

# The Economics of Competition Law

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## Overview

- competition provisions in the Fair Competition Act
- market definition
- assessment of market power
- case study

## Market Definition: Overview

- the importance of market definition
- what is a market?
- the hypothetical monopolist test

## The importance of market definition

- intermediate step in evaluating competitive effects
- often decisive and most contested part of competition cases
- relevant market → market shares → ability to affect competition

## What is a Market? I

- the term “market” is a reference to a market in Jamaica for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.<sup>1</sup>

<sup>1</sup> See Section 2(3) of the FCA.

## What is a Market? II

- dimensions
  - product
  - geographic
  - time
  - type of buyer

## What is a Market? III

- types of substitution:
  - demand-side substitution: sodas and juices
  - supply-side substitution: high- and low-quality paper
  - new entry
- hypothetical monopolist or SSNIP test

## The Hypothetical Monopolist Test I

'A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area, likely would impose at least a "small but significant and non-transitory" increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test'.<sup>1</sup>

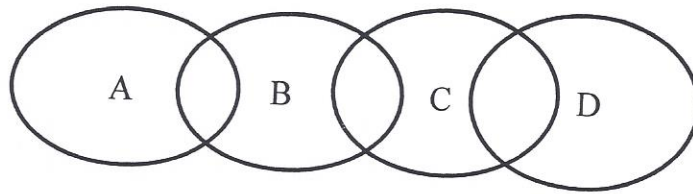
See US DOJ/FTC Horizontal Merger Guidelines (1992)



## The Hypothetical Monopolist Test II

- basic logic: if the hypothetical monopolist cannot raise price, this is because consumers would switch to other products or areas; include these other products in the relevant market
- hypothetical: not firms under investigation
- profit-maximizing firm: prices not regulated
- small by significant (5 - 10%), non transitory (1 - 2 years)

# Illustration: The Product Space



## The Hypothetical Monopolist

### Test III: Other issues

- chain of substitution effects - is the Mercedes and the Daihatsu in the same market?
- asymmetric markets - A is a substitute for B but B is not a substitute for A

## Assessment of Market Power: Overview

- definition of market power
- assessment of market power
  - market shares
  - barriers to entry
  - buyer power
  - economic regulation

## Definition of Market Power

- Market power describes a situation where the constraints, which would usually ensure that an undertaking behaves in a competitive manner, are not working effectively.

A company, unconstrained by competitive pressures, enjoys a discretion in its pricing and other market decisions. The application of competition policy to the conduct of such a firm may protect those with whom it deals.

## Assessment of Market Power I

- Market Shares
  - EU<sup>1</sup>
  - UK<sup>2</sup>
  - USA
  - FTC

<sup>1</sup> Case C-62/86 *Akzo Chemie BV v Commission* [1991] ECR I-3439, at para 60: “With regard to market shares the Court has held that very large shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position That is the situation where there is a market share of 50% .....”.

<sup>2</sup> See UK OFT Assessment of Market Power Guidelines (1999)

## Assessment of Market Power II

- Barriers to Entry
  - Absolute advantages<sup>1</sup>
  - Strategic advantages<sup>2</sup>
  - Exclusionary behaviour by incumbent<sup>3</sup>

<sup>1</sup> Examples of absolute advantages:

- license restrictions
- access to essential facilities

<sup>2</sup> Examples of strategic advantages:

- sunk costs
- economies of scale and scope
- informational constraints

<sup>3</sup> Examples of exclusionary behaviour by incumbent:

- vertical restraints
- predatory behaviour
- refusal to supply

## Assessment of Market Power III

- Buyer Power
  - Size of buyers
  - Buyers' ability to switch to alternative sources
- Economic Regulation



## Assessment of Abuse of Dominance: A Case Study

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### 1. Background on predation

1. Predation is an abuse of dominance and infringes Section 20 of the FCA. It comprises anti-competitive behaviour where a dominant undertaking deliberately incurs losses to expel rivals from the market, or to deter entry by potential competitors on the same or associated markets.
2. In *AKZO*, the European Court established criteria to assess predation. Pricing above average total cost could not be predatory. Pricing between average total cost and average variable cost (AVC) would be predatory if part of a plan to eliminate a competitor. Pricing below average variable cost should be assumed to be predatory. The Court stated that:

‘[p]rices below AVC ... by means of which a dominant undertaking seeks to eliminate a competitor must be regarded as abusive. A dominant undertaking has no interest in applying such prices except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position, since each sale generates a loss.’ (para. 71).
3. Variable cost refers to the costs that can be avoided if production was reduced or ceased, i.e., it is costs that vary according to the level of production. Total cost includes both variable and fixed costs.
4. In *Tetra Pak II*, the European Court stated that “prices below average variable costs must always be considered abusive. In such a case, there is no conceivable economic purpose other than the elimination of a competitor, since each item produced and sold entails a loss for the undertaking” (para. 41). In this case, prices were found to be considerably below average variable cost, and therefore the European Court found on appeal that ‘proof of intention to eliminate competitors was therefore not necessary’ (para. 42).

## 2. Allegations

5. On March 2002, the Office of Fair Trading UK (OFT) received a complaint from Independent News Ltd., which publishes a free newspaper, the *Independent*. It alleged that *Herald*, a free newspaper distributed within Aberdeen and the surrounding area published by Aberdeen Journals Ltd. ("Aberdeen Journals"), was pricing its advertising space at significantly below 'market value'. The Complainant stated that, in some cases, advertisers were being charged as little as \$30 per page, and on its analysis estimated that the *Herald* was losing between \$500,000 and \$1 million per annum.

## 3. Facts of the case

6. Aberdeen Journals publishes two paid-for daily newspapers (the *Evening Express* and the *Journal*), and one free weekly newspaper, the *Herald*. For the financial year 2001, Aberdeen Journals achieved a turnover of \$32 million, made a pre-tax profit of just over \$4m and employed 652 staff.
7. The only local newspapers within Aberdeen are those titles owned by Aberdeen Journals and the Complainant, who launched the *Independent* in March 1999.
8. Types of advertisements in these papers include classified, property, recruitment, motor vehicles and display/retail. With few exceptions, the demand for advertising space in the *Herald* is from local businesses, attractions and people.
9. Revenues from advertising space sold in each local newspaper are as shown in Table 1:

**Table 1: Advertising revenues (annualized figures)**

Newspaper	1998	1999	2000
<i>Evening Press</i>	20 million	20 million	20 million
<i>Journal</i>	10 million	10 million	10 million
<i>Herald</i>	2.5 million	1.3 million	1.3 million
<i>Independent</i>	1 million	1 million	1 million

10. Circulation of the free newspapers is heavily focussed on the urban area. 73% of the circulation of the *Journal* and 27% of the circulation of the *Evening Express* is outside the urban area of Aberdeen. The *Journal* is therefore a regional paper, while the *Evening Express* is local, focussed on the Aberdeen area and its outlying commuter areas.
11. The *Herald's* average advertising rates were cut from approximately \$3 - 4 per single column centimetre ("sscm") to approximately \$0.80 - \$1.00 per sscm in April 1999. The number of pages in each issue increased from under 100 pages a month gradually up to approximately 150 pages per month in 2000 and 2001.

12. Distribution increased from slightly over 80,000 copies per month to reach a peak exceeding 150,000 copies per month between November 1999 and October 2000. Distribution was then cut in October 2000 to around 110,000.
13. The *Independent* has been unprofitable since its launch and continued to make losses during the period under investigation. Aberdeen Journals as a whole (i.e., free and paid-for titles) continues to show profits.

#### 4. The *Herald's* revenue and costs

14. Advertising revenue accounted for approximately 75% of the *Herald's* revenue. The only other significant source of revenue was leaflet distribution.
15. The categories of cost for the *Herald* are newsprint (i.e., cost of paper), editorial, advertising (assumed to be the cost of staff selling advertising space), circulation and printing and ink/plate costs. Printing and ink/plate costs are incurred by Aberdeen Journals in producing *Herald* and are not usually reported in the management accounts for the *Herald*. Table 2 shows the annualized revenues and costs for the *Herald*.

**Table 2: Revenue and costs of *Herald***

	Oct 98 – Apr 1999 (annualized figures)	May 99 – Mar 2002 (annualized figures)
Revenue	\$ 2,500,000	\$ 1,300,000
Printing and circulation costs reported in the <i>Herald's</i> accounts	\$ 1,000,000	\$ 1,200,000
Printing and circulation costs reported in Aberdeen Journals accounts	\$ 900,000	\$ 1,100,000

#### 5. Memos

16. A search on premises also revealed the following internal memos from the Managing Director of Aberdeen Journals to the Chief Operations Officer:
17. Memo dated March 1999 says “You also proposed to place greater separate focus on the *Herald* so that it is our only title pitched against the *Independent*. Again, this is agreed for this could be an area where we could make substantial profit progress over the next 18 months to 2 years, given that we are successful in closing them down.”
18. Memo dated October 1999: “You agree to produce 2 scenarios as far as the *Independent* is concerned. The first assumes that we acquire them. The second assumes that you are given a sum of money to neutralize them.”
19. Memo date January 2000, after references to whether the *Independent* is making a profit or loss, “Finally, please keep your foot on their neck!”

## Questions

Participants will be divided into three groups: the Complainant, the Defendant and the competition authority.

Below, five issues are identified. Both the Complainant and the Defendant should be prepared to make their case by focussing on three of these issues. They should also be prepared to defend their case with respect to the issues chosen by the other party. The competition authority should evaluate all five issues, but focus its final decision on the issues presented by the parties.

Timetable for hearing:

25 minutes	Group discussions
8 minutes	Complainant's case
8 minutes	Defendant's case
2 minutes	Complainant's rebuttal
2 minutes	Defendant's rebuttal
10 minutes	Competition authority's verdict
10 minutes	General vote and final comments

### **(i) The relevant market**

1. What is the product concerned? What is the relevant market?
2. Is Aberdeen Journals dominant in that market?

### **(ii) Predatory pricing**

3. Is predatory pricing feasible in this case?
4. Is there a justification for the pattern in advertising pricing practised by Aberdeen Journals?

### **(iii) Intent**

5. Is there convincing intent of predatory behaviour?
6. Should a dominant firm be allowed to react to competition from new entrants?

### **(iv) Effect on competition**

7. Is there convincing evidence that the Independent would be forced to exit the market?

### **(v) Abuse of dominance**

8. Is this a case of abuse of dominance?