



School of Business,  
Economics and Law  
GÖTEBORG UNIVERSITY

# Abuse of Dominance

Johan.Stennek@Economics.gu.se

# Competition Policy

- **Anticompetitive agreements (ex: cartel)**
  - Article 101 TFEU (Treaty of the Functioning of the EU)
  - KL 2 kap. 1 § (Swedish competition act)
- **Abuse of dominant position (ex: predatory pricing)**
  - Article 102 TFEU
  - KL 2 kap. 7 §
- **Mergers that reduce competition**
  - EUMR
  - KL 4 kap.
- **Public restriction of competition (ex: subsidies)**
  - Article 107 TFEU (state aid)
  - KL 3 kap 27 § (konkurrensbegränsande offentlig säljverksamhet)

Google

# Google

- **European Commission decision** (June 27, 2017)
  - Google must pay fine of €2.4 billion
- **Reason: abusing dominance**
  - Search engine gives **illegal advantage** to own comparison shopping service

Two products:

- Search engines
- Comparison shopping services

# Google

- Search engines
  - Provides internet search results to people
  - Google flagship product
    - revolutionized search
    - ranks results according to relevance
  - 90% of Google's revenues = advertising shown to users
  - Google's market share >90% in most European countries

# Google

- Comparison shopping
  - Allows consumers compare products and prices
    - Online shops of manufacturers
    - Platforms: Amazon and eBay
  - Business model
    - Do not sell any products
    - Clicks = Revenues
    - Incoming traffic from search engines
  - Network effect
    - More traffic  $\Rightarrow$  more firms list their products  $\Rightarrow$  more attractive to consumers
    - A virtuous circle: a chain of re-enforcing events

# Google

- “Google shopping”
  - Started 2004
  - Not able to compete with existing comparison shopping sites

# Google

- Google's new strategy 2008
  - Use Google search engine to promote Google shopping
  - Google shopping
    - Top search result
    - Rich format
  - Rival comparison shopping sites
    - Displayed on page 4
    - Simple format
  - Expressed differently
    - Stop using generic algorithm for ranking search results
    - Create a bias

Ungefär 1 250 000 resultat (0,65 sekunder)



Betyg Tider

**Sapporo Grand Hotel**

4,2 ★★★★★ (492) · Hotell  
北1条西4丁目2番地  
Badtunna · Passar för barn



**Sapporo KANI-YA**

4,0 ★★★★★ (4) · Skalsjursrestaurang  
Minami 4 Jonishi, 2 Chome-1 1  
Mysigt · Grupper



**Ippudo Sapporo Tanukikoji shop**

3,9 ★★★★★ (122) · Tonkotsu ramen, restaurang  
Minami 3 Jonishi, 6 Chome-8  
Mysigt · Fri klädsel · Grupper



Fler platser

**The 10 Best Sapporo Restaurants 2017 - TripAdvisor**

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**Restaurants in Sapporo, Japan - Lonely Planet**

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Discover the best restaurants in Sapporo including Menya Saimi, Sushi-no-uo- masa, Kani-honke.

**tsunagu Japan | 20 Must-Go Sushi Restaurants in Sapporo, Hokkaido**

<https://www.tsunagujapan.com/20-must-go-sushi-restaurants-in-...> **Översätt den här sidan**  
20 Must-Go Sushi Restaurants in Sapporo, Hokkaido. Hokkaido is surrounded by sea and naturally counts seafood as its speciality. Freshly caught seafood are ...

**Sapporo Restaurants: What to Eat in Japan's Delicious North**

<https://savorjapan.com/.../sapporo-restaurants.../index.html> **Översätt den här sidan**  
Hokkaido has the freshest and most abundant variety of fish and seafood in all of Japan, so it's no surprise that Sapporo restaurants offers some of the best sushi ...

**Sapporo Gourmet Best 100 \_UU-Hokkaido**

[www.uu-hokkaido.com/sgs/index.html](http://www.uu-hokkaido.com/sgs/index.html) **Översätt den här sidan**  
Sapporo, Hokkaido is one of the leading gourmet city in Asia to be able to enjoy the food of all over Hokkaido. This is a special edition of popular restaurant in ...

# Google

- Research studies and surveys show:
  - Consumers click far more often on results appearing higher up in search results
- Desktop computers
  - 1 top result gets 35% of clicks
  - 10 top results get 90% of clicks
  - 1 result on page 2 gets 1% of clicks
- Experiments
  - show that this is *not* due to relevance
  - Moving 1'st result to place 3 reduces clicks by 50%
- Mobile devices
  - Effects even larger

# Google

- Effect of Google's new strategy
  - Traffic on Google shopping increased
    - 45-fold in UK
    - 35-fold in Germany
    - and so on
  - Sudden drop in traffic on rival sites
    - 80-90% drop
    - Cannot be explained by other factors

# Google

- Commission claims:
  - This will be negative for European consumers
  - “denied choice”

# Google

- Why illegal?
  - Google has abused a dominant position

# Google

- Google has dominant position in “search engine market”
  - Relevant market
    - General Internet search
    - National
  - Market share > 90% in European countries
  - Entry barrier: Network effects
    - More users ⇒ more attractive to advertisers ⇒ higher profits ⇒ can improve product ⇒ more users ⇒ ...
    - More users ⇒ better data on consumer behavior ⇒ more attractive to advertisers ⇒ ...

# Google

- Google has abused its position
  - Dominance is not illegal *per se*
  - But dominant firms have special responsibility
  - Must not take actions reducing competition
  - Google's strategy reduced competition in "comparison shopping market"

# Google

- Commission's decision
  - Fine: € 2.4 billion (10% of Google's world wide revenues)
  - Google must change search engine
    - give equal treatment of comparison shopping sites
    - within 90 days
  - Otherwise
    - additional fine every day of up to 5% of the daily worldwide turnover
  - Google's competitors can file for damages

# Comments

# Google

- Google has appealed
  - The decision is taken by the European Commission itself
    - Commission is both “prosecutor” and “judge”
    - The investigation took 7 years
  - But Google appeals to the General Court (previously Court of First Instance) (next level: European Court of Justice; “points of law”)

# Google

- Competition on the Internet

- On the one hand: Easy for users to switch

- If not satisfied with Google, users can switch to DuckDuckGo

- Competition should be encouraged

- On the other hand:

- A service that is not open to all customers

- Earns much higher profit

- Learns about consumer behavior

- Can improve its services further

Caution:

This particular version of the network effects argument is non-standard

# Google

- Whose interests is the Commission protecting?
  - Google offers its services to users for free
  - If 90% of users choose Google, it must be because they have a better product than other services
  - So why punish Google and help inferior firms?

# Google

- Commission's objectives
  - Does not protect **individual firms** – but **competitive process** – for the benefit of **consumers**
  - Google denied...
    - other companies the chance to compete on their merits
    - consumers genuine choice
  - Google shopping may not be better than other comparison shopping sites. It was given an unfair advantage.

# Google

- Importance of this case
  - Regulators such as European Commission may start to prescribe more detailed rules of conduct
  - General “search neutrality” regulation

# The law

## Article 102 TFEU

# Article 102 TFEU

“Any **abuse** by one or more **undertakings** of a **dominant position** within the internal market, which is **prohibited as in** a substantial part of that market, which **affect trade** between Member States.”

Key concepts (to be discussed later)

- undertaking
- affect trade

But, what is “dominance” & “abuse”?

# Abuse of dominance

Dominance = legal term

High level of market power = economic equivalent

## 1. Define relevant

- Product market (eg: general Internet search services)
- Geographical market (eg: Sweden)

## 2. Assess dominance

- Compute market shares and concentration
- Compare to thresholds. Example:
  - Market share  $< 40\%$   $\Rightarrow$  firm unlikely to be “dominant”
  - Market share  $> 50\%$   $\Rightarrow$  firm likely to be “dominant”
- Consider other factors. Examples:
  - Ease of entry
  - Countervailing buyer power

# Abuse of dominance

- Dominance is not illegal *per se*
  - But dominant firms have special responsibility
  - Must not take actions reducing competition even further
- The actions are not illegal *per se*
  - Same action legal if the firm is not dominant
  - Why?
    - Same action might not have anticompetitive effect
    - Reducing competition might not be as problematic

# Abuse of dominance

- **Exploitative practices**
  - Example: charge too high price
  - Obsolete?
- **Exclusionary practices**
  - Strategies to reduce rival's ability to compete
  - Ex: Predatory pricing
    - Low price → Rival exists → High price

# Abuse of dominance

- Predatory pricing
- Non-price strategies
  - Capacity expansion
  - Product proliferation
  - Long-term contracts with customers
  - Tying
  - Refuse rivals access to essential resource
- Effects
  - Deter entry
  - Induce exit
  - Raise rival's cost – to make them less competitive

Do we really need to worry?  
- Economic analysis

# Do we really need to worry?

- “Suspicious practices”
  - Large firms charge lower prices than smaller competitors
  - Prices especially low in segments with competition
- Is this predation?
  - i.e.: Is the purpose really to harm the competitors?
- Not necessarily
  - Normal business motives for “suspicious practices”
    - Economies of scale
    - Meet the competition
  - Many reasons why predation often not profitable

# Do we really need to worry?

- Arguments why predation not profitable
  - Large firms sell more and lose more by cutting price
    - But, selective price cuts
  - The assets may re-enter
    - But, entry is costly
  - They prey could borrow money to survive
    - But, banks may not be willing to
  - Merger is better
    - But, merger may trigger entry. May not be allowed. Predation may reduce acquisition price.

# Do we really need to worry?

- Perhaps no need for policy
  - Low prices often result of legitimate behavior
  - Predation often not profitable
- Policy may even be harmful
  - Firms may be afraid of lowering prices
  - Firms may falsely charge competitors for predation

# Do we really need to worry?

- Explanations why predation may be rational
  1. Long purse story
  2. Signaling story
  3. Reputation story
- Common themes
  - Explain the prey's reduced ability to compete
  - Incomplete information

# Long Purse Theory

# Long Purse Theory

- Basic idea

- Different firm have different financial resources
- Strong firm may start price war
- Only strong firm can survive

# Long Purse Theory

- **Objection**

- Weak firm could sign contract with bank
- Bank promises to grant weak firm loans to cover losses from predation
- Weak firm equally strong  $\Rightarrow$  price war could go on forever
- Strong firm will not start price war

# Long Purse Theory

- Counter-objection
  - Bank can not tell if weak firm's loss is due to predation or bad management
  - Bank only willing to lend firm money in proportion to the owners' own investments
  - Price war erodes the weak firm's financial resources
  - Bank stops lending

# Long Purse Theory

- Necessary conditions
  - Different financial strength
  - Information problem in financial market
- Other aspects of dominance could be of secondary importance
  - Market share
  - Cost advantage

# Limit Pricing

# Limit Pricing

- Basic idea

- Entrant does not know Incumbent's cost
- Incumbent sets a low price – Limit pricing
- Fools Entrant cost is low
- Entrant does not dare to enter

# Implications from Economic Theory

- Key elements of predatory pricing
  1. Short run: Incumbent sacrifices profit
  2. Long run: Incumbent must be able to recoup loss
- Competition authority must prove
  1. Low price is too low
    - Difficult
  2. Incumbent has ability to raise price later
    - “Easy”: Dominant firms have ability raise price

# Implications from Economic Theory

- How do we know the price is too low?
  - Definition: Price is **too low** if it is lower than it would have been if the incumbent competes “normally” i.e. without intent to harm rival.
  - Typically impossible to say

# Implications from Economic Theory

- Rule of thumb

- Price is too low if it is below the incumbent's own cost
- But no exact legal test

- Areeda-Turner test (modified)

- **$P \geq ATC$**   $\Rightarrow$  Clearly legal.
- **$AVC \leq P \leq ATC$**   $\Rightarrow$  Suspicious but presumed legal (Competition authority must prove, that there are no "objective reasons")
- **$P \leq AVC$**   $\Rightarrow$  Presumed illegal (Defendant must prove that there exists "objective reasons")

# Implications from Economic Theory

- Note

- Firms sometimes have good reasons to sell below cost, e.g. to promote product

# How economics is used

# How economics is used

## 1. Economic theories of harm

- Authorities and courts use economic models to
  - Explain why behavior (e.g. price below cost)
    - reduces competition
    - harms consumers
  - Check conditions that must be fulfilled
    - e.g.: limit pricing only works if there is incomplete information

# How economics is used

## 2. Presumptions based on theory

- Abuse is said to be an “**objective**” concept, which means that
  - It is not necessary to prove that the dominant firm has the **intention** to restrict competition
  - If the strategy has the **effect** of restricting competition, it is illegal

# How economics is used

- Sometimes effects can be *presumed*, rather than *proved*

# How economics is used

- But, important caveat
  - no presumption that a certain strategy always restricts competition
  - Must consider all **circumstances of the case** – i.e. the characteristics of the market
  - Economic theory helps show what circumstances are important
- Standard of proof:
  - If the strategy “in all likelihood” restricts competition, considering all circumstances of the case, then it is illegal



Weaker than “beyond reasonable doubt”

# How economics is used

3. Authorities & courts use economic evidence
  - Market definitions
  - Cost data (often difficult to calculate costs)