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BERGEN CENTER FOR COMPETITON LAW AND ECONOMICS

From Enso/Stora to Uber/Lyft: Uses and Abuses of Buyer Power

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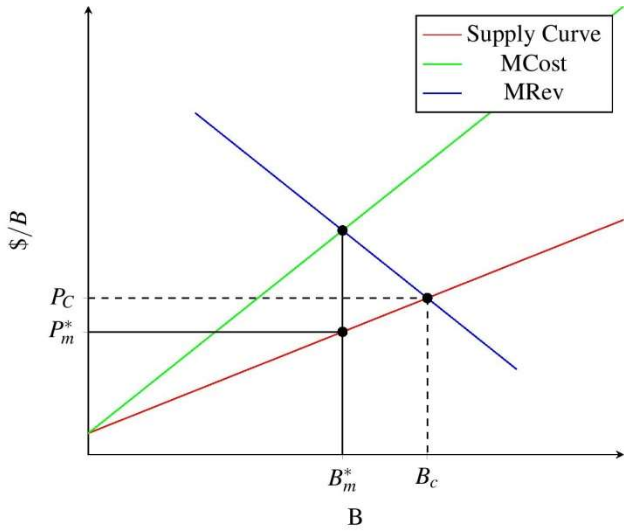
Agenda for the next 45 mins

- Crash course of buyer power economics
- How is buyer power exerted?
  - Exploitation
  - Exclusion
  - Countervailing buyer power
- General findings
- Q&A

What is Buyer Power?

- Umbrella definition
- Monopsony power ≠ 'bargaining' power
- Monopsony is the 'old' approach to buyer power
  - Requires demand withholding to reduce purchasing prices
  - "Mirror" image of monopoly



Implies a "withholding effect"

It is *always inefficient*

Does not happen much
in real life

Why not a lot of monopsony?

- It is **not** economically rational
  - Too much monopsony will push out suppliers (marginal suppliers first, then more!)
  - No alternative suppliers, no buyer power
  - Why withhold demand if I can get lower prices and more input?
    - Use bargaining power instead and sell cheaper = profit maximizing
  - Monopsony reduces prices for *all buyers*, why help competitors?

What is bargaining power?

- Bargaining power is the other side of buyer power. Tends to be welfare enhancing *if* downstream market is competitive
- Its exercise affects 2 markets: upstream and downstream

Bargaining power:

- **Does not involve withholding**
- **May be efficient,**
  - **If passes price reductions**
- **May neutralize seller power**
  - **Countervailing buyer power** (Galbraith, 1957)

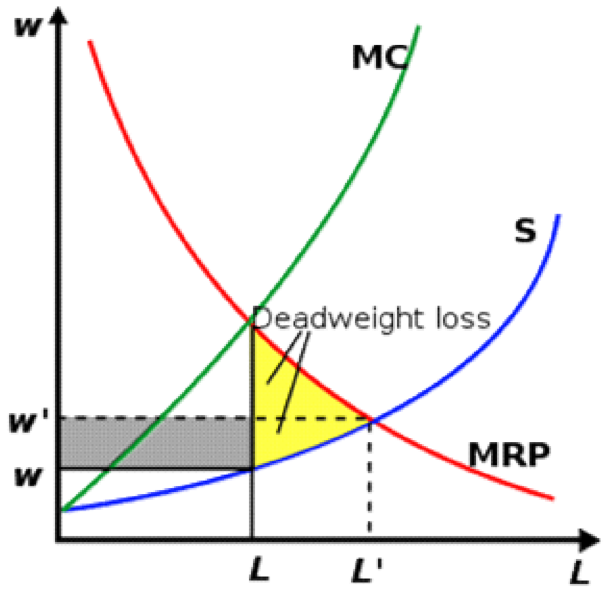
How do you exercise pernicious buyer power?

- 3 main ways:
  - **Exploitatively** – for instance by entering into a buyers' cartel
    - Or more obviously: "paying an unfairly low purchasing price"
  - **Exploitatively and unfairly**: through *unfair purchasing practices*
  - And **exclusionary abuses**: raising rivals' costs

Buyer power exploitation – low prices

Buyer power exploitation – low prices

- The *most intuitive* buyer power *exploitation*
  - Pay a very low purchasing price (below marginal cost and the competitive level)
  - For monopsony this implies reduction in purchasing – ***withholding*** -



However…

Unlikely to happen in practice – very, very few cases have ever dealt with demand withholding.

Are low purchasing prices a welfare issue?

Agreements imposing purchasing conditions

- **Buyers' cartels** vs **buying alliances**
  - The bad and the good
- Scrutinized by the Guidelines on Horizontal Agreements
  - Used to decrease downstream market competition and limit access
  - May not result in passing-on of lower purchasing prices (hourglass effect)
  - Impact on diversity of suppliers' production
- Safety zone:
  - Not above 15% on purchasing **and** selling market (combined)
- **But no clear distinction between alliance and cartel**
  - Helps colluding in downstream market (exchange of information; reduced variety, costs are in downstream market)

Buyers’ cartel: fixing purchasing prices

- Art. 101(a) prohibits fixing purchasing prices – regardless if exploitative or not (object restriction).
  - It is a violation, even absent substantive buyer power
  - May benefit from 101(3) TFEU (unlikely, though!)
  - In the US they are per se illegal
  - Outside of *De Minimis*
  - Clear cut when cartel is created to withold demand (monopsony)
    - What if cartel is for bargaining power?
      - More chances under 101(3)TFEU for pro-competitive benefits?
    - Should remain an object restriction (bargaining) –cf with Kokkoris (per se) or Ezrachi (ways of employing buyer power)

Buyers' cartel: fixing purchasing prices

- There is some limited case law
  - Raw Tobacco **Spain**
    - Dual cartel: buyer – seller
    - Fixing maximum delivery price: led to restriction of competition among members
    - Object restriction
  - Raw Tobacco **Italy**
    - Set purchasing quotas (Art. 101(a), (b), (c)).
    - Object restriction
    - Coordinated pricing policies downstream
    - Consumer harm

Buying alliances

- Usually pro-competitive: lower end prices, larger output/quality, increase innovation.

- Defined in Guidelines for horizontal agreements as: “an association of undertakings formed by a group of retailers for the joint purchasing of products”.

- Pools bargaining power to neutralize seller market power by integrating purchases (centralized purchasing = economies of scale)

Differences with cartels?

- Based on whether the purchasing agreement may lead to collusion by *facilitating the coordination downstream*.
- *Transparent* if it reduces exchange of sensitive information
- Purchasing is *made by an agent* (independent) and stable/permanent
- Legally speaking: pro-competitive and not object restrictions but in any case just effect based.
  - US Supreme Court not per se, but rule of reason (United States v. Topco Assocs., Inc., 405 U.S. 596 (1972); NW Wholesale Stationers v. Pac. Stationery, 472 U.S. 284 (1985)).

Unfair Trading Practices

- Practices that deviate from good commercial conduct, are contrary to good faith and fair dealing and are unilaterally imposed by one trading partner on another
- Often the result of someone taking advantage of their buyer (bargaining) power vis-à-vis a weaker party
- Transfer of profits or risks between the parties to a commercial relationship
  - No adequate compensation (Kirkwood)
- Can be welfare enhancing if effective competition downstream

Unfair Trading Practices

- Examples:
  - Exclusive supply
  - Refusal to buy and delisting
  - Joint marketing contributions
  - Unilateral contract amendments
- Newly regulated at EU level by Directive 2019/633
  - Only applies for the food supply chain
  - Big vs Small approach
  - Some conducts blacklisted and others conditioned to previous agreement
  - Rules apply in addition to competition law
  - May affect the activitity of the NCA

Exclusionary buyer power

Exclusionary buyer power

- Buyer power exercised **vis-à-vis supplier** to put competing **buyers at a disadvantage** by **increasing rival's costs**
  - Competing buyers acquire ***same input*** but
    - Carry out *retailing in* ***different markets***
      - IKEA purchases wood for furniture
      - XEROX purchases wood pulp for paper
    - Carry out *retailing* ***in same market***
      - Weyerhaeuser buys tree logs for paper and packing products
      - Ross-Simmons Hardwood buys tree logs for paper and packing products

- Disadvantage can be in the *upstream* **and/or** *downstream* market

Overbuying - Weyerhaeuser

- **Weyerhaeuser** (WY) and **Ross-Simmons Hardwood** (RS) competed buying tree logs (regional market) and in selling hardwood lumber (national market)

- WY had **65% of the purchasing market** – large national seller as well (largest owners of timberland in the world)

- From 1998 to 2001 **prices of logs increased** but hardwood **lumber prices declined** (including WY's profit)

- RS blamed WY for manipulating prices by hoarding timber, a breach of Section 2 Sherman Act

Overbuying - Weyerhaeuser

- Ninth Circuit Court of Appeals **did not apply Brook Group** test (downstream predation) and affirmed decision

- WS "*purchased more logs than it needed*, or *paid a higher* price for logs more *than necessary*, in order to *prevent* [Ross-Simmons] from *obtaining the logs they needed at a fair price*".

- Appeal Court held that **predatory buying is worse than predatory selling**
  - Buyers pay less for input, charge the same to consumers
  - Unlikely to have new entrants (and why would they enter a market with high prices? Suppliers are happy to get extra profit)

Overbuying - Weyerhaeuser

- However **US Supreme Court disagreed**
  - Argued that **predatory buying is analogous to predatory selling**
  - Overbuying is rare because little chance for recoupment
  - Positive for consumers (if no recoupment downstream)
    - Pure consumer welfare approach
  - Many reasons why overbuying is not illegal
  - US Supreme Court ordered retrial and **application of *Brooke Group Test*** (downstream predation and recoupment)

Targeted predation?

- Uber & Lyft case in the US
- Intersection between competition and labor law
  - Class action by Lyft drivers
- Uber tracked drivers that dual apped
  - Drove for Uber and Lyft at the same time
- Uber identified these drivers and sent them more rides with a premium paid,
  - Reducing drivers available to Lyft users, Lyft service quality and Lyft market share and profits

Targeted predation?

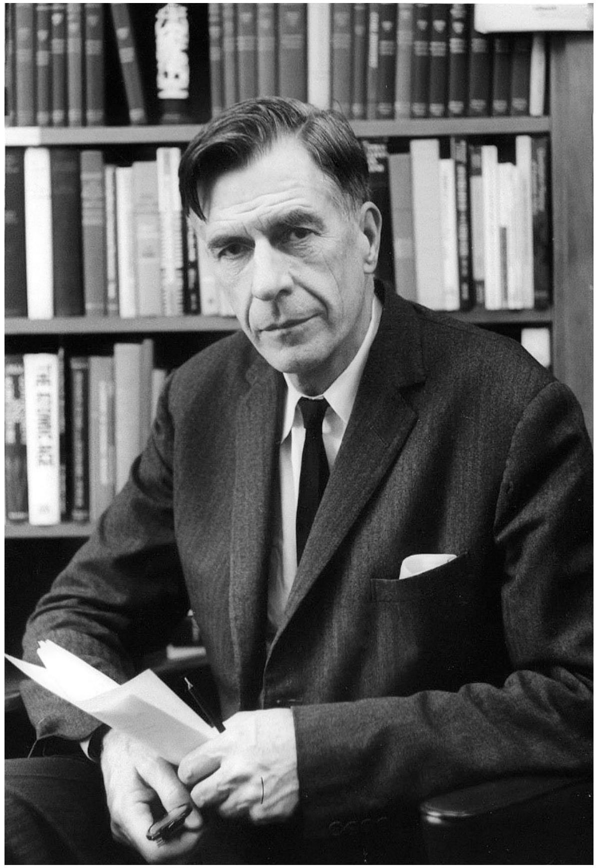
- Uber & Lyft case in the US
  - Is this purchasing predation or fight for an input?
    - Maybe Uber simply pays more for its input because it values it more?
  - Case was ultimately dismissed by California District Court in 2017
  - Hell discontinued by Uber in 2016

- Now common in procurement markets
  - Very low offers on price, or even negative selling prices
  - «Predatory procurement bidding»
  - Seeing responses such as the preço-base in Portugal
    - Countervailing buyer power?

Countervailing buyer power

Countervailing buyer power

- One of the most popular buyer power topics
- Theory put forward by J.K. Galbraith
- CBP is analogous to the figure of bargaining power
- It neutralizes opposing market power
- … but
  - My use of CBP is in narrower sense
  - I define CBP as sufficient enough to neutralize seller market power (dominance or SIEC) and as a legal concept
  - Acts as a procedural defense

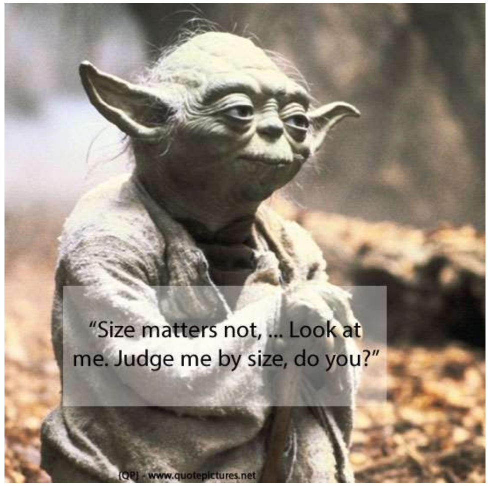


Sources of CBP

- **Alternative supply sources** *(Cementbouw Handel)*
  - Most important sources: shift orders, vertically integrate, sponsor entry, in-house production *(Sun Chemical)*
  - Dual sourcing strategies *(Car Glass)*: supermarket retailers
  - Must happen in a **reasonable time**
    - Irish Sugar required *short term*
    - Enso/Stora *short term*
    - In CVC/Lenzing was a case assessment (need to adjust supply)
    - But in Cementbouw shifts:
      - "within a reasonable time". T-282/02 - *Cementbouw Handel & Industrie v Commission*, EU:T:2006:64 E.C.R. [2006] II-00319, para 230.
      - "dans un délai raisonnable" and "en un plazo razonable"

Sources of CBP

- **Buyer's size** (and market share)
  - Very relevant source (Sun Chemical)
    - The larger, the more CBP to neutralize seller market power
    - But even small buyers might have a lot of CBP (Enso/Stora and Korsnäs)
  - Also a relevant source in Carglass
    - Sheer size and purchasing structure (centralized one) + alternative supply
  - … but be wary
    - Size only does not matter (that much)



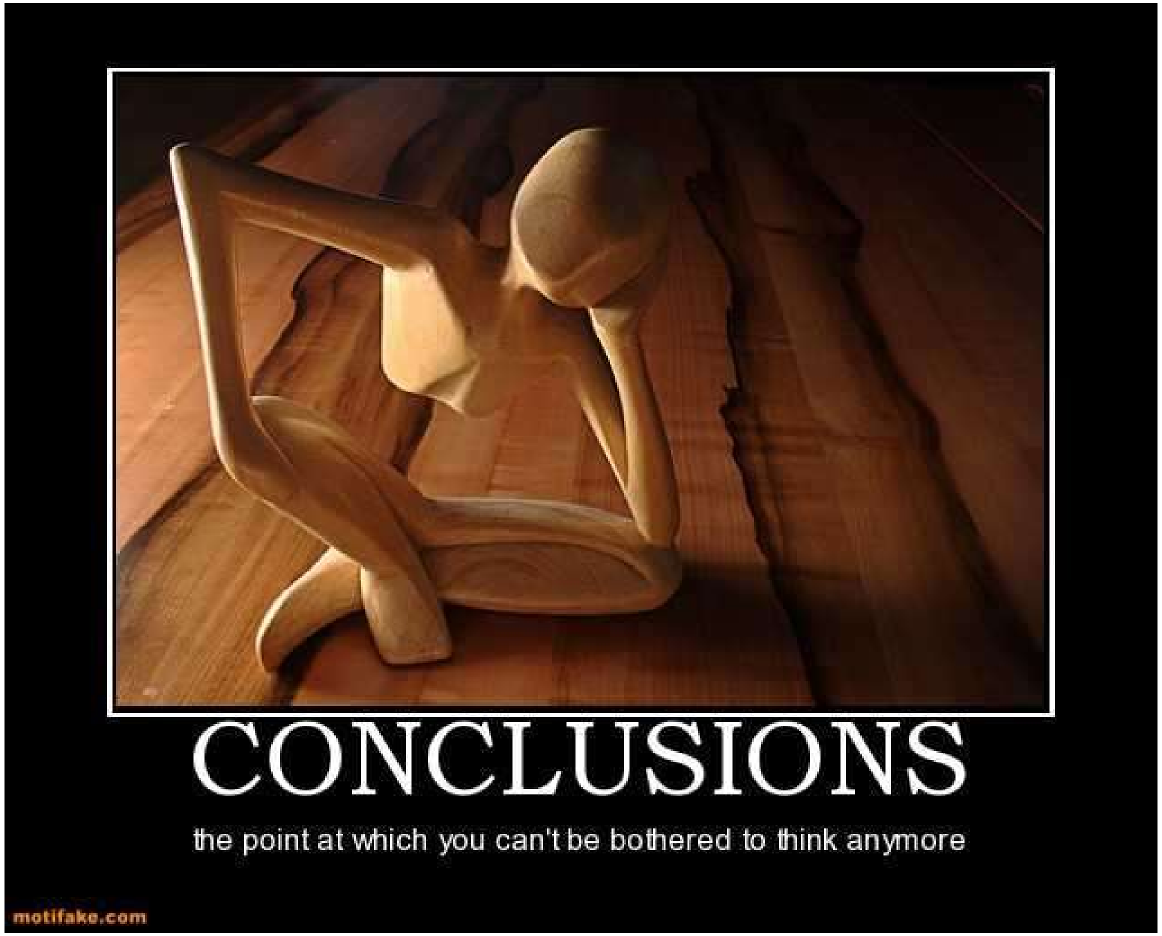
Sources of CBP

- **Commercial significance: ratio of business**
  - Proportion of profits a buyer represents
  - It also shows whether there is dependence and/or substantive buyer market power
    - Famous taux de menace: 22% in Carrefour/Promodes and Rewe/Meinl
  - Enso/Stora: Tetra Pak was more than 50% of the profit
  - Cementbouw held: “no single customer accounts for a substantial part of CVK’s turnover”. *(T-282/02 - Cementbouw Handel & Industrie v Commission, para 233)*

How to assess sufficient CBP?

- Done through the "**comparison test**"
  - Determines if CBP can off-set opposing market power
- Applies in all areas of EU Competition law
- Test contrasts sources and indicators of CBP vis-à-vis the seller market power
  - Key is that it must be sufficient enough
    - That is a key difference with bargaining power
      - CBP does not always exist; bargaining power always
- Originally based on comparison of market shares, market structure and concentration (Nestlé/Perrier and Irish Sugar)
- Evolved beyond symmetry (fortunately)

The message about buyer power or…

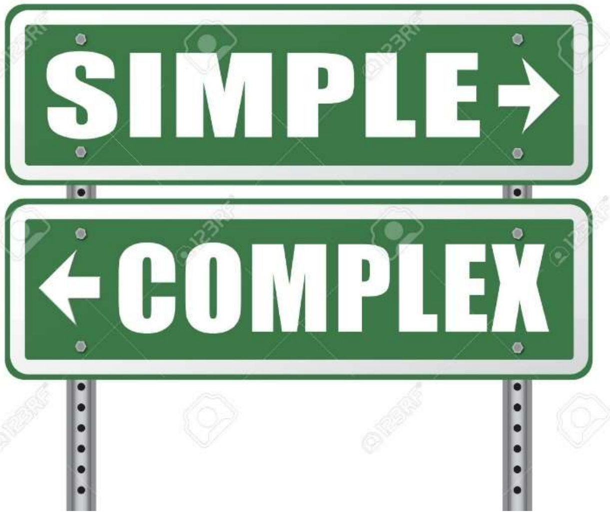


General findings

- Rare, infrequent and somewhat neglected
  - Anticompetitive buyer power is rare
  - Bargaining power tends to be welfare enhancing
  - Not a prioritized area (particularly if we only care about short term evidence of consumer harm)
  - Present in different markets but affecting those with a gatekeeper
    - Typical of retailing (supermarkets)
  - Little legal information on what is buyer power abuse
  - *Unfair* bargaining power has become a thing

General findings

- From a legal perspective
  - **Monopsony is *straight forward***: it is a competition problem and an inefficient purchasing strategy
    - Not really an issue because it happens rarely
      - Not a profit maximizing behavior
      - Assumptions make it too narrow
  - **Bargaining power is *complex***
    - Effects on competition depend on market power as buyer and retailer
    - This is the interesting and juicy bit
    - Most theories of harm I discuss are about bargaining power



General findings

- Buyer power needs a **dualistic perspective**
  - Focus in BOTH the upstream and downstream markets
  - Effects in both
  - Typical if buyers compete upstream for input and downstream as retailers
    - Buying tree logs for paper production
  - Not the case when competing only upstream
    - Buying tree logs
      - For paper production
      - For furniture
  - Dualistic means also means you care for BOTH type of cases
    - Difference to the US approach in *Weyerhaeuser*?

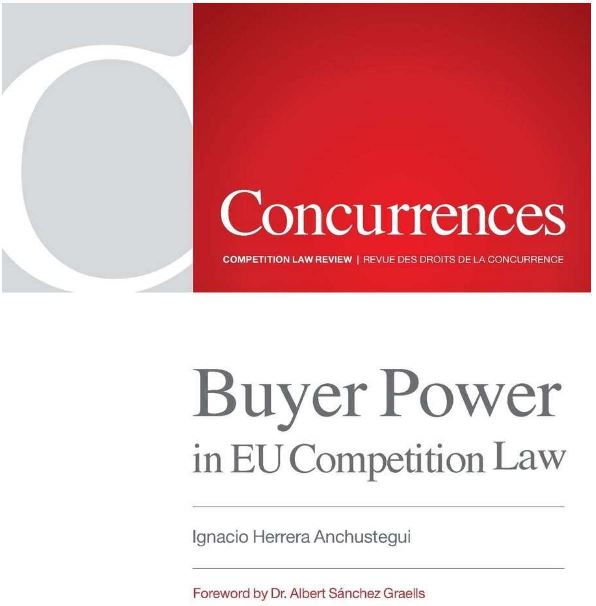
General findings

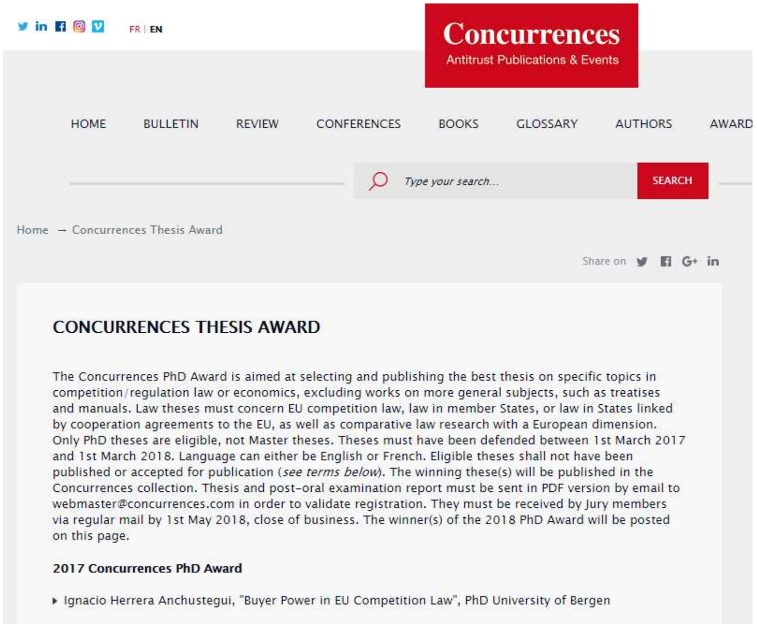
- When is buyer power red light?
  - When undertaking has substantial market power upstream and downstream (hourglass shape)
- When is it yellow light?
  - When buyer has substantial upstream and little competition (but not dominant) downstream
  - When buyer has substantial upstream and quite a lot of competition (this is almost green)
- When is it green light?
  - Substantial upstream and full competition downstream
  - Not substantial market power upstream or downstream

General findings

- When does EU competition law get triggered?
  - No requirement of evidence of direct end consumer harm
  - Triggers if upstream harm affects substantially the competitive process, competition as such
    - Aim is to protect medium and long term welfare (allocative and distributive)
  - Takes into account the welfare considerations of all market participants
    - Hence why harm to suppliers can trigger applicability
      - Hey, I did not say protection of inefficient suppliers!
    - Hence why harm to rival buyers can trigger applicability
      - Hey, I did not say protection of inefficient buyers/retailers!

For more on this…





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