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Anticompetitive behaviour by firms with market power

Introduction

The first two chapters consider cases where there is a single firm that can be identified as dominant in the market. Each was engaging in identifiable business practices that rivals considered to be an abuse of economic power. The two dominant firms in question could claim that they achieved their dominance by success in the competitive process of giving customers what they wanted. The core economic issue was whether the practices in question went beyond consumer satisfaction. Did they entrench dominance and stifle the competition that would be necessary for consumers to continue to be given what they wanted at a reasonable price?

Both cases were investigated by the European Commission under Article 82 of the EU Treaty which prohibits the abuse of a dominant position. Both cases were also appealed unsuccessfully to the CFI. Article 82 is not specific as to what is an abuse but it provides a number of examples, including 'unfair purchase or selling prices' and price discrimination that leaves trading parties at a 'competitive disadvantage'. If a firm is found to have broken the prohibition, it can be fined up to 10 per cent of its turnover and be required to comply with remedies that eliminate the identified problem. Article 82 has almost exclusively been applied to business practices that exclude rivals and not to directly exploitative high prices. This can be justified up to a point in the context of dominant firms that have achieved their position by virtue of offering consumers what they want. However, it is less persuasive if dominance has been achieved by virtue of government regulation or structural barriers to entry.[1]

In the 2001 case known as *Michelin II*, the tyre manufacturer was found to have abused its dominance by using a complex system of rebates in the French

[1] See Lyons (2007).

market for heavy-vehicle tyres. Michelin, which had a market share of 55–60 per cent, was fined €20 million and required to change the scheme. Motta takes issue with the lack of economic analysis used by both the EC and the CFI to reach this verdict. The Commission did not provide a coherent theory of exclusionary effects and made no serious attempt to identify consumer harm – it merely considered the scheme capable of harm. Motta acknowledges that some elements of the rebate schemes might have had an equivalent effect to tying or exclusivity contracts, but there were also identifiable incentives for service support. Furthermore, quantity discounts can be pro-competitive by encouraging dealers to fight for marginal customers. Motta outlines the theoretical framework necessary to formulate a theory of foreclosure due to various types of rebate and so points the way to a better economic analysis. He notes that Michelin's market share and prices were falling at the time of the case and concludes that it was fairly implausible to expect the rebate schemes to exclude multinational rivals such as Continental, Goodyear, Pirelli, Bridgestone and Sumitomo/Dunlop.

Microsoft has been involved in a number of competition cases on both sides of the Atlantic. In 2004, the EC found that Microsoft had abused its dominant position by deliberately restricting the interoperability between Windows PCs and non-Microsoft workgroup servers and bundling Windows Media Player with its Windows operating system. It had a market share exceeding 90 per cent in PC operating systems and its share of server operating systems rapidly rose from 20 per cent in the late 1990s to over 60 per cent in 2001. It was fined €497 million and a further €280 million for delaying compliance with a required remedy, which was to provide technical information on the Windows interface that would facilitate interoperability.[2] Kühn and Van Reenen concentrate on the interoperability issue. Their analysis supports the Commission's case, though the EC's economic argument could have been improved. The authors demonstrate how Microsoft had both the ability (through restricting interoperability) and the incentive to foreclose rivals in server operating systems. The incentive came both in extracting surplus from consumers and in preserving its PC operating system monopoly. This could be achieved in the long term by preventing users from being able to switch to server-based operating systems and so bypassing the need for a sophisticated PC operating system. An important issue was the extent to which these competition issues should outweigh Microsoft's intellectual property rights. The authors argue that

[2] This is a large sum of money that would build several new hospitals, but from another perspective it is less than a half a per cent of Microsoft's market capitalisation.

even if Microsoft's incentive to invest in developing better software may be compromised by the remedy, the incentive for rivals will be much enhanced. Finally, they briefly review the Windows Media Player part of the case and criticise the Commission's chosen remedy.

The next two chapters address rather different issues under different legislation. A common feature is that both have four leading firms with broadly similar market shares. In each case, these firms appeared to be competing reasonably vigorously with each other, but there were concerns expressed about some of their practices. These raised a Goldilocks problem: were these practices leading to prices that were too high, too low or about right?[3] The first case investigates the boundary between full regulation and competition policy. The case followed an appeal by lightly regulated firms over a price cap on mobile phone termination charges. The second is based on a distinctively UK element of competition policy which allows for the investigation and remedy of markets which do not have a single dominant firm yet are apparently not working well.[4]

Mobile networks charge the originating network for providing the service of delivering a call from a fixed line to their subscribers. This is known as a termination charge. Since most customers have only one mobile phone, each network holds a monopoly on call delivery to its customers. It must therefore be expected to set inefficiently high termination charges, which will be passed on to fixed-line customers. This makes it very attractive to sign up mobile subscribers and leads to strong competition for them, so creating some offsetting benefits (e.g. in the form of 'free' handsets). The monopoly delivery is sometimes called a bottleneck and the competition for customers makes it a 'competitive bottleneck'. Mobile-to-mobile calls are different in that mobile networks negotiate reciprocal charges. With similar-sized networks, these charges will more or less cancel out and the parties argued that this changes the economics. It may even become more profitable to set inefficiently low termination charges in order to soften competition for subscribers. The Competition Commission was unconvinced by this argument and determined that negotiated termination charges were too high and would have to be

[3] Goldilocks is a fairy-tale character who stumbled across the house of the three bears (Daddy, Mummy and Baby) while they were out and found that the three bowls of porridge they had left on the table were either too hot, too cold or just right.

[4] Since 2003, the European Commission also has powers to investigate markets, though it does not have the powers of remedy that are available to the UK Competition Commission. UK powers under the Fair Trading Act (1973) have since been revised in part 4 of the Enterprise Act (2002). This major revision included a move from a public-interest test to an explicit competition test. EC powers derive from Article 17 of Regulation 1/2003 EC.

reduced. Armstrong and Wright show how a simple model which takes account of the essential characteristics of the market can help to reveal where the truth lies. They conclude that the Competition Commission's findings and the implications of their own modelling are broadly consistent, though the model does point out some inconsistencies in the reasoning.

The top four UK grocery chains in 1999 commanded 84 per cent of the sales of large supermarkets and nearly two-thirds of all grocery sales. The sector accounted for 40 per cent of all retail spending, so it had a very high profile and the leading firms were investigated in 2000 as a 'complex monopoly' (i.e. an oligopoly).[5] Concerns related to both pricing practices and buyer power. The former included below-cost selling and price flexing (geographic price discrimination). One finding was that price flexing was against the public interest because consumers paid more when their local supermarket faced weaker competition. However, Dobson draws on economic theory to observe that this is unlikely to harm consumers on average because, if there is national pricing, consumers will be charged a price that reflects average market power, so some consumers will get lower prices just as others pay more. Furthermore, national pricing may facilitate coordinated effects. The case also raises issues relating to the effect of buyer power on the dynamics of retail competition, the possibly predatory effect of below-cost selling and the difficulty of designing effective remedies even when a problem is identified. For example, drawing on evidence from elsewhere in Europe, remedies to make prices more cost reflective might soften competition and so do more harm than good.

[5] Since this chapter was written, the Competition Commission has published another report into the wider groceries market.