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Working Party No. 3 on Co-operation and Enforcement

ROUNDTABLE DISCUSSION ON TECHNIQUES AND EVIDENTIARY ISSUES IN PROVING DOMINANCE/MONOPOLY POWER

-- Lithuania --

7 June 2006

This note is submitted by the delegation of the Lithuania to WP3 FOR DISCUSSION at its forthcoming meeting to be held 7 June 2006.

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1. What is Monopoly Power/Dominance?

1. The concept of dominance is defined in the Law on Competition of the Republic of Lithuania[1] and thoroughly explained in the Explanations of the Competition Council Concerning Definition of the Dominant Position (further referred as the Explanations)[2]. According to the Law on Competition a dominant position means the position of one or more undertakings in the relevant market directly facing no competition or enabling it to make unilateral decisive influence in such relevant market by effectively restricting competition. Unless proved otherwise, the undertaking with the market share of not less than 40% shall be considered to have a dominant position in the relevant market. Unless proved otherwise, each of a group of three or a smaller number of undertakings with the largest shares of the relevant market, jointly holding 70% or more of the relevant market shall be considered to enjoy a dominant position.

2. The aforementioned Explanations clarify that

> [t]he unilateral decisive influence is understood as an ability of the undertaking to operate in the relevant market sufficiently independently from competitors, suppliers or buyers and eventually from consumers by exercising an influence upon the product prices, market entry possibilities or other operating terms whereby competition in the market is significantly restricted.

3. Although the concept of unilateral decisive influence is used in the Explanations instead of market power, the meaning of the former is essentially equivalent to the latter.

4. The definition of dominance provided by the Law on Competition contains a threshold of 40% market share as a sufficient condition to presume that a business entity is dominant. However, in the Explanations the Competition Council has acknowledged that “the market share … is not the only and indisputable criterion demonstrating the dominance of the undertaking.” The Competition Council has also promised to assess other factors potentially impeding the undertaking from operating in the market sufficiently independently from competitors, suppliers or buyers even when the market share of the undertaking concerned is relatively large, or would enable an undertaking enjoying a relatively small market share to exercise a unilateral decisive influence. Such factors shall include shares in the market held by other competitors, distribution and stability of market shares, possibilities for the increase of market shares of the competitors, or barriers to market entry impeding potential competition.

5. The emphasis on stability of market shares and possibilities of expansion and/or barriers to entry suggests that the successful rebuttal of the presumption of dominance should prove that alleged dominance is not durable. On the other hand, the Competition Council could be able to prove dominance even when a business entity does not have 40% market share by demonstrating that its competitors are much smaller and face significant barriers to expansion and/or entry.

6. Nevertheless, this still remains a theoretical possibility because in most of the cases in which the Competition Council has found abuse dominance, the market shares of dominant firms were significantly higher than 40%.

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1 Article 3(1)(1) Law on Competition, 23 March 1999, No VIII-1099, Vilnius. (As amended by 15 April 2004 No. IX-2126.)

2 Resolution No.52 of the Competition Council, 17 May 2000. (Official Gazette, 2000, No. 24-363.)

2. Evidence Used to Prove Market Power in Abuse of Dominance/Monopolization Cases

7. According to the Explanations evidence used to prove a position of dominance can be grouped into three categories: market shares, barriers to entry and/or expansion, and other factors.

8. First of all, the Competition Council treats the distribution of market shares among competitors as an important indicator of the existing competition intensity. According to the Explanations an undertaking may not be dominant even with a market share in excess of 40% provided there are one or more undertakings in the market holding a relatively large market share and capable of effectively constraining the undertaking's ability to exercise a unilateral decisive influence. Another important factor is the stability of market shares. When market transactions are large-scale, long-term, and irregular, the Competition Council may choose to analyze changes in market shares for a period of 4-5 years. In a lot of other markets it should be enough to analyse a relatively shorter period of time.

9. In order to assess probable changes in market structure the Competition Council tries to assess barriers to entry and/or expansion. The possibility of existing rivals to increase their market share depends on the availability of excess capacities, whether existing capacities could be expanded without delay, or capacities used to produce other products could be redeployed. The Competition Council views the barriers to entry as belonging to the three broad categories: absolute advantages, strategic advantages, and exclusionary behaviour.

10. The first category encompasses factors that allow incumbents to enjoy privileged position created by the government regulation that restricts access to the market, e.g. licensing rules. On the other hand, an incumbent might derive an absolute cost advantage from owning an essential facility or important patents that allow an exclusive use of crucial technology.

11. The second category includes factors that make entry strategy riskier. In this case sunk costs play a prominent role. The presence of substantial sunk costs makes the Competition Council think that the potential entrant will face a significant risk when deciding whether to enter and therefore the entry might be unlikely. The asymmetry of information concerning production costs might play a similar role.

12. The first two categories consist of factors that might be taken as given by an incumbent, however the last category relates to incumbent's behaviour. One of the ways by to exclude other competitors is by using vertical restrains. An incumbent might be able to prevent the entry by foreclosing access to related markets. This could take a form of vertical restraints on distribution channels or vertical integration upstream.

13. When assessing whether the entry into the market is efficient all available and relevant evidence should be used. The Competition Council often asks the undertakings operating in the market and potential entrants to express their views concerning duration and costs of capacity expansion and/or new entry.

14. The facts related to a new entry or expansion of existing capacity are crucially important in the assessment of barriers to entry and/or expansion. The Competition Council seeks to find out about entry attempts that have taken place recently (successful or not) and documented plans to enter the market and/or expand existing capacity in the future.

15. On the other hand, the absence of entrants does not necessarily mean that the entry is difficult. It may be the case that the market is highly competitive and therefore there is no excess profit to attract entrants. Profit and loss statements and analysis of financial standing of incumbents can provide evidence on incentives to enter or expand.

16. The last important factor mentioned in the Explanations is the existence of a strong buyer who is likely to constrain the ability of a seller to exercise a unilateral decisive influence. For example, large-scale multi-product retail chains often significantly constrain the ability a supplier to exercise market power, are also well informed about the alternative supply sources, and may often immediately substitute supply source at low cost.

2.1 Case Examples

17. All available evidence has to be assessed very thoroughly in order to avoid misdiagnosing market power. Certain practices can be found abusive when exercised by a dominant firm and harmless when exercised by firms lacking market power. On the other hand, misdiagnosing possible creation or strengthening of a dominant position could result in preventing efficiency enhancing mergers from taking place.

18. In 2004 the Competition Council received the notification concerning the intended merger of AB Alita and AB Anykščių vynas[3]. Both of them were national producers of strong alcoholic beverages and wines. The Competition Council identified that the sum of pre-merger market shares significantly exceeded 40% in several product categories, i.e. fortified wine segment and brandy. The Competition Council also received complaints from the merging firms' competitors, claiming that the merged company would be able to bundle the expanded range of its products thereby creating barriers to entry and/or expansion for other undertakings. Nevertheless, these circumstances were not enough for the Competition Council to find creation of a dominant position. When clearing the merger, the Competition Council chose to rebut presumption of dominance by taking into account the combination of the recent abolishment of the state monopoly on production of strong alcoholic beverages, the liberalization of trade following the EU accession and the countervailing buyer power exercised by the large retail chains. All these factors were supposed to constrain the ability of the merged entity to behave independently and to significantly impede competition in the market. The events that followed confirmed the judgement of the Competition Council. During the next year the general level of prices of strong alcoholic beverages significantly decreased (especially in the premium quality segment), the market share of the merged company also decreased while the total production of strong alcoholic beverages in Lithuania increased by 15%.

19. In 2002 the Competition Council began the investigation of the alleged tying practices exercised by the bank AB Lietuvos žemės ūkio bankas after receiving the complaint. The investigated bank used to issue loans for activities in the sectors of agriculture, hunting and forestry under condition that borrower also acquired insurance policy from the subsidiary of the aforementioned bank. Although the market share of the investigated bank in the relevant market of the loans for activities in agriculture, hunting and forestry exceeded 40%, there was a significant fluctuation of market shares in the past. Three years ago the investigated bank had only approximately 30% market share. The Competition Council conducted a survey of competing banks in order to find out their views on barriers to entry and/or expansion. All responses indicated the growing demand for loans and the absence of significant barriers to entry into the relevant market. As a result, the Competition Council didn't find dominance and terminated investigation.[4]

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3 Resolution No. 1S-80 of the Competition Council of the Republic of Lithuania on issuing permission for AB Alita to implement a concentration by acquiring a share package of 100 percent in AB Anykščių vynas, 27 May 2004.

4 Resolution of the Competition Council on the termination of the investigation of compliance of actions of AB Lietuvos žemės ūkio bankas and UAB Lietuvos žemės ūkio banko draudimas with Articles 5 and 9 of the Law on Competition, 3 April 2003.

20. In 2005 the Competition Council adopted the decision concerning the abuse of a dominant position by the local oil refinery AB Mažeikių nafta.[5] This was the first application of EC competition rules in Lithuania that resulted in the highest fine ever imposed by the Competition Council (LTL 32 million – approximately EUR 9.27 million). The Competition Council established that the two relevant markets of the ex-refinery sales of diesel and the ex-refinery sales of petrol included only the territories of Lithuania, Latvia and Estonia. The high barriers to entry resulting from the lack of adequate storage facilities for imported products reinforced the strong position of the local oil refinery. AB Mažeikių nafta was found guilty of infringing both Article 82 of the EC Treaty and Article 9 of the Law on Competition. Although most of the charges were related to the discrimination of customers, the dominant oil refinery was also accused of forcing its largest customers (three regional retailers of oil products with refineries abroad) into signing annual contracts with a minimum purchase obligation in exchange for the economically unjustified price reductions equivalent to loyalty-inducing target rebates.

21. AB Mažeikių nafta argued that the definition of the geographic market was too narrow and as a result the company was assigned a larger market share than it actually had. Furthermore, according to the oil refinery the barriers to entry and/or expansion were not significant because there was no lack of adequate storage facilities. If the company had not been declared dominant, it would have only engaged in the legitimate import parity pricing which is an accepted industry practice. According to the AB Mažeikių nafta, the company only reacted to the competitive pressure of the alternative sources of supply. Presently the case is appealed and it is for the courts to decide which party is right.

5 Resolution of the Competition Council on compliance of actions of AB Mažeikių nafta with Articles 5 and 9 of the Law on Competition and Article 82 of EC Treaty, 22 December 2005.