnen worden gepleit voor beleid dat bijvoorbeeld is gericht op een volledig verbod van de uitoefening van inkoopmacht (en/of verkoopmacht) of op het bevorderen van compenserende inkoopmacht (en/of compenserende verkoopmacht). Een dergelijke visie gaat echter voorbij aan het dynamische karakter van het concurrentieproces. Het concept van volledige (of

perfecte) concurrentie dat centraal staat in traditionele evenwichtsmodellen is namelijk niet meer dan theoretisch. Concurrentie is geen statisch concept dat leidt tot een specifiek evenwicht maar is een dynamisch proces waarin ondernemingen voortdurend worden geprikkeld om nieuwe technologieën, producten en processen te ontwikkelen om een concurrentievoordeel ten opzichte van hun rivalen te bemachtigen. Het mededingingsbeleid dient er rekening mee te houden dat sprake kan zijn van een afruil, waarin de ontwikkeling van marktmacht en de allocatieve inefficiëntie die daarmee gepaard kan gaan noodzakelijk kan zijn om productieve en/of dynamische efficiëntie te bevorderen. Zo kan productieve efficiëntie vereisen dat bedrijven die bijvoorbeeld door schaalvoordelen efficiënter opereren dan hun rivalen marktmacht verwerven. Daarnaast is van belang dat voor de bevordering van dynamische efficiëntie over het algemeen risicovolle en zeer kostbare investeringen zijn vereist, waartoe bedrijven enkel bereid zijn indien zij redelijkerwijs kunnen verwachten daardoor een aanzienlijk hogere winst te kunnen behalen om die investeringen ruimschoots terug te kunnen verdienen. Beleid dat erop is gericht om te voorkomen dat bedrijven de marktmacht uitoefenen die zij hebben verkregen als gevolg van succesvol ondernemerschap, schaalvoordelen of innovatie zou daarom de belangrijke prikkels verstoren die ten grondslag liggen aan het fundamentele principe dat concurrentie economische efficiëntie bevordert.

Gelet op het dynamische karakter van het concurrentieproces dient mededingingsbeleid zich daarom niet te richten op inkoopmacht (en/of verkoopmacht) die via het concurrentieproces tot stand is gekomen maar op gedragingen die zijn gericht op het verkrijgen, versterken of behouden van inkoopmacht door het verstoren van het concurrentieproces. Anticompetitief gedrag stelt ondernemingen in staat marktmacht te verkrijgen, te versterken of te behouden buiten het concurrentieproces om. Gelet op de symmetrie in de efficiëntie-effecten van inkoopmacht en verkoopmacht is in het onderhavige onderzoek aan de hand van economische literatuur over verkoopmacht een drietal categorieën potentieel anticompetitief inkoopgedrag geïdentificeerd. De eerste categorie betreft collusie, waarbij afnemers de parameters waarop zij op de inkoopmarkt concurreren onderling afstemmen om zodoende gezamenlijk inkoopmacht te kunnen uitoefenen. Hoewel dit kan leiden tot verminderde economische efficiëntie, kan samenwerking tussen concurrerende afnemers ook efficiëntiebevorderend werken, bijvoorbeeld omdat gezamenlijke inkoop de betrokken ondernemingen in staat stelt productieve en/of dynamische efficiëntie te bevorderen. Een tweede categorie potentieel anticompetitief inkoopgedrag betreft uitsluiting, waarbij een onderneming die beschikt over een (zeer) grote mate van inkoopmacht deze aanwendt om een (potentiële) concurrent van diezelfde of van een aanverwante markt te weren. Er zijn veel verschillende gedragingen die deel kunnen uitmaken van een uitsluitingsstrategie, bijvoorbeeld het gebruik maken van exclusiviteitscontracten, loyaliteitsprogramma's, roof- en boycotgedrag en het koppelen of bundelen van bepaalde producten of diensten. Tegelijkertijd geldt dat voor alle gedragingen die wellicht ogenschijnlijk

onderdeel zijn van een uitsluitingsstrategie verschillende verklaringen bestaan waarom zij de efficiëntie juist kunnen bevorderen. De derde categorie van potentieel anticompetitief inkoopgedrag betreft de fusie (of acquisitie), waarbij meerdere ondernemingen tot één worden samengevoegd en inkoopmacht daardoor mogelijk kan worden verkregen, versterkt of behouden. Over het algemeen leiden horizontale fusies sneller tot een toename van inkoopmacht dan verticale fusies, omdat de betrokken partijen bij horizontale fusies directe concurrenten betreffen. Beide typen fusies kunnen voorts belangrijke efficiëntievoordelen met zich brengen, bijvoorbeeld omdat zij de betrokken ondernemingen via kostenbesparingen in staat stellen productieve en/of dynamische efficiëntie te bevorderen.

De aanpak van inkoopmacht in het Europese mededingingsrecht

In het onderhavige onderzoek is voorts nagegaan of de geïdentificeerde potentiële mededingingsproblemen kunnen worden geadresseerd onder het huidige materiële juridische kader van het Europese mededingingsrecht. Dit vereist dat de mededingingsregels zodanig zijn geformuleerd dat zij de bevoegdheid geven om bij alle typen potentieel anticompetitief inkoopgedrag in te grijpen om zodoende systematische ‘Type II fouten’ te kunnen voorkomen, waarbij anticompetitief inkoopgedrag ten onrechte niet wordt aangepakt. Tegelijkertijd is het van belang dat de mededingingsregels niet te strikt zijn en ermee rekening kunnen houden dat de verschillende gedragingen die onder omstandigheden de economische efficiëntie schaden ook positieve efficiëntie-gevolgen kunnen hebben om zo ‘Type I fouten’ te kunnen voorkomen, waarbij ten onrechte wordt ingegrepen bij gedragingen die niet anticompetitief zijn. Ten slotte is van belang dat rekening wordt gehouden met de reguleringskosten die gepaard gaan met de mededingingsregels en de toepassing daarvan in de praktijk, zoals administratieve lasten, toezichtlasten, handhavingskosten en rechtsonzekerheid.

Hoewel het materiële juridische kader van het Europese mededingingsrecht vaak wordt gerelateerd aan verkoopgedrag, kan het ook worden toegepast op inkoopgedrag. Daarbij geldt wel een beperking. Toepassing van de mededingingsregels vereist dat sprake is van een ‘onderneming’, een concept dat vereist dat de desbetreffende entiteit een ‘economische activiteit’ verricht. Omdat het concept ‘economische activiteit’ vereist dat sprake is van het leveren van goederen of diensten kwalificeert inkoopgedrag niet als zodanig als ‘economische activiteit’, maar is dat enkel het geval indien het latere gebruik van het gekochte product of de gekochte dienst wordt aangewend voor een ‘economische activiteit’ (het leveren van goederen of diensten). Deze beperking lijkt met name als gevolg te hebben dat inkoopgedrag van eindgebruikers (die over het algemeen niet over inkoopmacht beschikken) en van overheden (waarvoor specifieke inkoopregels kunnen gelden) over het algemeen buiten de reikwijdte van het mededingingsrecht vallen. Inkoopmacht dat wordt uitgeoefend

door bedrijven zal in de praktijk veelal kwalificeren als ‘economische activiteit’ en daarom, wat deze voorwaarde betreft, onder de reikwijdte van het Europese mededingingsrecht vallen.

Uit het onderzoek volgt dat alle geïdentificeerde categorieën van potentieel anticompetitief inkoopgedrag kunnen worden geadresseerd onder het Europese mededingingsrecht. Collusie onder afnemers kan worden aangepakt met artikel 101 van het Verdrag betreffende de werking van de Europese Unie (VwEU). De mogelijk schadelijke effecten van collusie onder afnemers is in verschillende gevallen erkend en geadresseerd door zowel de Europese Commissie en de Europese rechters. De Spaanse en Italiaanse tabakszaken zijn een praktijkvoorbeeld daarvan. In deze zaken werd geoordeeld dat de desbetreffende partijen onder meer de inkoopprijs onderling afstemden en werd het inkoopkartel vergelijkbaar behandeld als een verkoopkartel. Tegelijkertijd hebben zowel de Europese Commissie als de Europese rechters aangegeven dat samenwerking tussen afnemers niet altijd schadelijk hoeft te zijn, bijvoorbeeld indien sprake is van gezamenlijke inkoop. Ten aanzien van uitsluitingsgedrag door een afnemer is het afhankelijk van het type uitsluitingsstrategie of dit kan worden geadresseerd door artikel 102 VwEU (bij unilaterale gedragingen) en/of artikel 101 VwEU (bij verticale overeenkomsten). Hoewel de Europese Commissie in haar richtsnoeren met betrekking tot het verbod op misbruik van een economische machtspositie en verticale overeenkomsten vooral aandacht aan verkoopmacht besteedt, blijkt uit bijvoorbeeld de zaak *British Airways* dat dit verbod ook kan worden toegepast op uitsluitingsgedrag door een afnemer met inkoopmacht. Ten slotte kunnen fusies met mogelijke inkoopmachtproblemen worden geadresseerd op grond van de Europese Concentratieverordening (139/2004). In haar richtsnoeren ten aanzien van haar fusietoezicht erkent de Europese Commissie dat fusies tot problemen kunnen leiden met betrekking tot inkoopmacht. De Europese Commissie heeft in verschillende fusiezaken specifiek gekeken naar mogelijk schadelijke effecten als gevolg van een toename van inkoopmacht, zoals bij *Kesko/Tuko*, *Rewe/Meinl* en *Carrefour/Promodes*.

Omdat alle potentiële mededingingsproblemen van inkoopmacht onder het Europese mededingingsrecht kunnen worden geadresseerd, volgt uit het onderhavig onderzoek niet de conclusie dat er sprake is van een leemte in de mededingingsregels waardoor deze niet in staat zouden zijn om mogelijke inkoopmachtproblematiek aan te pakken. Wel is een kritische kanttekening geplaatst inzake de welvaartsstandaard die wordt gehanteerd in het Europese mededingingsrecht. Afhankelijk van de precieze vormgeving van een mededingingsregel vergt toepassing daarvan een bepaalde mate van zaakspecifieke analyse, waarbij een welvaartsstandaard een behulpzaam middel kan zijn om statische efficiëntie-effecten te kunnen beoordelen. Er worden in de rechtseconomische literatuur over het algemeen twee typen welvaartsstandaarden

onderscheiden. Bij de consumentenwelvaartsstandaard wordt bij de beoordeling van mogelijke schadelijke effecten (of efficiëntievoordelen) enkel gekeken naar de consumentenwelvaart. Onder de totale welvaartsstandaard vindt deze beoordeling plaats op basis van de efficiëntie-effecten voor zowel afnemers als leveranciers.

Hoewel het Europese mededingingsrecht geen specifieke welvaartsstandaard voorschrijft inzake de beoordeling van mogelijke anticompetitieve effecten lijkt de Europese Commissie gelet op haar beschikkingspraktijk en richtsnoeren de consumentenwelvaartsstandaard toe te passen. In beginsel hoeft dit niet tot andere uitkomsten te leiden dan de totale welvaartsstandaard. De schade die anticompetitief inkoopgedrag kan toebrengen aan het concurrentieproces, een proces dat ondernemingen stimuleert om zoveel mogelijk aan te sluiten bij de voorkeuren van consumenten, zal zich veelal doorvertalen in verminderde consumentenwelvaart. Dit kan echter anders zijn indien anticompetitief inkoopgedrag de betrokken onderneming(en) in staat stelt monopsoniemacht uit te oefenen op de inkoopmarkt maar er geen sprake is van marktmacht op de verkoopmarkt (verkoopmacht) waarop het desbetreffende product of de dienst wordt verkocht aan de consument (of andere afnemers). Dit scenario kan ontstaan indien de reikwijdte van de geografische inkoopmarkt kleiner (bijvoorbeeld regionaal) is dan die van de geografische verkoopmarkt (bijvoorbeeld landelijk of Europees) of indien ondernemingen die op de verkoopmarkt onderling concurreren gebruik maken van andere productiemiddelen of halffabricaten en deze dus op een andere inkoopmarkt aanschaffen. Indien er op de verkoopmarkt geen marktmacht is, kan anticompetitief inkoopgedrag de economische efficiëntie schaden maar hoeft dit zich niet rechtstreeks door te vertalen naar schade voor de consumentenwelvaart. Dit heeft als gevolg dat de toepassing van de consumentenwelvaartsstandaard ertoe kan leiden dat anticompetitief inkoopgedrag ten onrechte structureel niet wordt geadresseerd (Type II fout) indien dit impliceert dat schade aan de consumentenwelvaart een noodzakelijke voorwaarde is om een inbreuk van het mededingingsrecht te constateren.

Tegelijkertijd is in dit onderzoek opgemerkt dat er indicaties zijn dat de Europese Commissie het bovengenoemde risico erkent en in haar handhavingpraktijk onder omstandigheden afwijkt van toepassing van de consumentenwelvaartsstandaard. In haar bijdrage voor een rondetafelgesprek van de OESO over monopsonies en inkoopmacht heeft de Europese Commissie toegelicht dat het onder omstandigheden noodzakelijk kan zijn om te onderzoeken of er mogelijk schadelijke effecten optreden op de inkoopmarkt, ook als is vastgesteld dat er geen schade is op de verkoopmarkt. Deze aanpak heeft de Europese Commissie gehanteerd in de fusiezaak *Sovion/Südfleisch*. Hoewel deze observatie illustreert dat het risico dat anticompetitief inkoopgedrag structureel niet wordt geadresseerd (Type II fout) mogelijk beperkt is, duidt dit op een discrepantie tussen de daadwerkelijke aanpak van inkoopmacht door

de Europese Commissie en de geschetste aanpak in de richtsnoeren van de Europese Commissie. Tegen deze achtergrond is dit onderzoek de suggestie gedaan de richtsnoeren op dit punt aan te passen. Daarbij kan mogelijk een voorbeeld worden genomen aan de aanpassing die het Department of Justice en de Federal Trade Commission in de Verenigde Staten in 2010 hebben aangebracht in hun richtsnoeren ten aanzien van de beoordeling van horizontale fusies. Deze richtsnoeren benadrukken dat horizontale fusies die mogelijk leiden tot mededingingsproblemen inzake inkoopmacht niet (enkel) worden beoordeeld aan de hand van de effecten op de consumentenwelvaart en de consumentenwelvaartsstandaard in deze gevallen dus niet wordt toegepast.

Conclusie

Op basis van de rechtseconomische analyse die in dit onderzoek is uitgevoerd, is geconcludeerd dat alle potentiële mededingingsproblemen van inkoopmacht in beginsel kunnen worden geadresseerd in het huidige materiële juridische kader van het Europese mededingingsrecht. Wel zijn enkele kritische kanttekeningen geplaatst inzake de toepassing van de consumentenwelvaartsstandaard in plaats van de totale welvaartsstandaard. De consumentenwelvaartsstandaard leidt in beginsel niet tot andere uitkomsten dan de totale welvaartsstandaard en kan bovendien wenselijk zijn omdat dit reguleringskosten en mogelijk ongewenste lobbyinvloeden kan beperken. Een belangrijk nadeel van de consumentenwelvaartsstandaard ten opzichte van de totale welvaartsstandaard geldt specifiek voor de mogelijke mededingingsproblemen van inkoopmacht. Omdat monopsoniemacht niet direct de consumentenwelvaart hoeft te schaden, kan toepassing van de consumentenwelvaartsstandaard onder omstandigheden ertoe leiden dat anticompetitief inkoopgedrag ten onrechte niet wordt geadresseerd (Type II fout). Tegen deze achtergrond is in dit onderzoek de suggestie gedaan om, in navolging van een vergelijkbare aanpassing in de Verenigde Staten, in de richtsnoeren van de Europese Commissie te verduidelijken dat potentieel anticompetitieve gedragingen niet (enkel) worden beoordeeld op basis van de effecten op de consumentenwelvaart.

Klachten over inkoopmacht lijken niet altijd betrekking te hebben op economische efficiëntie, op grond waarvan het materiële juridische kader van het Europese mededingingsrecht in dit onderzoek is getoetst. Voor een belangrijk deel lijken klachten over inkoopmacht gebaseerd op een bepaalde perceptie van 'rechtvaardigheid' omdat bepaalde specifieke gedragingen soms worden geacht 'oneerlijk' te zijn, zoals het bedingen van een te lage inkoopprijs, te late betalingen en eenzijdige wijzigingen van (inkoop)voorwaarden. Artikel 102 VwEU biedt weliswaar enige grondslag om 'onbillijke' voorwaarden te adresseren maar kent ook beperkingen, bijvoorbeeld omdat het de aanwezigheid van een 'economische machtspositie' vereist en de desbetreffende gedragingen niet per se de concurrentie op de markt beïnvloeden (maar veeleer de

bilaterale onderhandelingsrelatie tussen een leverancier en afnemer). Omdat het Europese mededingingsrecht mogelijk geen afdoende handvat biedt voor alle gedragingen die partijen als 'onrechtvaardig' kunnen percipiëren, zouden additionele beleidsmaatregelen kunnen worden overwogen om 'oneerlijke' handelspraktijken tegen te gaan. In dit verband is benadrukt dat de mogelijkheid om marktmacht uit te oefenen een essentiële voorwaarde is voor het basisprincipe dat het concurrentieproces economische efficiëntie bevordert. Maatregelen om 'oneerlijke' handelspraktijken tegen te gaan kunnen daarom de economische efficiëntie schaden indien zij zijn gericht op het beperken van de mogelijkheden om inkoopmacht uit te oefenen. Bovendien hebben maatregelen die zijn gericht op het voorkomen van specifieke 'oneerlijke' gedragingen veelal niet als gevolg dat de desbetreffende onderneming(en) inkoopmacht niet op andere wijzen kan (kunnen) uitoefenen. Dit kan de vraag doen rijzen in hoeverre de beoogde bevordering van 'rechtvaardigheid' daadwerkelijk effectief is, of dat dit wellicht mogelijk zodanig ingrijpende maatregelen vergt die lastig met de economische doelstellingen van het mededingingsbeleid zijn te rijmen.

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