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ADDRESSING TRADING FAIR ADDRESSING A TRADING UNFAIR PRACTICES TRADING GARIA PRACTICES ING IN BULGARIA ADDRESSING UNFAIR ES TRADING A PRACTICES

Competition Knowledge and
Advisory Services Program



THE WORLD BANK
Europe and Central Asia Region
Financial and Private Sector Development Department

ADDRESSING UNFAIR TRADING PRACTICES IN BULGARIA

COMPETITION KNOWLEDGE AND
ADVISORY SERVICES PROGRAM

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THE WORLD BANK GROUP
EUROPE AND CENTRAL ASIA REGION
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ABBREVIATIONS AND ACRONYMS

AFTFP	Africa Finance and Private Sector Development, World Bank
B2B	Business-to-business
CCO	Czech Competition Office
CPC	Commission for Protection of Competition
CZK	National currency of the Czech Republic
DG	Directorate General
DPM	Deputy Prime Minister
EC	European Commission
ECA	Europe and Central Asia
ECCBG	European Country Unit, World Bank Sofia Office
ECN	European Competition Network
ECSPF	Private and Financial Sector Development Unit of the World Bank, Europe and Central Asia Region
EU	European Union
EUR	Currency of the European Union
FIEEI	Innovation and Entrepreneurship Unit, World Bank
GoB	Government of Bulgaria
HCA	Hungarian Competition Authority
HUF	National currency of Hungary
ICA	Italian Competition Authority
K&A	Knowledge and Advisory Services
LPC	Law on Protection of Competition
MEE	Ministry of Economy and Energy
NCA	National Competition Authority
NFCSO	National Food Chain Safety Office
OECD	Organization for Economic Cooperation and Development
PRMTR	International and Trade Unit, World Bank
SMEs	Small and Medium-sized Enterprises
SMP	Significant Market Power
SSNIP	Small but significant and non-transitory increase in price
TFEU	Treaty of Functioning European Union
UNCTAD	United Nations Conference on Trade and Development
UTP	Unfair Trading Practices
UK	United Kingdom
US	United States
USD	United States Dollars

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GLOSSARY

Unfair Trading Practices	<p>Unfair Trading Practices (UTP) is associated with contractual relationship between businesses where larger companies abuse their better negotiating position to diminish the ability of smaller companies to negotiate mutually acceptable contractual terms. Imposing contractual terms and conditions on business partners becomes 'unfair' when the party with the 'weaker' bargaining position cannot afford to reject the imposed terms.* Examples include introducing different contractual terms and conditions to suppliers for essentially the same transaction; or impose additional, unrelated obligations as a condition to conclude a contract, or require payment of unrelated fees and charges for services, enforce contract changes retroactively, etc.</p>
Market Dominance	<p>Market dominance, a well-defined concept under EU competition law: <i>"is the ability [of a company] to prevent effective competition being maintained on the market and to act to an appreciable extent independently of other players."**</i> At the core of the analysis is finding out how a company interacts with other market players when it holds a substantially better position in the relevant market compared to its competitors. The EC considers that dominance may be presumed if a company controls a 50 percent share and its rivals have significantly smaller shares.</p>
Economic Dependence	<p>Economic dependence, as a concept under competition law, allows the enforcing the rules on market dominance in cases of abuse even if dominance is not present. By leveraging the concept of economic dependence, a powerful market player is treated the same as a dominant market player who abuses its position.</p>
Significant Market Power	<p>Significant Market Power (SMP), similar to dominance, assesses a company's ability to influence competition in a particular market. It is a concept developed and defined in the context of regulated markets, where a company is considered to have SMP if <i>"it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers."***</i></p>

* - Businesses with a 'weaker' bargaining position agree to unfavorable terms for various reasons. Overall, the motivation is led by the perception, or certainty, that the relationship with such a "stronger" party, despite being built upon unfavorable and unbalanced contractual terms, is the precondition for pursuing a business opportunity or for entering a new market and in certain cases even for staying in business.

** - EC (2005, p.10)

*** - Article 4, Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services

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EXECUTIVE SUMMARY

Relations between buyers and suppliers have changed enormously over the past twenty-five years. Large buyers now source products from a global market and take advantage of the cost reductions that come from economies of scale. Economies of scale have increased market concentration, which, in turn, has changed contractual relations between buyers (retailers) and their suppliers. Some large buyers appear to have considerable negotiating power to bring down prices paid to their suppliers and also extract other discounts. More harmfully, some claim that buyers can unilaterally set the terms of contracts with suppliers.

As consolidation gains momentum, the Government of Bulgaria is concerned that large buyers could impose increasingly unfair contract terms on their local suppliers. The Government is already hearing from suppliers that unfair trading practices are being used by buyers to impose contract terms. Unfair trading practices are contrary to good faith and dealing and at times unlawful. These are typically imposed by a stronger party on a weaker one and can exist from any side of the contractual relationship between businesses. Large buyers can refuse to cover supplier costs, pass on a disproportionately high share of market risk, unexpectedly, unilaterally, and sometimes retroactively, change or cancel contracts and/or pass on costs to suppliers that were not initially agreed to, just to name a few.¹ These are the types of complaints that the Government receives from suppliers, prompting it to act.

The Government's concerns with unfair trading practices have translated into a proposal to amend the competition policy framework. More specifically, the Government is considering introducing the concept of 'significant market power' in the competition law. The Government recognizes that retail markets have many large players, but no one dominant player. These large buyers can substantially affect the fortunes of their suppliers when they threaten not to buy or to reduce their purchases. When threatened this way, suppliers have few options to negotiate a fair deal.

The Government frames unfair trading practices as a competition policy issue. In contrast, this could be seen as an issue of commercial law, sector regulation, or business conduct. These are approaches used in other EU Member States. Recognizing that large buyers do not hold a dominant position in retail markets, the Government contends that the large buyers' 'superior bargaining position' is a form of market power. In addition, the Government argues that if the practice of unfairly squeezing suppliers is prevalent and persistent, it could, on one hand drive suppliers out of business; and on the other hand, it could it will incentivize more consolidation of the retail market, which could negatively affect consumer choice.

However, the decision to seek a policy solution to unfair trading practices in the competition policy framework is not obvious and could present downside risks. The case in favor of using competition policy may be difficult to support when the welfare implications of the proposed remedies are unclear. Indeed, to the extent that bargaining power exercised

¹ In particular, the European Commission identifies what it considers to be seven common unfair trading practices that are apparent across European Union Member States; namely, ambiguous contract terms, lack of written contracts, unfair variations, unfair transfer of commercial risk, unfair use of information, unfair termination and territorial supply restrictions.

by buyers is offset by the market power of suppliers, it may result in improving the welfare of consumers in the retail market. Large buyers are often more efficient and can offer lower priced goods and improved services to consumers.

Recognizing the challenges of amending the competition law to address unfair trading practices, the Government asked the World Bank for technical support. The Government is aware of initiatives of other EU Member States to adapt their competition legislation to address the same issues. The Government asked the World Bank to help identify and present the benefits and of the lessons learned from the collective experiences of fellow Member States. In response, the World Bank organized a technical workshop, titled *“Significant Market Power and Unfair Trading Practices: Issues and Challenges”* in collaboration with the office of the Deputy Prime Minister for Economic Development and the Bulgarian Commission for Protection of Competition. The event took place on January 28th, 2014 in Sofia and gathered competition experts from the Organization of Economic Cooperation and Development (OECD), United Nations Conference on Trade and Development (UNCTAD), academics and the experts from the national competition authorities from the Czech Republic, Italy, and Hungary. The event was also attended by experts from the Bulgarian government and a local think tank.

The workshop presented the mixed success of international practices in addressing unfair trading practices. At the event, experts from the Czech Republic, Hungary and Italy presented their experiences with national competition laws designed to protect the weaker parties. All of these countries have modified the approach to unfair trading practices, following several years of enforcement. All competition authorities confronted the serious issue in deciding when and under what criteria they should intervene to rebalance contracting relations. The difficult issue of false positives, intervening when they should not have, was left unaddressed. Finally, and most importantly, the central issue of economic welfare implications from protecting suppliers against buyers’ drive to bring down prices was left an open.

During the workshop, representatives of OECD and UNCTAD provided their perspective from governments that tried to address unfair trading practices through competition policy and through other means. Based on several cases from across the globe, the UNCTAD representative expressed a pessimistic view about the likelihood of success in using competition policy to address unfair trading practices. The OECD representative argued that changing the focus of the nation’s competition agency in this way may be counterproductive. They both cautioned the Government to proceed in the proposed direction with care. In sum, the technical workshop discussions concluded that challenging but surmountable implementation and enforcement issues are apparent in using competition policy to address unfair trading practices. Uncertainty about the benefits of these efforts also remains.

In addition to the workshop, the World Bank provided a review of the approaches of EU Member State in addressing unfair trading practices. The EU competition rules formed the basis for this review. Stricter national competition rules than those provided by the EU were adopted in Austria, the Czech Republic, France, Germany, Hungary, Italy, Latvia, Portugal, Romania, Spain and the United Kingdom, among others. The review highlights distinct approaches, ranging from the least interventionist approach, such as adopting code of business conduct, to the most interventionist approach, introducing significant market power, which is being considered by the Bulgarian Government.

The World Bank analyzed EU Member State policies in addressing unfair trading practices against the following criteria: effectiveness, alignment with economic principles, adaptability, efficiency and timeliness, and analytically based, dependent, transparent, contestable and reversible practice with due process.

Based on these criteria, the World Bank proposes six options for Bulgaria, ordered by suitability:

Option 1: *Enrich the commercial law with specific provisions, prohibiting unfair trading practices in business-to-business relations.* Unfair trading practices in business-to-business relations are defined in the legislation on commercial contracts and the Commission for Protection of Competition is tasked with enforcing these provisions in cases where business conduct affects overall competition.

Option 2: *Amend the competition law to introduce the concept of ‘economic dependence’.* With this option, the Commission for Protection of Competition could apply provisions on ‘abuse of market dominance’, even in cases where the dominance test is not met, by finding that ‘economic dependence’ exists in buyer-supplier relations. However, addressing unfair trading practices through antitrust law enforcement is associated with risks that the work of the Commission for Protection of Competition is politicized and the impartiality of the competition authority is questioned. Also, it is likely that the competition authority would be overburdened by a large number of cases requesting the attention to the practices of ‘abusive’ large buyers. This could ultimately backlog the system and hamper enforcement.

Option 3: *Enhance the authority of the Commission for Protection of Competition to apply legal instruments on unfair competition practices.* Implementing this option would be associated with significant reform efforts, in terms of associated changes of both, competition and consumer protection laws, and in terms of enhancing the capacity of the Commission for Protection of Competition in the consumer protection area.

Option 4: *Promote codes of conduct applicable to trading relations of businesses.* This is the option implemented in the United Kingdom, where voluntary codes of business conduct, aimed at tackling imbalances in the supply chain, favor suppliers and prevent retailers from unduly shifting costs and risks onto suppliers.

Option 5: *Adopt national rules aligned with the debated EU-level rules on unfair trading practices.* Such an option, however, would delay significantly designing a solution to address unfair trading practices in business relations in Bulgaria as it is unclear when (and whether) such EU-wide rules would be adopted.

Option 6: *Adopt sector specific legislation to introduce the concept of ‘significant market power’.* The Commission for Protection of Competition could be tasked with enforcing sector rules that introduce the concept of ‘significant market power’ in business-to-business relations. It is important to note that this ‘least preferred’ option, albeit endorsing the introduction of the concept of ‘significant market power’ in Bulgaria, is distinctly different from the approach proposed in the draft bill for amending the Law on the Protection of Competition submitted to Parliament by a group of Members of Parliament on March 7, 2014. Under the draft bill ‘significant market power’ is proposed as a general competition law instrument applicable to all sectors and markets. In the Czech and Hungarian cases ‘significant market power’ is introduced through sector legislation on the agriculture and food retail sectors, and the competition authority, as in the Czech case, is tasked with enforcement of such sector legislation. In the Hungarian case, a separate agency is tasked with enforcement. A draft bill recently submitted to the Bulgarian parliament proposes an approach that will likely put a significant strain on the Commission for Protection of Competition, both in terms of capacity and resources.

Additionally, the World Bank provided an economic assessment of how implementable and effective the significant market power would be to address unfair trading practices using competition policy. This assessment is based on the economic principles proposed by the European Commission guidelines,² i.e. take corrective action when abusive behavior harms consumers, not competitors. In other words, a market assessment must show that the actions of a buyer with significant market power must negatively affect consumers, *present and future*, before the application of competition policy sanctions and remedies are justified. It is unclear how SMP would meet this test other than in the narrowest of circumstances. In addition, this type of abusive practice is unlikely to occur repeatedly between the same pair of buyers and suppliers unless specific barriers to entry or expansion exist in this market.

The economic analysis concluded that the introduction of significant market power to address unfair trading practices will likely result in substantial uncertainty in the market. This conclusion reinforces the findings of the review of EU Member State experiences. For example, unfairness is not a well-defined economic concept and it is certainly outside the scope of most competition policy frameworks. The issue of economic dependence on the buyer's continued purchases is argued to be the root of what make suppliers weak in bargaining but it is also unclear in economic theory. Finally, lowering the market power threshold, from dominant to significant, to address the abusive conduct of non-dominant undertakings increases the chances of false positives. In sum, the economic principles defined in the competition policy framework are important to abide by because they guide competition authorities to act only when economic welfare is being negatively affected. This is also important because remedies found in any competition policy framework can be powerful, but when misapplied, damaging.

Based on these analyses, the World Bank established that addressing unfair trading practices through commercial courts was likely the most viable and effective option for Bulgaria. First, unfair trading practices mainly result from an imbalance in bargaining power between two parties. In addition, the bilateral relationship between buyer and supplier is governed by a contract. Commercial law was designed exactly for disputes between parties over breach of contract or unfair dealings. In comparison, competition policy is primarily concerned with remedies to behavior that affect the whole market – not a handful of market players. The body of commercial law is likely comprised of good, legal precedent on which practices deviate from good commercial conduct. Furthermore, the application of competition policy remedies are based on evidence of damage to consumer or overall economic welfare. The damages that may be caused by unfair trading practices are likely to be incurred by a few suppliers and are not clearly apparent to consumers. Finally, if terms of the contract are fair to some, but seem unfair to others, the courts can determine if this is so because of differences in the efficiency of the operations of the seemingly injured party. By rejecting claims of damage from the least productive suppliers, the courts would be helping the market sustain the lowest cost suppliers and improving market efficiency. It is unclear that the more blunt remedies available to a competition authority would be so discriminating and lead to these kind of efficiencies. Attempting to adapt the competition policy framework to address these bilateral contractual issues would have to appeal to a new set of concepts in the Bulgaria jurisprudence. Doing so will mean it will take some time before these untested concepts can be pinned down and provide the kind of certainty that market competition requires.

² Article 102 (formerly Article 82) of Treaty on the Functioning of the European Union is a fundamental part of the competition policy framework dealing with abuses of market power. The European Union's top enforcement authority, the European Commission, issued a guidance paper on how to implement and enforce provisions under Article 102. The EC Guidance Paper (2008) places significant emphasis on an 'effects-based approach' to identify which unilateral actions from dominant entities should be of concern to the competition authorities.

CHAPTER ONE

SUMMARY OF INTERNATIONAL WORKSHOP PROCEEDINGS “SIGNIFICANT MARKET POWER AND UNFAIR BUSINESS PRACTICES: ISSUES AND CHALLENGES”

INTRODUCTION

The Government of Bulgaria is concerned that large retail chains may be using their superior bargaining position to dictate the terms of contractual relations with their suppliers. The Government believes that this constitutes unfair trading practices (UTP) and remedies should be found in the nation's competition policy framework. However, the European Union (EU) competition legislation, itself, is silent on the relations between businesses even if these are based on unfair terms. At the same time, EU law does allow Member States, like Bulgaria, to set national rules if they want to address unfair practices resulting from abuse of bargaining power.³ Using this authority to amend its competition framework, the Government of Bulgaria (GoB) is considering the introduction of the concept of 'significant market power' (SMP) into the competition legislation.

Expansion of the CPC's mandate to address UTP through the application of SMP as a competition law instrument raises questions about enforcement. How will the CPC enforce this broader authority to protect against consumer harm and at the same time avoid the risk of deterring pro-competitive conduct through arbitrary enforcement? Avoiding arbitrary enforcement of this new authority requires setting clear, objective criteria and standards when the CPC can apply sanctions and remedies based on the competition policy framework. Questions remain unaddressed about whether the constraints, specificity and methods of a competition policy framework would allow designing effective remedies

To address the UTP issues in business to business (B2B) relations in the buyer-supplier relations, the Minister of Finance of the GoB asked the World Bank in end-October 2013 for technical support in the area of competition. The Deputy Prime Minister (DPM) for Economic Development was appointed as the designated key counterpart. In November 2013, the task was further specified and the GoB asked the World Bank to explore how and whether the SMP concept, anchored in the competition policy framework, would effectively address UTP in B2B relations. In follow up meetings, the CPC expressed interest in collaborating as well, sending a formal communication in December 2013.

In response, the World Bank convened, in cooperation with the Bulgarian counterparts, experts from the Organization of Economic Cooperation and Development (OECD), United Nations Conference on Trade and Development (UNCTAD), national competition authorities from EU member states, academics as well as key experts from the Bulgarian government and the CPC to address the SMP design and implementation issues in a technical workshop on Significant Market Power and Unfair Business Practices: Issues and Challenges.

Chapter one is a summary of the discussions during the workshop that took place on January 28 2014 at the Boyana Residence in Sofia (Agenda and List of participants are available in Annex 1-2).

³ Article 3 of EC Regulation 1/2003, in addressing the relationship between national competition laws and the EU competition rules, states that where national competition authorities or courts apply both European and national competition law in parallel, the application of the latter is subject to an obligation of convergence contained in Article 3(2).

WELCOMING REMARKS

H.E. Daniela Bobeva, DPM for Economic Development

The DPM for Economic Development welcomed the audience and confirmed at the outset that a priority of the GoB's program is countering UTP in the chain: supplier – processor – distributor retailer – consumer. The DPM noted that in recent years there is the emergence of small number of relatively strong participants in the supply chain of the food and non-food retail sector that exercise pressures during the negotiations with their suppliers, in certain cases leading to UTP.

UTP have been identified in all EU member states, as the DPM noted, and the European Commission (EC) has taken an active part in addressing the issue. For example, it published in 2013 the Green Paper on UTP in the B2B relations which identified the following types of UTP: (i) unfair contractual conditions; (ii) lack of written agreements; (iii) retroactive amendment of agreements; (iv) unfair transfer of trade risk; (v) inappropriate use of information; (vi) unfair termination of trade relations; and (vii) territorial limitations of deliveries. Moreover, EC also published a study on the economic and legal aspects pertaining to illegal use, appropriation and court disputes regarding confidentiality of trade information and secrets.

The DPM emphasized that the case of Bulgaria mirrors the same issues raised in the Green paper. Non-written contracts are offered to suppliers by retailers, who impose also other unfavorable conditions (e.g. transfer of trade risk to suppliers/producers; six-month delay in payments, among others). These create a spiral of issues with suppliers and producers, who have to postpone payment of salaries to their workers, social security payments, etc. The process also contributes to the increased inter-firm indebtedness and affects trust in the system. Issues related to sharing confidential information among retail chains is also present, as the DPM noted.

To respond to the 2013 protests of suppliers, the GoB decided to introduce changes in the competition framework that will address UTP in B2B relations. The draft Law on Amendments and Supplements to the Law on Protection of Competition, noted the DPM, aims at complementing existent regulations by creating conditions for the conduct of a consistent policy for protection of national markets, production, delivery and distribution of goods and services, to ensure conditions of equal standing in negotiating during the implementation of trade deals and prevent UTP.

The DPM emphasized at the end that the draft bill is prepared on the basis of German and Czech legislation and is largely based on the findings of the EC's 2013 Green Paper.

Mr. Markus Repnik, World Bank Country Manager for Bulgaria, Czech Rep. and Slovakia

Mr. Repnik began his speech stating that competition is at the heart of the market economy and a driving force behind product and service innovation. He stressed the linkages between competition and business environment – the ability to enforce contracts - is crucial for a competitive environment, and vice versa. Strong and fair competition contributes to a better business environment serving as a guarantee that all companies operate on an “even playing field” regardless of size and economic power.

The speaker noted that the GoB has requested the World Bank support Bulgaria's efforts to strengthen competition through an advisory partnership that will aim to strengthen all aspects of the business environment. Then, Mr. Repnik clarified the World Bank is not present to promote a specific methodology or approach but would like to encourage a technical expert discussion about the ways to strengthen competition. Thus, the workshop could provide a space for open technical discussions by bringing together Bulgarian and international experts; to harvest collective expertise and experience; and to identify options how to address noncompetitive behavior, address unfair B2B trading practices. Identifying the options will help better understand the choices and tradeoffs and the respective costs and benefits, concluded Mr. Repnik.

Mr. Petko Nikolov, Chair of the Bulgarian Commission for Protection of Competition

The CPC Chairman began by pointing out that the issue of market power and contract business practices has been in discussion for quite some time. Hence, the importance of the workshop's topic. The past several years have witnessed both CPC and the GoB aiming to better understand the relationship between local suppliers and retail chains in the food sector.

Local suppliers allege abusive practices in the distribution chain (e.g. the imbalance of bargaining power allows supermarkets to impose pressures, costs and risks upon suppliers). Concerns about the trading relationships between suppliers and retailers are not unique for Bulgaria, Mr. Petkov clarified. Many countries in Europe and around the world face the same problem and there are a number of approaches to address these.

In Bulgaria, several ways to deal with the issue of UTP have been already offered, including self-regulation by business and legislative amendments to the Law for Protection of Competition to incorporate the SMP concept. However, Mr. Petkov noted that the SMP intervention, in particular, is broad enough to cover every industry and business in Bulgaria. Thus, in practice this is not a special but universal prohibition which can impact any market. In that line of thought, CPC has voiced several times concerns in the past few years and has undertaken a number of initiatives in the food sector, including advocacy instruments, anti-trust investigations, and sector inquires to address the issues in the sector and improve its capacity.

PANEL I: SETTING THE STAGE

The first panel of the workshop focused on setting the stage for the discussion. The moderator, Mr. Darin Stankov, representative of the Bulgarian CPC, opened the panel with the proposal that there is a need to outline the problematic before there is a search for a reasonable solution. Mr. Alvaro Gonzalez from the World Bank outlined the key goals of the workshop, as follows:

(i) Provide information. The World Bank called this a technical workshop because the Bulgarian Government is dealing with a highly complex issue laden with a gigantic amount of intricate technical details with several points and counterpoints. A team of technical experts has been assembled that have scoured through this sizeable amount of detail and complexity and can provide the workshop audience with the kind of clarity that can only come from deep experience.

(ii) Identify and understand the choices and tradeoffs. The options available to the Government of Bulgaria are numerous. The calculus of costs and benefits for each option, while not always easily providing the clarity of a single number to guide government policy, is nonetheless a useful exercise.

(iii) Initiate a useful process. The technical workshop may be useful to the representatives of the Government of Bulgaria and all other participants. Whatever the Government decides to do—or not to do—it is hoped that the process of consultations within and across governments and international organizations is worth replicating.

Contributions from the World Bank

The first presentation in the panel was offered by Mr. Evgeni Evgeniev from the World Bank on “*Issues in B2B relationship in the Food Supply Chain: The case of Bulgaria*”. He firstly noted that the EU retail services contribute €454 billion to the EU value added, which accounts for 4.3 percent of total EU value added and employ no less than 18.6 million citizens. In fact, Europe has witnessed the emergence of big retail chains in the last two decades (e.g. there have been 430 mergers between 2004 and 2011, only).⁴

Large retailers have the highest bargaining power *vis-à-vis* many small producers and suppliers. This gives them the power to set unilateral terms and conditions on other players down the supply chain – producers and suppliers. The presenter recalled that the focus on the food sector at the EU level has been intensified since the food price crisis broke out in 2007. From mid-2007 to mid-2008, agricultural commodity prices rose sharply, which resulted in increased consumer prices. Since then, prices of many commodities have come down to levels even lower than 2007 but consumer food prices have continued to increase and only started declining in mid-2009. This raised concerns about the functioning of the food supply chain. In particular, some retail chains have set unilateral terms and conditions on business partners. Hence, allegations and accusations of unfair trading practices started to come out in EU member states.

As a result, the EC was given a mandate to improve its knowledge of how food retail markets function. To that end, the EC set up a Task Force to analyze the functioning of the European food supply chain. Questions arose about the competitive structure of the food

⁴ Today, top 4 retailers in the UK account for over 60 % of the market. Finish top 2 retailers (over 70 %), Latvia top 2 (60 %), Dutch top 3 (over 80 %), Slovenia (top 3 for over 60 %).

supply chain. The Directorate General (DG) for Competition carried out a survey through a series of informal discussions in 2009 with different associations in the sector to discuss the European food supply chain. The outcome of the consultations is best expressed in the following conclusion: *“Competition at the retail level is fierce and margins are low, which results in better prices for consumers”*.

Given the emerging debates on the nature of B2B relations in the food supply chain, the European Competition Network initiated a number of its own investigations, between 2004 and 2011. The result is that overall 180 antitrust investigations, 1,300 merger control proceedings and more than 100 market monitoring actions were undertaken.⁵

In terms of types of infringements, the presentation specified that competition authorities have focused on horizontal agreements among competitors, which account for about half of all cases investigated (49%).⁶

Authorities have also been engaged in extensive general market monitoring, so as to understand how food markets are working. The practices that result from the imbalance in bargaining power that exists between the parties in the supply chain are a recurring concern. The competition authorities have usually found that these practices fall outside the jurisdiction of competition law. For that reason, several EU countries have sought to address this problem through other solutions, such as laws addressing UTP (Austria, Belgium, France, Germany, Portugal, Slovakia) or codes of good practice (Czech Rep., UK, Hungary, Portugal, Spain).

The Supply Chain initiative, launched in end-2011, was also presented. As of today, 31 multinationals and 267 of their subsidiaries throughout the EU have signed the Principles of Good Practices. These were endorsed by few food retailers that operate in Bulgaria as well (example, METRO, LIDL). Mr. Evgeniev echoed the DPM’s words in mentioning the EC’s 2013 Green Paper, launched by DG Internal Market, which was based on over 300 expert opinions. These opinions, unfortunately, comprised conflicting messages, which confused even more the debate on which tools could be used to address UTP.

The presentation of the Bulgarian case followed. The speaker noted that the retail market has witnessed high competition in the past few years, similar to the European context. Currently, there are 1,900 hypermarkets, supermarkets and drugstores, which is 400 percent more than in 2005, and this number is projected to rise by 6-7 percent per year, reaching 2,600 in 2016.⁷ The market share of retail chains in Bulgaria stands at 35 percent at present and is expected to reach 50 percent in 2014.

⁵ The largest number of cases in the period 2004-2011 concerned the processing level (28%), retail (25%) and manufacturing (18 %). With respect to specific food sectors, the largest number of cases concerned cereals; then milk and dairy; followed by fruits/vegetables, meat, poultry and eggs.

⁶ Competition authorities have detected horizontal infringements in the form of price fixing, market and customer sharing and exchanges of confidential information at most levels and for most products investigated, in particular in cereals (processing and manufacturing) and meat, poultry and eggs (primary production). In practice, this means that authorities have imposed sanctions in respect of more than 50 cartels in the food industry and are investigating more than 30 further potential cartels.

⁷ The reasons for the retail market expansion may be: (i) the rising disposable incomes of Bulgarians (growing urban population) seeking choice and (ii) low prices offered by foreign/domestic chains.

The presenter emphasized on the three key issues claimed by government authorities in the debate on UTP in B2B relations, namely:

- Small local independent food retailers and local suppliers have not equally gained from the expansion as prices have been pushed down.
- Large food chain retailers are bargaining hard against small domestic producers and suppliers.
- That savings from the tough bargaining appear not to be passed on to consumers as claimed.

The CPC has undertaken recently three sector inquiries (dairy products market, sunflower seed and sunflower oil markets, and wheat and flour markets) to respond to the issues in the food supply chain. The results:

- A cartel was fined for price agreements in the sectors of production and distribution of sunflower seeds, processing of seeds, and production and trade of sunflower oil.
- Bread and pastry producers associations were fined in July 2008 for coordinating the pricing policies of their members from 2002 to 2007. In addition to price fixing, the practices involved the exchange of sensitive business information, namely the collection of data on retail prices, which were disseminated among their members with instructions on their respective pricing policies.
- Similarly, in Bulgaria, the members of a buyer cartel of dairy processors were fined on the basis of national legislation in 2008. In the context of this cartel, lasting between 2002 and 2007, associations of processors had agreed on purchasing prices for raw milk and exchanged information thereupon. The anti-competitive conduct also encompassed the setting of minimum prices for white cheese and the exchange of sensitive business information within the associations.

Furthermore, two antitrust cases, related to food retail chains, were launched by the CPC. After thorough investigation, the following conclusions were made:

- Case No.1: Competition law violations for fixing of prices and other commercial conditions by some of the largest food retail chains. The authority did not act as no dominant position was found.
- Case No.2: Some of the major retail chains were implementing common mechanisms for coordination of trade policy on the market for the supply of goods and of common marketing policy in terms of promotions (violation of Art. 15 (1) LPC). The commitment decision obliged the retailers to remove some of the clauses in the contracts with their suppliers in order to eliminate the existing competition concerns.

Finally, the CPC found that incidents of UTP are contracting issues that cannot be addressed from a competition law perspective under existing legislation, unless there is a finding of dominance. EU and Bulgarian competition legislation provide no remedies to address such UTP, unless there is a finding of abuse of dominant market position. However,

EU Member States could address instances of UTP through stricter national rules and the Bulgarian Government chose to introduce rules on “significant market power” in the national competition legislation.

After consultations with key stakeholders, conducting a survey, expert opinions from government institutions and an expert analysis, introducing SMP in the national competition framework was the recommended option under the Ex Ante Impact Assessment, commissioned by the Ministry of Economy and Energy in 2011-12. Due to its superior bargaining power from having relatively large market shares, retailers in the Bulgarian market, as emphasized by the Ex-Ante Impact Assessment, may impose certain conditions on suppliers. For example, suppliers, especially of fast-moving consumer goods, are required to provide certain commercial discounts when delivering goods, accompanied by numerous other expenses such as extra fees, bonuses, rebates, sanctions, forfeits and others.

Retailers often offer relatively low market prices. These lower prices could improve the economic welfare of the end-consumer. It can also have a positive impact on the suppliers/producers, motivating them to become more efficient. On the other hand, as the Impact Assessment claims, pressure in the food supply chain by the retailers could be harmful to the whole supply chain due to the inability of suppliers and producers to restructure and optimize in order to respond to the new requirements. In addition, imposing hard bargains by retailers could drive suppliers and producers out of the market, harming the competitive environment.

The Impact Assessment also claims that the local suppliers are treated differently compared to foreign suppliers. The contracts between retailers and local suppliers for fast-moving consumer goods are signed for one year only and they involve high entry fees for inclusion in the list of suppliers. The contracts are individual. There are over 100 fees, sanctions, bonuses, premiums and others that are imposed by the retailer on the local producer/supplier. In cases in which the local supplier/producer does not have any control on the pricing policies of different retailers, they are still subject to sanctions by the retailer (e.g. suppliers/producers are sanctioned if another retail store has a lower sales price of their product).

Finally, the speaker explained that the Ministry of Economy and Energy proposed in 2012 a draft bill to amend the Law on Protection of Competition. This amendment introduced the concept of SMP (definition, specification of types of abuses and proposal to introduce a methodology to assess significant market power). New draft bill was proposed to the national parliament on March 7, 2014. It is a result of discussions about using the SMP as a tool to address UTP, which were resumed in mid-2013 under the championship of the DPM for Economic Development.

Contributions from the World Bank

In this presentation on “*Options for Bulgaria in addressing unfair trading practices*”, Mr. Christian Filipov from the World Bank firstly discussed the use of established legal solutions to address unfair trading practices (dominance, economic dependence).⁸ Then, he spoke about SMP as the novel solution to address UTP. As in the case of dominance, the SMP of a company is the ability to influence market competition. However, SMP is not a well-established instrument under competition law. Moreover, the concept focuses on future market developments and it is an instrument that is appropriate in sector-specific solutions.

The following options for Bulgaria were identified during the workshop:

- (i) **Amend commercial law/sector specific laws:** Introduce specific rules prohibiting UTP in general commercial and/or sector specific legislation to prevent a buyer from threatening or ruining its supplier - for example, impose discriminatory prices, delays in payments, or other conditions of sale or purchase. Based on existing EU Directives, requirements on standard supplier agreements can be introduced, prescribing uniform supplier conditions, delivery and payment terms.
- (ii) **Opt for market regulation based on SMP analysis:** Introduce market regulations based on an SMP economic analysis of a specific sector confirming that unrestricted competition in the market in question would not be possible due to the presence of players with SMP that would behave as dominant players. This was highlighted solely to advance the discussion as to the sector-specific nature of SMP solution.
- (iii) **Amend competition law to introduce ‘economic dependence’:** Amend competition law allow the CPC to apply rules on ‘abuse of market dominance’, in cases where dominance is not present, by leveraging the concept of ‘economic dependence’ in contractual relations between larger and smaller companies, to treat a firm that abuses its superior bargaining position the same as a dominant player who abuses its market position. The presenter noted that this is the direction taken by most other Member States.
- (iv) **Amend sector-specific laws to introduce ‘SMP’:** Amend competition law framework to prohibit abuse of SMP based on stricter national rules applicable to unilateral conduct of companies. This option requires, as specified by the presenter, the competition authority to monitor the market in question, conduct regular sector inquiries and collect relevant information concerning supplier-retailer relationships etc. (forces the competition authority to act as a quasi-sector regulator). It was clarified that implementation is difficult, as SMP is not well defined as a competition law instrument at the EU level and internationally.

⁸ Instruments under dominance - when a firm could behave independently of competitors, suppliers and customers. Instruments under economic dependence - when one firm is economically dependent on another; allows the application of ‘abuse of market dominance’ in cases where a player that abuses bargaining power does not hold a dominant position in the market. (The concept is applied in many European countries to non-dominant players with the ability to exercise market power towards SME suppliers, purchasers or competitors companies).

Summary of the Discussion

Antitrust cases in Bulgaria, related to the food supply chain, underwent a rigorous analysis for the assessment of non-dominance position. Furthermore, it was specified during the discussion that market share is the least indicator in the analysis. The discussants concluded that there is a need to talk about the product and the relevant market when the relationship between suppliers and retailers is in the focus.

Then, the debate focused on differences between contractual law and competition law and also the point was raised that the SMP concept is indeed difficult to define. The following key question arose; namely, which of the problems can be addressed by contractual law and what solutions can be addressed by competition law?

The DPM for Economic Development posed a question on whether there is an existing trend that more countries have introduced legal interventions to address UTP. Prof. Kokkoris from the University of Reading (UK) responded that indeed all EU member states have addressed the issue, either from contractual or from competition perspective. Ms. Sabine Zigelski, OECD representative, mentioned however, that legal interventions face also additional problems. The case of Germany is relevant in this respect. The application of the economic dependence concept has been hardly effective there at all.

During the discussion, the DPM raised the issue that producers often complain and show evidence of contracts, which look like an obvious abuse on the side of commercial chains. And, the suppliers are afraid to submit a complaint at CPC because they will be pushed back from any contractual relationships with the retail chains.

At the end of the panel, Mr. Alvaro Gonzalez from the World Bank offered the economic perspective. He specified that there is a need to focus on the issue of assessment of market power. More specifically, market power on the negotiating side of the market. However, the SMP tool is used on the retailer side, not the negotiation side between supplier and retailer. He pointed out to the case of exercise of the market power between two agents and that when one does not know anything about the relationship with other suppliers and retailers, then it should not be deemed as a competition issue. The reason is that competition works across sectors and it does not solve a contractual relationship between a supplier and a retailer. This does not mean, however, that the issue should not be addressed, Mr. Gonzalez specified. But, it means that there may be other tools that can be used to solve the specific issue.

PANEL II: EUROPEAN PRACTICES

The second panel was opened by the moderator, Mr. Kiril Pangelov, representative of the Bulgarian CPC. He noted that obviously there are problems on the market, connected to the retailers and their suppliers. How to define the problem and how to design the public policy to address this problem in the best possible way seems to be still the key issue. If the issue is not addressed correctly through appropriate measure, then money and resources of the government will be lost, the moderator pointed out.

Mr. Pangelov re-emphasized that unfair B2B trading practices is debated in Europe and most EU countries faced the issue. Some fellow EU Member States adopted specific legislation, others amended their competition acts, and still others made several further changes in the legislation. Some other countries are still discussing non-legislative approaches to address the issues, like self-regulation or information campaigns. The EC also dealt with this issue, as mentioned earlier. However, the 2009 EC Communication specifically noted that the unequal bargaining power and the imposition of UTP conditions for food supply did not necessarily constitute a problem of abuse of buyer power under the competition law.

The EC insisted specifically, as the moderator noted, to make a strict separation between the two concepts. On the one hand, the problem of unequal bargaining position between private actors is an inter-parties issue. On the other hand, the abuse of superior bargaining position could be qualified as competition infringement provided that this behavior affects the very functioning of the market and the consumer's welfare. So, the EC recommends that the problems related to B2B practices to be addressed not by the means of competition law or other law or other means – contract law, commercial law, common agricultural policies, laws on unfair commercial practices, non-legislative approaches, appointments of ombudsman, etc.

The European Competition Network also dealt with the problem of unfair B2B trading practices. They published a report in May 2012, which found that varying approaches were applied in Member States but with different degree of effectiveness. Therefore, it was suggested that further legislative or other outcome of this discussion may have a relevance to the policies of the EU's Internal Market and not the Competition policies *per se*. This was recognized also by the responses to the EC's Green paper, which recognized a lot of issues with the proposed approaches to overcome unfair b2b practices.

Leading international organizations in the sphere of competition policies – International Competition Network (ICN), OECD, and UNCTAD also dealt with UTP, as the moderator clarified. In 2008, the ICN published a report on abuse of superior bargaining position and concluded that the existing rules are quite different among member states, depending on their jurisdictions. OECD and UNCTAD drafted several peer reviews of legislations and assessed the effectiveness of the tools that address unfair B2B practices. Therefore, two key tasks for the panel were proposed: i) there is a need to clearly define the problem; ii) there is a need to gather best approaches that exist in other countries.

Italian Competition Authority

To what extent or whether competition agencies should be involved in assessment of purely contractual issues between actors which is not usual? The response of Mr. Gianluca Sepe (representative of the Italian Competition Authority) was that, competition authorities are able and should deal with contractual issues between actors.

In Italy, the issue of unfair B2B practices has been a key political concern. The Italian Competition Authority (ICA) undertook a sectoral inquiry to identify and understand whether if buyers (retail chains) might have market power over their suppliers. Economic literature defines buyer power as “*the ability of a buyer to get from its suppliers better conditions than those applied to its competitors or expected in a competitive environment.*”

Mr. Sepe posed two key questions in this regard:

- What are the effects of buyer power on competition?
- What is the role of competition agencies?

Three elements which strengthen the bargaining position of distributors vis-à-vis their suppliers were identified, namely: i) Increasing levels of concentration on the demand side; ii) Buying alliances; iii) The success of *private label*.

Comparing short-term positive effects and long-run potential restrictions makes the competitive assessment of buyer power somewhat ambiguous and difficult, explicitly pointed out by the presenter. Then, he discussed the antitrust instruments of the ICA. He concluded that the prosecution of anticompetitive unilateral conduct flowing from buyer power may prove problematic because:

- First of all, one should assess whether the buyer is dominant;
- If dominance cannot be established, vertical restraints agreed with suppliers might be assessed under the rules on anticompetitive agreements; and
- However, some behavior may not be caught by the scope of application of competition rules.

Then, the presenter moved on to discussing the ‘abuse of economic dependence’ concept in the case of Italy.⁹ Economic dependence is assessed taking into account; *inter alia*, the effective possibility for the aggrieved party to find satisfactory alternatives on the market. The abuse of economic dependence may also consist in a refusal to deal, the imposition of unfair or discriminatory trading conditions, or the unlawful breaking off of existing contractual relations. The ICA may only intervene, as Mr. Sepe pointed out, when the abuse of economic dependence may have a significant impact on competition and the market.

The presenter also shared his views on the *ad hoc* rules in the food sector which were introduced in Italy as of January 2012. In all B2B contractual relations the following shall be prohibited:

- Imposing – directly or indirectly – unfair trading conditions, as well as non-contractual retroactive conditions;

⁹ Economic dependence is defined in Italian law as the situation where an undertaking is able to determine an excessive imbalance of rights and obligations in its dealings with another undertaking.

- Applying dissimilar conditions to equivalent transactions;
- Making the conclusion and the performance of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts;
- Requesting the unilateral performance of additional obligations, not justified by the nature or the content of the relevant contractual relations;
- Adopting any other unfair trading conduct.

According to the presenter, the law brings about a dual system of control, whereby the ICA's intervention does not exclude the ability of private parties to bring their claims before civil courts. Finally, Mr. Sepe spoke about the implementation of new rules. While the law is silent on this issue, implementing regulations clarify that the new provisions are meant to be applied in contractual relations where a significant imbalance exists between the bargaining positions of the parties, as their rationale is the protection of the weaker party. Such interpretation brings the new rules closer to the abuse of economic dependence, which also stems from the unlawful exploitation of a superior bargaining position.

Competition agencies may prove well-equipped to enforce rules against contractual abuses, as they are most likely to ensure the proper balancing of the public interest to the correct functioning of the market which underpins such provisions, with the competition principles. This conclusion may hold true in particular when competition agencies are already called to enforce diverse sets of legislation, including consumer protection or unfair competition laws, such as in the case of the Italian Competition Authority.

Czech Office for the Protection of Competition

The representative of the Czech Competition Office, Mr. Petr Gajdusek, started his presentation going back to the early 1990s with the opening of the economy and the first economic reforms, which enabled the entry of many retail chains. He further explained that supermarkets and hypermarkets that prevail today in the Czech Republic started a fierce competition sometimes in mid-1990s.¹⁰ He noted also that a Price Act is available in the Czech context since early 1990s that regulates the prices on the market. The rapid development of retail chains have caused a lot of complaints, submitted by suppliers for unfair B2B trading practices. No retail chain has a dominant position in the Czech Republic and no 'middle ground' to solve the issue existed.

The debate on including provisions in the Act on Protection of Competition started in late 1990s. However, no provisions were adopted, although there were several concrete proposals. In 2009, a new sector law was enacted, introducing SMP in the sale of agricultural and food products. The Czech Competition Office (CCO) was not involved in the debates which followed the adoption of the SMP. It was approved and came into force in 2010. The Act regulates so many retail chains in the Czech Republic but leaves the supply side completely deregulated. The CCO was mandated to enforce SMP, besides other standard competition responsibilities.

¹⁰ The definition of supermarket in the Czech law is as follows: a store with a retail space of up to 2,500 sq.m. Hypermarket is a store which exceeds this. Currently, the Czech rep. is the largest retail space in terms of per capita. 26 hypermarkets are available on each 1 million inhabitants.

The presenter pointed out that the CCO does not analyze each and every relationship between the retailer and suppliers but takes an absolute position. That is to say, they define a retailer to have an SMP position and they focus at the absolute level. The reason is that they could not analyze all interactions in the food supply chain. The authority introduced also a list of prohibited abusive practices under the SMP Act. The CCO has also developed a methodology how to assess SMP.

In February 2010, the first sector inquiry was initiated. The CCO examined the relationship between retailers and suppliers, terms and conditions, and system of rebates, among others. The inquiry concluded that the retail chains abused their SMP towards their suppliers in the negotiating terms of conditions with the suppliers. For example, a problem was identified - retailers asked for fees for which they provided no services and they also set too long periods of payment between 60 and 90 days, without any reason.

The adoption of the SMP Act led to removal of some UTP. In 2011, the Czech Government decided to amend competition legislation based on the SMP Act. There was a huge debate in the competition office for the introduction of new provisions in the competition law framework. The result is that the CCO was mandated to draft the amendments to the Act on Protection of Competition, and drafting work is still ongoing.

At the end of the presentation, Mr. Gajdusek spoke about other instruments used under the SMP Act, like advocacy tools and dynamic discussions that focus on prevention. He also mentioned about the LIDL case, which demonstrated a typical abuse. LIDL prolonged the payment period from 60 to 90 days without explanation. The suppliers argued that there is an infringement of the contractual freedom, which invokes constitutional issues. The case is still subject to proceedings.

Hungarian Competition Authority

Dr. Marton Kocsis, Case Handler, Antitrust Section, Hungarian Competition Authority, made a presentation on *“Buyer Power – Legal Background and Case Law in Hungary”*. He gave Hungary’s legal background pointing to the regular competition rules in the Competition Act.¹¹¹² The presenter echoed the most relevant question - not how the legislation was developed but whether it worked effectively.

The Hungarian representative said that Hungary has experienced similar problems as in Bulgaria, regarding relationship between foreign retailers and local suppliers. On the one hand, the entry of large retail chains led to the reduction of the end-price for consumers. On the other hand, this meant difficulties for producers/suppliers but also for starting farmers who are a very important group in Hungary.

SMP was introduced in the Act on Trade in 2005. The legal text was drafted by the legislator, the Competition Authority was also involved during the drafting. SMP was introduced because the retail chains at the time did not have a dominant position (Art. 102), but are still too strong players.¹³

11 Art. 21. equivalent of Art. 102 TFEU; the Act CLXIV of 2005 on Trade.

12 Art. 21. equivalent of Art. 102 TFEU; the Act CLXIV of 2005 on Trade.

13 A lower threshold than dominance was introduced in the Hungarian case: „Significant buyer power vis-à-vis suppliers exists where the consolidated net turnover derived from commercial activities of the group of undertakings in question, including all the parent companies and subsidiaries under Act C of 2000 on Accounting or, for the case of joint purchasing, all the undertakings establishing the purchasing association in the previous year (hereinafter: “the consolidated net turnover”) was higher than HUF 100 billion.”

All retail chains, as a result of the threshold, were caught within the SMP threshold, which identified several practices of abuse¹⁴.

As related to the procedure, the Hungarian representative pointed out that it is regulated by the rules of the Hungarian Competition Act on the prohibition on the abuse of dominant position. Moreover, pursuant to Article 75 of the Hungarian Competition Act, commitments binding on the parties are offered. Mr. Kocsis confirmed that the commitment tool is a very useful one.

The presenter conveyed the following two examples of case law for abuse of market power, which were initiated due to several complaints from suppliers. All undertakings concerned offered a commitment to modify, and bring in compliance with the Competition Act and the Act on Trade, their respective supplier contracts. The second case he offered was the SPAR case. In 2010, the Competition authority initiated an investigation to find out whether SPAR has breached Article 7 of the Act on Trade, when it forced its bonus system on suppliers in its contracts. The conclusion was that SPAR only distributed products, when the suppliers have agreed to pay a bonus to SPAR. However, the Competition Authority ascertained that SPAR has abused its market power when it enforced the bonus-system (unilaterally and without any benefit for the supplier) on its suppliers, and therefore infringed the Act on Trade. The fine was 50.000.000 HUF (ca. 170.000 €) and SPAR had to change their contracts with suppliers. However the case is still pending before the courts, after SPAR decided to apply against the decision of the Competition Authority.

The presenter reviewed also the 2009 Unfair Distribution Practices Act. Some sector-specific rules (e.g. prohibition of verbal contract, the right to unilaterally change the contract in favor of the retailer, etc.) were introduced in Hungary and the enforcer became the National Food Chain Safety Office (NFCSO), applicable to food and agriculture products. Thus, clear separation was made, as *de facto*, the NFCSO has to suspend its investigation when the Competition authority launches proceeding based on the Competition Act or on the Act on Trade.¹⁵

14 An abuse, in particular, consist in:

- a) unjustifiably discriminating against suppliers.
- b) unjustifiably restricting suppliers access to sales opportunities.
- c) imposing unfair conditions on suppliers, which result in a distribution of risks one-sidedly benefiting the dealer (devalue the costs of the retailer to the supplier).
- d) unjustifiably altering contract terms, to the detriment of the suppliers, after concluding the contract.
- e) subjecting future business relations of the dealer with the suppliers to conditions, in particular stipulating or retrospectively enforcing the application of a most-favorable-conditions clause.
- f) charging fees one-sidedly to suppliers (especially to get into the assortment of the retailer).
- g) threatening with termination of the agreement (delisting) with the intention to enforce one-sidedly beneficial contractual terms.
- h) unjustifiably forcing suppliers to avail themselves of third persons as suppliers or of an own service provider of the dealer
- i) applying sales prices, in cases in which the dealer is not the owner of the goods, which are lower than the invoice prices determined in its contracts.

15 From 1st of August 2012, the Act on Trade can only be enforced in the non-food sector by the Competition Authority. Regarding the food sector, only the Unfair Distributional Act can be enforced by the NFCSO.

Summary of the Discussion

The panel discussion evolved around the SMP criterion. According to the representative of the Italian Competition Authority, it creates more problems than it solves. It was discussed that in the Czech case, absolute terms are used, which does not seem to be favorable because one applies rules to prevent practices of future market position that may not create a balance today, but may do so in the mid-term. In this case, no fairness issues are treated in the case of LIDL that was given as an example by the Czech representative. For example, the Italian representative stressed that payment delays by retailers could be viewed as a form of discount offered by suppliers. The supplier is obliged or willingly colludes with the buyer. Some suppliers would argue that this is fine with them because it provides competitive leverage against competitors - other suppliers. Those suppliers that are strong on the market can provide discounts to retailers in the case of prolonged payment. An unclear assessment of SMP risks creating more problems and may result in distorting competition. Therefore, it is best to clearly specify criteria for assessment of UTP.

The panel discussion can be summarized as follows: *firstly*, all presenter countries offer a set of rules, adapted to address unfair B2B practices. *Secondly*, all rules are not regarded as stricter national competition laws, but some they come from other branches of the national law i.e., commercial or sector specific legislation. *Thirdly*, all rules are designed to protect the weaker parties in the contract relationship, but the competition authority has a mandate to intervene in cases where there is sufficient public interest affected by the respective behavior, (which results in very few examples of successful case law) and these rules do not seem to be effective at the national level. *Fourthly*, the drafting of the legislation related to UTP was not in the hands of competition authorities in Italy and the Czech Republic. Still, they took part in the drafting of secondary legislation (in the case of Italy), while the Czech Competition Office is engaged in drafting the amendments to the competition law framework. Finally, competition agencies may be better placed to respond to contractual relationships. Their intervention would allow for more harmonious enforcement of the rules on competition. However, a competition agency cannot apply the law in each and every case where there is unequal bargaining position.

PANEL III: THE LEGAL AND ECONOMIC ARGUMENTS

The final panel presented the legal and economic arguments that would support the use of the SMP concept in the competition policy framework of Bulgaria. It was moderated by Ms. Boryana Shotekova, representative of the Bulgarian CPC. She introduced the issues related to legal and economic arguments. The contribution from UNCTAD was included in this panel.

Contributions from UNCTAD

The representative from UNCTAD, Mr. Hasan Qaqaya, Head of Competition and Customer Policies, pointed out the need to understand the nature of the public policy problem that is the aim of this initiative. He noted the conflation of terms between competition, competitiveness, dominance, unfair bargaining, trading practices and abuse.

The emphasis on the importance of good public policy definition was made with a series of examples from around the world where good intentions lead to poor results. The case of Armenia seemed to be the most pertinent where, like in Bulgaria, the government used the competition policy framework to address unfair trading practices in cases where buyers use their superior bargaining position to extract unfair deals from their suppliers. Effectively, the implementation of the policy in Armenia turned the competition authority into a price regulator, examining the details of contracts between buyers deemed, and listed, to have significant market power and their supplier. In addition, to adding a mandate not in line with its previous responsibilities, this policy distracted the Armenian competition authority from the more impactful work of mergers and antitrust enforcement.

Contributions from the OECD

The participant from the OECD, Ms. Sabine Zigelski, emphasized that implementation of competition law instruments always faces difficult theoretical and practical obstacles that are general to all competition policy issues, but are particularly 'thorny' with respect to the new concept of 'significant market power'. She introduced old and new concepts used to determine the definition of markets, market power, and abuse, noting that even in the best of circumstances it is hard to interpret findings unequivocally. Detection, measurement and remedying harm to competition all pose serious challenges. The OECD emphasized damages which competition authorities could do in applying remedies to firms and markets that either the market would better address in the longer-term, or could be features of an evolving market or could be demonstrating more complex market adaptations that need closer scrutiny.

After demonstrating difficulties in the application and interpretation of the concepts that are part and parcel of the competition policy framework, the OECD representative addressed the particular issues surrounding the assessment of buyer power. This category of market power is even harder to assess and markets with large buyers have to be examined very carefully from all sides and cannot be unambiguously interpreted as anti-competitive.

Contribution from a professor at the University of Reading

Prof. Ioannis Kokkoris, legal expert and professor of law from the University of Reading (UK), presented arguments in support of the use of the SMP concept to remedy UTP stemming from the abuse of superior bargaining position of non-dominant firms. In addition, the professor presented a series of concerns about changes to priorities, effectiveness and resource requirements that would need to be addressed to make the competition authority effective if given the authority to address UTP.

Principles set out the factors that must be taken into consideration in deciding whether to take a case forward; namely:

- **Impact:** what would be the likely effect (direct or indirect) on consumer welfare in the market or sector where intervention takes place?
- **Strategic significance:** does the work tie-in with the Competition Authority strategy as set out in the annual plan and/or with other objectives?
- **Risks:** what is the likelihood of a successful outcome?
- **Resources:** what are the resource implications to the Competition Authority of doing the work?

Using the examples of other countries, such as the France, Germany and the UK, the professor answered each of these questions. In Germany, where the competition authority has been most explicit about remedying unfair bargaining practices of large buyers against small companies, the number of cases has been limited. However, the cases have been substantial. Most importantly, all of these countries have made it a priority to address these cases, putting together the requisite legal framework, as well as staff and resources as to not distract the competition authorities from their core functions.

Lastly, the professor stressed the need to provide resources for new mandates. He stressed the need not to distract the competition authority from its core functions and not to stretch current resources, but the need to add to these resources if new responsibilities were going to be added to the authority's portfolio.

Contribution from the World Bank

Mr. Alvaro Gonzalez from the World Bank pointed out in his presentation that the strength of the competition policy framework is its specificity. At the same time, the framework's specificity means that it can be unwieldy if it is used to address policy issues outside of its scope. For this reason, careful consideration about the appropriateness of this framework to the public policy concern is recommended. One test of how well the competition policy framework can address the issue of concern is to use the direction the EC provided on the use of economic theory to guide how competition policy assessments should be carried out. More specifically, the presenter questioned whether SMP could effectively and clearly address UTP considering that when buyers are alleged to use their superior bargaining position to extract unfair deals from their weaker placed suppliers corresponds to economic theory.

The World Bank emphasized the EC 2008 Guidance Paper on how to implement and enforce provisions under Article 102.¹⁶ The Paper places significant emphasis on an ‘effects-based approach’ to identify which unilateral actions from dominant entities should be of concern to the competition authorities. The effects-based approach stresses the need for corrective action when abusive action harms consumers; however, if unilateral action is deemed to harm competitors, this may not be sufficient grounds on which to apply corrective measures.

The World Bank contribution pointed out that the GoB’s proposal to amend the competition policy framework presents serious conceptual challenges. It first relies on the concept of SMP which needs to be clear, predictable and objective if enforcement is to be effective. Distinctions between ‘significant’ and other levels of market power need to be clarified, for example. In addition, in buyer-seller relations, it is unclear how market power in the downstream market is leveraged in the upstream market – where the alleged abuse is taking place. The terms ‘abuse’, ‘unfair’, and ‘superior bargaining position’, among others, also require greater clarity. Based on the guidance from the EC, clarification of these terms and concepts would be best if they are based on sound economic theory. Economic theory would support these concepts in cases that are extremely narrow and specific – specific enough to conclude that the case of public policy interest in Bulgaria would likely not apply.

Summary of the Discussion

The UNCTAD representative emphasized the need for careful thought to guarantee that the proposed instrument of intervention would fit the nature of the problem that legitimately concerns the GoB, whereas the OECD encouraged the government to proceed with great care and to be cognizant of the fact that the remedies found in any competition policy framework can be powerful, but when misapplied, damaging. The professor of law from the University of Reading stressed that the GoB has legal authority to address UTP under Article 102 of the TFEU. Moreover, he argued that some of the methodological issues that had been mentioned by others were being addressed by many other EU member states. Bulgaria was not alone in this. Finally, the World Bank summarized the messages of implementation challenges that the OECD intervention emphasized and the need for problem definition that the UNCTAD contribution stressed.

16 Guidance on the Commission’s Enforcement Priorities in Applying Article 102 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings’.

CHAPTER TWO

REVIEW OF SELECTED EUROPEAN POLICIES IN ADDRESSING UNFAIR TRADING PRACTICES AND OPTIONS FOR BULGARIA

INTRODUCTION

The Government of Bulgaria is concerned that large buyers may be using their size and superior bargaining position to dictate the terms of contractual relations with their suppliers. The Government argues that because some of these terms are onerous to suppliers, this constitutes unfair trading practices (UTP).

These concerns have translated into a proposal to address these unfair trading practices by amending the competition policy framework. The rationale for addressing UTP from a competition law perspective is that the prevalence of such practices could potentially harm competition in a specific market, as well have negative impact on consumers.

There are some issues to address before this proposal can be implemented. European Union (EU) competition legislation, does not address contractual relations between businesses even if these are based on unfair terms. At the same time, EU law does allow Member States, like Bulgaria, to set national rules. Using this authority, the Government of Bulgaria (GoB) is considering to introduce the concept of 'significant market power' (SMP) into the competition legislation. However, any proposal to change the competition framework would be best aligned to the principles and guidelines provided by the EU on how to enforce competition policy.

The Bulgarian Commission for Protection of Competition (CPC) has reservations about introducing SMP to the Law on Protection of Competition (LPC). The CPC does not endorse the introduction of the SMP as proposed in the draft bill (see Annex 3).¹⁷ The key arguments expressed by the CPC against this proposal are that: (i) the tools and methodologies to survey and assess market power of in the context of dominance in the relevant market are not appropriate for assessing SMP; (ii) the concept of SMP needs to be understood and implemented under the notion of 'economic dependence', rather than a concept similar to market dominance; and (iii) the forms of abuse that are identified in the draft bill are not aligned with CPC's capabilities to assess market dynamics.

Recognizing the need to address the unresolved issues, the GoB asked the World Bank to provide analytical services to better identify available policy options. The Deputy Prime Minister (DPM) for Economic Development, who championed the discussions since mid-2013, asked the World Bank to provide knowledge and advisory support to review European policy and legal practices and clarify the technical issues in the area of UTP and the possible application of SMP within the competition policy framework.

In response, the World Bank is providing a review of approaches applied by fellow EU Member States to address UTPs within and outside the competition policy framework. The GoB could consider these in designing its own proposals to address UTP. *Section I*, presents the EU context and the European Commission (EC) initiatives, whereas *Section II* looks at the Bulgarian context and how it is aligned with EC policy. Emphasis is placed on particular issues in the B2B relationships that are of primary concern to Government authorities.

¹⁷ The Bulgarian CPC opposed to the introduction of the SMP concept in the way as it was presented in the draft bill, prepared under the mandate of the previous government. Several official CPC decisions have identified the key constraints of the draft proposal, see Decisions No.495/04.05.2010, No.815/13.07.2010, No.338/18.03.2011, No.716/27.06.2012, and No.1090/25.09.2012. CPC came out with a Decision 386/19.03.2014 as a result of a bill, submitted to parliament on 7.03.2014.

Section III offers a review of selected EU policies that address UTP by focusing first on EU rules through the prism of the competition law concepts of 'dominant market position', 'significant market power' and 'economic dependence'. Then, the approaches used to address UTP practices in Germany, France, Italy, Czech Republic, and Hungary among others, are discussed. Based on these examples, *Section VI* offers a 'menu' of six options for Bulgaria. Finally, the paper concludes that solutions to address UTP would need to be designed comprehensively, leveraging simultaneously government policies, economic analysis and legal tools.

EU RULES

There is a public policy debate across EU on UTP in the local buyer-supplier relationship. EU Member States have taken different policy actions to protect against UTP in the local buyer-supplier relationship at the national level.¹⁸ Most Member States adopted special sector legislation while others put in place codes of conduct.¹⁹ There is also a difference in the scope of interventions, as some EU Member States applied these rules across all sectors.²⁰

Recent regulatory efforts at the EU level address this topic as well, but specifically in the retail food sector. The EC issued a communication on “A Better Functioning of Food Supply Chain in Europe” (COM 2009/591).²¹ In this communication, the EC states “contractual imbalances associated with unequal bargaining power have a negative impact on the competitiveness of the food supply chain as smaller but efficient actors may be obliged to operate under reduced profitability, limiting their ability and incentives to invest in improved product quality and innovation of production processes.” Moreover, the EC’s Directorate General (DG) for Competition carried out a survey through a series of informal discussions in 2009 with different associations in the sector to discuss the European food supply chain. The outcome of the consultations is best expressed in the following conclusion: “Competition at the retail level is fierce and margins are low, which results in better prices for consumers”.

Given that food supply chains are national in nature, the EC started working closely with national competition authorities to understand better how they function. The EC collaboration with the national competition authorities is carried out within the framework of the European Competition Network (ECN). National competition authorities launched investigations (case by case) of actors in the food supply chain and conducted inquiries regarding the food markets.²² On July 5, 2010, the EC adopted a Retail Market Monitoring report (IP/10/885) that identifies key issues that potentially hamper more efficient and fairer retail services within the Internal Market. On July 30 2010, the EC also set up a High Level Forum for a Better Functioning Food Supply Chain. In 2011, the European Parliament adopted a resolution on a more efficient and fairer retail market (2010/2109/INI), (see Box 1).

18 The focus on the food sector at the EU level has been intensified since the food price crisis broke out in 2007. From mid-2007 to mid-2008, agricultural commodity prices rose sharply, which resulted in increased consumer prices. Since then, prices of many commodities have come down to levels even lower than 2007 but consumer food prices have continued to increase and only started declining in mid-2009. This raised concerns about the functioning of the food supply chain. In particular, some retail chains have set unilateral terms and conditions on business partners. Hence, allegations and accusations of UTP started to come out in EU member states.

19 Czech Republic, Hungary, and Italy adopted laws that cover UTP in the agro-food sector, for instance. Ireland, Germany, Romania and Hungary have taken initiatives as well.

20 In France, provisions of the commercial law address UTP across the board to all B2B relations. It is relevant to note that there is a distinction between the use of competition law and laws aimed at preventing unfair trading practices. For instance, it is claimed that unfair trading rules regulate the contractual relationship between companies, see Regulation 1/2003 of the implementation of the rules on competition laid down in Art.101 and Art.102 of the Treaty on the Functioning of the European Union (TFEU) formerly Art. 81 and Art. 82 of the EC Treaty.

21 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0591:FIN:EN:PDF>.

22 <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2011-307>

Box 1: Concerns of the European Parliament about dominance by bigger actors in the food supply chain

The European Parliament resolution...

26. Reaffirms that free and fair competition, freedom of contract and proper enforcement of relevant legislation are key to a well-functioning retail market;

27. Recognizes that companies have different market power, that they need to act in an economically sound way and that the EU needs economic champions to compete globally;

28. Stresses, however, that there is widespread concern about market dominance by bigger actors, who are often perceived to impose unfair terms on weaker suppliers and retailers, for instance through unjustified mechanisms of selective distribution, geographical segmentation, price control, delisting without notice, and other restrictive practices, thereby distorting competition; underlines that the entire retail supply chain is affected by such practices; denounces practices that misuse power imbalance between economic actors and affect true freedom of contract; stresses that raising all actors' awareness of their contractual rights, especially [small and medium enterprises] SMEs, would contribute to preventing these practices.

Source: European Parliament Resolution, 2010/2109/INI.

Principles of Good Practices have been proposed for B2B relationships. In end-2011, principles of Good Practices have been proposed by the core group of the B2B platform on "Vertical Relationships in the Food Supply Chain", which contributes also to the High Level Forum for a Better Functioning Food Supply Chain.²³ Among these principles, one finds that imposing general terms and conditions that contain unfair clauses is not acceptable, as well as unilateral termination of a commercial relationship without notice, or subject to an unreasonably short notice period and without an objectively justified reason (for example, on the grounds that unilateral sales targets are not reached).

Food Task Force and Green Paper on UTP were launched as well. *Food Task Force* was set up January 2012 within DG Competition to better focus on the developments in the agri-food industry. Furthermore, the EC published a Green Paper on UTP in the B2B food and non-food supply chain in Europe in end-January 2013.²⁴ In this context, the EC conducted over 200 consultations with business associations, government agencies, competition authorities, consultancy groups, academia and experts, which were made public.²⁵

²³ http://ec.europa.eu/enterprise/sectors/food/files/competitiveness/good_practices_en.pdf.

²⁴ EC (2013b).

²⁵ See information on the consultations at: http://ec.europa.eu/internal_market/consultations/2013/unfair-trading-practices/contributions_en.htm#registered-org.

BULGARIAN CONTEXT

An *ex ante* Impact Assessment on the proposed amendments to the LPC was prepared in 2012.²⁶ Consultations with key stakeholders, a survey, a collection of expert opinions from government institutions, and expert analysis were basis of the conducting an *ex-ante* Impact Assessment of the proposed amendments to the LPC. The Ministry of Economy and Energy (MEE) championed this work with the support of a local consultancy firm.

The Impact Assessment identified problem areas in the buyer-supplier relationships in Bulgaria. Due to its superior bargaining power, stemming from their relatively large market shares, some large buyers in the Bulgarian market can unilaterally impose contractual obligations on their suppliers. For example, some suppliers may be required to provide certain commercial discounts when delivering goods in addition to incurring extra fees, bonuses, rebates, sanctions, forfeits and other expenses.

Large buyers often offer relatively low market prices but these may come at a cost to competition. On one hand, lower prices could lead to better conditions for the consumer and could have a positive impact on the suppliers/producers, by motivating them to become more efficient. On the other hand, as the Impact Assessment claims, the pressure by the large buyers could be harmful to the whole supply chain. Suppliers and producers may be unable to restructure and optimize in such a short time frame to respond to the new requirements. In addition, imposing hard bargains by retailers could drive suppliers and producers out of the market, harming competition in the supplier market.

In sum, the Impact Assessment found a number of UTP by large buyers in Bulgaria. The CPC, in their own review, found that some contracts between retailers and local suppliers for fast-moving consumer goods are signed for one year only and are associated with high entry fees for inclusion in the list of suppliers. Among the identified problems are delays in payments by the retailers, supplementary discounts are required, fees for TV commercials, branding, birthday, opening of new site, reconstruction of site and merchandizing are imposed.²⁷ Also even though local supplier/producers do not have control on the pricing policies of different retailers, they have been sanctioned by the retailer if another retail store has a lower sales price for their product.

In light of these findings, the Government of Bulgaria decided to act. Its policy aim is to balance the relationship between local suppliers/producers and large buyers. A solution was designed in 2012 under the leadership of MEE. This solution introduced SMP, to be applied across all sectors, by amending the LPC. A corresponding draft bill was submitted to Parliament on March 7, 2014, introducing significant changes to the competition policy framework and to the responsibilities of the CPC (Annex 3) and defining SMP as follows: *“Significant market power has an undertaking which is not dominant, but in consideration of its market share, financial resources, opportunities for market access, technological development and commercial relations with other undertakings, could prevent competition on the respective market, when its supplier or customers are dependent on it.”*

²⁶ The entire Ex-Ante Impact Assessment is available in Bulgarian only at: http://ec.europa.eu/internal_market/consultations/2013/unfair-trading-practices/docs/contributions/registered-org/bulgarian-center-for-ria-2-annex-1_bg.pdf; http://ec.europa.eu/internal_market/consultations/2013/unfair-trading-practices/docs/contributions/registered-org/bulgarian-center-for-ria-3-annex-2_bg.pdf

²⁷ In fact, there are over 100 fees, sanctions, bonuses, premiums and others that are imposed by the retailer on the local producer/supplier.

REVIEW OF SELECTED EUROPEAN POLICIES

European Union

There is no straightforward answer to the question which is the most appropriate legal instrument to address UTP.²⁸ It is a complex matter as unfair practices are essentially an issue of contract negotiation between businesses. Any attempt to balance the relationship between buyers and suppliers through legal means could limit the contracting freedom of the parties. Furthermore, the economic welfare outcomes of balancing this relationship are unclear. Large buyers may in fact be pushing the most costly and least innovative suppliers out of business and creating a more efficient supply chain. Improving these efficiencies will ultimately benefit consumers. For that reason, public policy would do well not to block this competitive dynamic.

The decision to frame UTP as a competition policy issue is not obvious. There is a myriad of available options for designing legal instruments to address UTP, including through market regulation of a specific sector,²⁹ as a commercial law instrument, or alternatively as instruments under the competition law framework. Competition law also does not provide a direct answer as to the most appropriate instrument: there are arguments in support of addressing UTP from both the anticompetitive, as well as from the unfair competition perspectives; also there are various options for addressing UTP under either perspective.

The EU has yet to provide guidance on how to frame this issue. The EU may provide guidance by adopting EU-wide rules on UTP in B2B relations in the near future: *“It is understood that there are other commercial practices which, although not harming consumers, may hurt competitors and business customers. The European Commission should carefully examine the need for Community action in the field of unfair competition and, if necessary, make a legislative proposal to cover these other aspects of unfair competition.”*³⁰ However, such overarching rules have not been adopted so far.

The lack of uniform EU rules addressing UTP in B2B relations adds to the complexity of the issue. Existing EU competition rules are not justified³¹ unless there is a direct negative impact on the functioning of the Internal Market or affect consumers.³² EU competition law addresses some instances of UTP,³³ but *“on the whole, a company confronted with unfair trading practices by a business partner is not able to benefit from consistent protection across the EU.”*³⁴

28 UTP should not be confused with unfair competition practices i.e., practices such as fraud, bribery, espionage, misrepresentation, etc. These are not necessarily related to the existence of a dominant position of a business in a certain market.

29 Market regulation is noted solely as a theoretical construct. Free market competition is a simple and efficient means of guaranteeing consumers the best choice in terms of quality and price of goods and services, and also forces firms to strive for economic efficiency and innovation. For a detailed discussion, see EC (2012).

30 Directive 2005/29/EC, Recital 8a

31 The EU level rules on anticompetitive practices must be differentiated from competition rules that could address business to business practices under competition law. Many EU countries, including Austria, have adopted rules in their competition framework that defines dominance in a situation where a company has a superior position on the market vis-à-vis its suppliers or customers. Such national rules apply when affected suppliers or customers are dependent on the maintenance of business relations with this company in order to avoid very heavy financial losses (See Art. 4 (3) Austrian Cartel Act and discussion further in this Note on examples from Germany, Italy etc.). These competition rules explicitly incorporate the concept of economic dependence in its definition of a dominant market position and in different Member State jurisdictions that apply to various sides of the market (suppliers/customer or both), which allows Competition Authorities to address “abuse of superior bargaining position” in B2B relations as an abuse of dominant position.

32 These rules, as defined under the Articles 101 and 102 of the TFEU, apply only to agreements between businesses that “are capable of having an appreciable effect on trade between Member States.” See, EC (2012).

33 For this reason the European Commission is addressing unfair trading practices on a sector by sector basis, for example the dairy sector, fisheries and aquaculture sector.

34 EC (2013).

To fill this gap, several EU Member States adopted national legislation addressing instances of UTP as abuse of buyer power. They have done so by taking advantage of EU law,³⁵ allowing stricter rules at the national level. The adopted rules leverage concepts such as ‘economic dependence’ or abuse of ‘significant market power’ in B2B relations.³⁶

A review of the national legislation adopted by other EU Member States to address UTP in B2B relations is provided in this document. The aim of this review is to provide the Bulgarian Government a ‘menu of options’ to be considered in designing their own specific national rules on this matter.

Unfair Trading Practices

UTP diminishes a company’s ability to negotiate mutually acceptable contractual terms. These practices also erode the foundation for fair and constructive business partnerships and market efficiency.³⁷ ‘Big buyers’ at times introduce different contractual terms and conditions to suppliers for essentially the same transaction; or impose additional, unrelated obligations as a condition to conclude a contract, or require payment of unrelated fees and charges for services, enforce contract changes retroactively, etc. (see, Box 2). For this reason the abusive behavior of ‘big buyers’ towards suppliers is debated in many countries across the globe.

At the same time, unrestrained competition rewards the most efficient and innovative companies. When commercially successful, companies grow into powerful market players or the leaders of markets. Based on the innovative products and services that they create, they gain market share and market power. Becoming a powerful market player³⁸ also gives a company the ability to influence competition or to use its ‘buyer power’ to shape business relationships in its favor. Policy makers must keep in mind that some of that market power has been gained by being successfully responding to consumer needs. As long as consumers benefit, caution would best govern interventions into that process. The balance is delicate and fragile.

35 Art. 3, Regulation 1/2003.

36 For detailed discussion see, Kokkoris, I. (2010).

37 In 2011, the EC proposed a Common European Sales Law (COM (2011) 635); one of its aims is protecting SME against unilaterally imposed unfavourable conditions and imposes mandatory provisions to ensure a fair balance between the interests of both businesses, such as the duty to act in good faith and fair dealing; not individually negotiated contract terms are to be considered unfair if these are significantly different from good commercial practices; if prices are set by one party only, and these are grossly unreasonable, then payable would be prices normally charged in similar transactions. For details see, EC (2013b).

38 Market power provides one party with a favourable bargaining position and opens the possibility for it to behave unfairly. Some companies, however, have only “limited” or “transitory” market power and can only exert their influence over short periods of time or in specific product segments. But when the economic power of a company within a certain market endures over time, this market power could be significant enough to allow the company to maintain prices above the competitive level, and/or restrict output or quality below competitive levels without the associated reductions in sales or losses in profitability.

Box 2: Market Power

In perfect competition, firms are price-takers and the profit acquired by them is normal profit, which just about ensures a rate of return on investment commensurate with the risks taken. No economic profit is earned in this situation; normal profits are the maximum these firms are able to achieve and these are determined by the market price. In contrast, the perfect monopolist is able to set its price level and will choose to raise it so as to maximize its profits. A monopolist's profit exceeds that earned by sellers in a perfectly competitive market, and includes economic profit in addition to normal profit. In this context, the ability to raise price above competitive levels is of key importance; it is known as market power. Market power is a firm's ability not to reject the market price, and instead set its prices above the competitive benchmark. To be more precise, a firm with market power is able to maintain a price that is substantially higher than the competitive price, on a long-term basis, without making losses.

Source: Hungarian Competition Authority, May, 2007.

Imposing contractual terms and conditions on business partners becomes 'unfair' when the party with the 'weaker' bargaining position cannot afford to reject the imposed terms.³⁹ This is most often the case when small businesses have no other outside options and are forced to accept unilaterally imposed terms. Sometimes even larger suppliers cannot afford to switch over to another business partner (demand or supply substitution)⁴⁰ due to high costs associated with switching-over or in cases where switching-over is not an alternative at all.⁴¹

Agreements containing terms⁴² typically associated with UTP violate EU rules on anti-competitive practices. These specifically prohibit all agreements that "*apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;*" or "*make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.*"⁴³ Prohibited also are 'abuse of superior bargaining position' in contract negotiations, imposing contract terms retroactively.

39 Businesses with a 'weaker' bargaining position agree to unfavorable terms for various reasons. Overall, the motivation is led by the perception, or certainty, that the relationship with such a "stronger" party, despite being built upon unfavorable and unbalanced contractual terms, is the precondition for pursuing a business opportunity or for entering a new market and in certain cases even for staying in business.

40 The inability to switch to another business partner and to terminate the existing relationship is one of the core concerns associated with UTP, specifically when the 'weaker' party has no alternative than to deal with an 'abusive' partner. The matter is further complicated as the 'weaker' party in the equation often fears that the commercial relationship could be terminated in the event of a complaint on its part. This 'fear factor' makes such complaints significantly less likely and is therefore one of the most important issues to be examined when assessing the appropriateness of an enforcement mechanism. See EC (2013b).

41 This places the other party in a favourable bargaining position and opens the possibility for it to behave unfairly. The inability to switch to another business partner and to terminate the existing relationship is a key factor in the development of UTP. In addition, the weaker party often fears that the commercial relationship could be terminated in the event of a complaint on its part. This 'fear factor' makes such complaints significantly less likely to occur and is therefore one of the most important issues to be examined when assessing the appropriateness of an enforcement mechanism (See, EC 2013b).

42 Generally, contracts do not cover all aspects of the parties' behaviour in the phase of the execution of the contract or are so complex that the parties do not fully understand what the terms imply in practice. Moreover, parties might not have the same level of information about the transaction, which may lead to unfair conduct by the stronger party towards a weaker counterpart. For detailed discussions see, EC (2013).

43 See, Article 101(1)(d) and (e) (formerly Article 81 TEC) of the Treaty on the Functioning of the European Union (consolidated version) C 326/88 EN Official Journal of the European Union, 26.10.2012.

To approach UTP, a contractual issue, from a competition law perspective fellow Member States leveraged concepts, such as ‘dominant market position’, ‘significant market power’ and ‘economic dependence.’

The Concept of Dominant Market Position

The application of competition rules on abuse of dominant position is relevant in the context of abuse of superior bargaining position (See, box 3), specifically, with respect to potential abusive behavior of large buyers towards smaller, economically weaker suppliers. However, as the finding of market dominance is a condition precedent to applying the rules on abuse of dominant position within the market, rules on abuse cannot be enforced against ‘abusive’ market players with a market share or turnover below the threshold for a finding of dominance.

Box 3: The Concept of Abuse of Superior Bargaining Position

Abuse of superior bargaining position is when a party makes use of its bargaining power relative to another party with whom it maintains a continuous business relationship to take any act such as to unjustly, in light of normal business practices, cause the other party to provide money, service or other economic benefits.

Austria, France, Germany, Italy, and the Slovak Republic employ this concept to address abusive behavior of large buyers towards suppliers with whom they have an economic dependent relationship. For example, Germany has leveraged this concept to address economically dependent business relationships in its competition legislation; Austria used the concept in legislation designed to protect local suppliers in rural areas; France leverages the concept in its commercial contract legislation; Italy’s legislation allows addressing abuse of superior bargaining position in economically dependent business relationships under a private civil remedy statute; while the concept is introduced in the Slovak Republic in an administrative regulation of retail chains.

The concept is embraced in countries outside of Europe as well. For example in Japan, abuse of superior bargaining position addresses the parties’ comparative bargaining positions, not their overall dominance in the market. Superiority is analyzed based on the level to which the weaker party is dependent on the allegedly superior party’s business, i.e., the weaker party’s sales to the stronger party as a percentage of the weaker party’s total sales; the superior party’s position in the market - market share; the weaker party’s ability to change customers and the scope of the weaker party’s investment in its business relationship with the superior party; as well as other factors, including the monetary value of their business relationship, the growth prospects of the superior party, and the difference in the sizes of the parties’ businesses. The Japan Fair Trade Commission issued Guidelines Concerning Abuse of Superior Bargaining Position under the Antimonopoly Act as of October 30, 2010.

Source: “Report on Abuse of Superior Bargaining Position”, prepared by a Task Force for the 7th Annual Conference of the ICN Special Program, April 14-16, 2008, Kyoto, Japan, accessible at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc386.pdf>. Information about the Guidelines concerning abuse of superior bargaining position under the antimonopoly act is available at: http://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines.files/101130GL.pdf.

Dominant market position under EU law⁴⁴ is a prerequisite for ‘abuse of dominant position’. ⁴⁵ However, a *“finding of a dominant position does not preclude some competition in the market. It only enables the undertaking that enjoys such a position, if not to determine, at least to have an appreciable effect on the conditions under which that competition will develop, and in any case to act in disregard of any such competitive constraint so long as such conduct does not operate to its detriment.”*⁴⁶ In essence, a company is dominant in a certain market when because of its economic power it could prevent competition in this market and could behave independently of competitors, suppliers and customers.

Dominance is defined by three interlinked elements: “(a) there must be a position of economic strength on a market, which (b) enables the undertaking(s) in question to prevent effective competition being maintained on that market by (c) affording it the power to behave independently to an appreciable extent.”⁴⁷ So in the context of EU competition law *“dominance is the ability to prevent effective competition being maintained on the market and to act to an appreciable extent independently of other players.”*⁴⁸

Dominance is well defined both at the EU level and under Bulgarian competition law.⁴⁹ The definition is centered on the ability of a dominant company to act independently from its competitors, suppliers and customers. This independence is established by assessing the competitive constraints on the particular company. In other words, the assessment to determine market dominance is designed to reveal whether a company, or companies, has sufficient economic power in the relevant market to influence prices and output levels. If it does, the company is considered to have dominance due to “substantial market power”.⁵⁰

The Concept of Significant Market Power

The assessment of market power for SMP exploits different concepts from those used to determine dominance. SMP is a concept developed in the context of regulated markets and to address sector-specific issues. It is not a concept from competition policy. In regulated markets, analyzing SMP follows the same methodology as the analysis of dominance; however, the market power analysis does not focus as much on the current situation on the particular market. Instead, the focus is on the future development of the market and the likely impact of a company (or companies) that have SMP in a market to affect downstream markets and on competition in the future. SMP analysis is used as the basis for decisions to regulate a market for the benefit of consumers.

However, similarly to dominance, SMP reflects the market player’s ability to influence competition in a particular market: *“An undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers.”*⁵¹

44 Article 102 (formerly Article 82 TEC) of the Treaty on the Functioning of the European Union (consolidated version) C 326/88 EN Official Journal of the European Union 26.10.2012.

45 As noted dominance is a prerequisite for abuse but both are not placed on equal footing. The determination that a company has sufficient economic power to prevent competition, influence prices etc., does not translate automatically to abuse.

46 See, EC (2002).

47 EC (2005, p.8).

48 EC (2005, p.10).

49 The EC considers that dominance may be presumed if a company controls a 50 percent share and its rivals have significantly smaller shares. For the lower market shares, shares in the range between 40 and 50 percent are more likely to be associated with a dominant position than shares below 40 percent. Market shares of 25 percent or less are usually not associated with a dominant position.

50 The reference ‘substantial’ addresses market power that is likely to be enduring over time, and should not be confused with the concept of ‘significant market power’.

51 Article 4, Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services.

With difficulty and some ambiguity, SMP has been adapted to address UTP as a competition law tool. As a concept ‘borrowed’ from regulated markets, SMP analysis is appropriate to address sector-specific problems. Competition policy is not sector-specific. The SMP concept worked well as a regulatory tool because regulatory policy is sector-specific and based on the assumption that a competitive equilibrium cannot be achieved without the continuous application of regulations and rules. In comparison, competition policy is sector neutral and assumes that by addressing a particular behavior a competitive equilibrium can be achieved.

Competition policy, as opposed to regulation, is applied in markets in which the competitive process is viable in principle, and only occasionally endangered by actions of individual firms or groups of firms. In addition, SMP incorporates forward looking approach⁵² and requires that markets are monitored on a regular basis. This is most appropriate as a regulatory activity. Sector regulators in markets such as telecommunications, energy, and banking are required to conduct market reviews to determine whether a particular market has players with SMP to prevent future anti-competitive pressures.⁵³ Also, the similarities between the concepts of SMP and dominance, create confusion and for this reason many Member States do not address UTP through SMP as a general competition law instrument, but rather apply established legal doctrines, such as dominance, leveraging the concept of ‘economic dependence’ to apply the rules on ‘abuse of dominant market position.’⁵⁴

The Concept of Economic Dependence

Many countries in Europe have employed the concept of ‘economic dependence’ in their national competition legislation to address behavior that appears to be abuse of dominance within a certain market but falls short of the definition of dominance. Focusing on economic dependence due to imbalance in bargaining position is a direction taken in more advanced interpretations of Article 102 Treaty on the Functioning of the European Union (TFEU) since EU competition law on the abuse of economic dependence defines a more lax regime than Member States’ own legislation. Member States could adopt “*stricter national laws which prohibit or sanction unilateral conduct engaged in by undertakings*”⁵⁵ to “*prohibit or impose sanctions on abusive behavior toward economically dependent undertakings.*”⁵⁶

While approaches across Member States vary, all define economic dependence when a supplier is economically dependent on a buyer or vice versa. The concept enables competition authorities to enforce the rules on abuse of dominant market position in cases where the dominance test is not met. By leveraging the concept of economic dependence, the national competition authority could treat an ‘abusive’ large buyer the same as a dominant market player who abuses its position. The concept was embraced by more countries in the

⁵² See EC (2002).

⁵³ This is a reference to a regulated market, outside of the scope of general competition law. For example, in the telecommunications sector, there should be reasonable certainty that entrants will be able to compete. This would require to ensure that the SMP player does not have an unmatchable advantages by virtue of its economies of scale and scope, especially if derived from its presence in the market, in order (i) to prohibit the SMP player from discriminating in favor of its own group of business (price or non-price basis), (ii) to provide an effective deterrent element and to ensure that the policies adopted by the SMP player towards commissioning new infrastructure allows all market players the same opportunity to compete. These rules should be ensured under regulatory supervision of a sector regulator. (See also ERG (07) 54 final 080331)

⁵⁴ Linking economic dependence with rules on abuse of dominant position is a solution applied by the vast majority of EU Member States; it is however, a concept from the 1970s and there are discussions to introduce a more modern concept. Several EU Member States, most notable Hungary and the Czech Republic, have introduced SMP in sector-specific legislation and entrusted their competition authorities with enforcement of these rules; while Latvia defined ‘abuse of dominance in retail’ in its competition law to address UTP.

⁵⁵ Regulation 1/2003, Article 3(2)

⁵⁶ Regulation 1/2003, Recital 8.

EU recently in light of higher industry concentrations over the past years and the resulting harm caused on small businesses by the practices of larger corporations.⁵⁷

The concept of economic dependence is related to the essential facilities doctrine. The essential facilities doctrine defines as anticompetitive the practice of market players denying potential competitors access to ‘bottleneck’ facilities to prevent their entry. In the context of the doctrine, a facility is essential (or infrastructure) to serve customers or to enable competitors to carry out their business where its duplication is impossible, impractical or extremely difficult due to physical, geographical, legal or economic reasons. The doctrine is best illustrated in cases where the duplication of infrastructure required by all market players to reach consumers is impractical and all depend on access to the existing infrastructure, and in the EU competition law context elevates a company to position within a market that effectively exceeds dominant market position.

The essential facilities doctrine originates from the United States but it has been adopted with some modification in the European Union.⁵⁸ Under EU law⁵⁹, the development of the essential facilities doctrine has been based on Article 102 of the TFEU, prohibiting abuses of dominant position within the common market. Denying access to an essential facility may be considered an abuse of a dominant position by the company controlling it, in particular where it prevents competition in a downstream market. In essence, under EU law, the refusal to deal could be construed as an abuse of dominant position under Article 102.⁶⁰

Review of Fellow Member States’ Practice

Historically, the concept of ‘abuse of economic dependence’ based on a ‘superior bargaining position’ has been applied to address the noncompetitive behavior of big retailers against suppliers with a weak bargaining position.⁶¹ It is applied in many European countries to non-dominant undertakings that have the ability to exercise market power in relation to SME suppliers, purchasers or competitors companies. Although the ability of Member States to apply stricter rules compared to Article 102 is acknowledged in Regulation 1/2003, the EC does not apply such rules. Thus, the gap in the application of the dominance in ‘economic dependence’ relations between buyers and suppliers is hidden in the traditional test of dominance.⁶²

57 For detailed discussion see, Këllezi, Pranvera (2008).

58 The doctrine originates from the judgment of the Supreme Court in United States vs. Terminal Railroad Association, where an association was set up by 14 out of 24 rail companies that were serving the St. Louis Railway Station to set-up a joint venture to manage the infrastructure required to access the railway station, which included a bridge that was technically impossible to duplicate. The Supreme Court imposed a duty on owners of essential facilities to deal with competitors and ruled that the joint venture set up by the association excluded the other rail companies from using the necessary infrastructure to access the St. Louis Station and in effect restricted their market access. For detailed discussion see Hatzopoulos, V. (2006).

59 It is important to note that there is a difference in the interpretation of essential facility in the U.S and in the EU: In the EU ‘essential facility’ is viewed as position exceeding market dominance, in effect defining the market player(s) as more-than-dominant in the market.

60 The Court of Justice restricts the scope of the essential facilities doctrine by limiting its application to situations in which the owner of a facility holds more than a dominant position and requires that a facility is indispensable. For detailed discussion see, E. Sebastien, 2004.

61 For detailed discussion see, Kokkoris, I. (2010).

62 Kokkoris, I. (2010).

Counterbalancing the relationship between big buyers and their smaller suppliers gained prominence in Western Europe in the early 1970s. Germany was the first country in Europe to amend its competition law to allow applying the rules on abuse of market dominance to economic dependent relationships between buyers and suppliers. France also developed an approach to UTP; however, French law allows addressing UTP both as a commercial contract issue under competition law and affords broader enforcement responsibilities authorities to the French competition authority in this respect.

Most Member States apply rules on abuse of dominance to cases of ‘economic dependence’ in B2B relations. Austria, Cyprus, Hungary (see box 4), Italy, Portugal, Romania, Slovakia, and Spain, to name a few, extended the concepts in this way to address the balance in economic relations between larger and smaller companies. A similar approach is taken in Latvia, which introduces a unique prohibition on the abuse of ‘superior bargaining position by retailers’ to “addresses both the abuse of economic dependence of smaller suppliers or producers as well as abuse of superior bargaining power by retailers”.⁶³

Box 4: Addressing SMP from a commercial law perspective in Hungary

UTP in Hungary are addressed in several pieces of legislation – the Commercial Act, the Trade Act, the Unfair Distributional Practices Act; and these are enforced by two bodies – the Hungarian Competition Authority (HCA) and the National Food Chain Safety Office (NFCSO).

Hungary’s competition legislation does not contain specific rules on buying power or economic dependency; however, Hungary’s commercial legislation – the Trade Act; defines the notion of SMP as the equivalent of “buying power”. According to the definition set out in Article 2 of the Trade Act “the term “significant market power” refers to a market situation as a consequence of which the dealer becomes or has become a contracting partner for the supplier which the latter is unable to reasonably evade at forwarding its goods and services to the customers and which is able, due to the size of its share in the turnover, to influence regionally or all over the country market access of a product or a group of products”. (Article 2 of the Trade Act) The SMP threshold is defined as follows: “significant buyer power vis-à-vis suppliers exists where the consolidated net turnover derived from the commercial activities of the group of undertakings in question, including all the parent companies and subsidiaries under Act C of 2000 on Accounting, or in the case of joint purchasing, all the undertakings establishing the purchasing association in the previous year was higher than 100 billion HUF” (approximately EUR 332 million). (Article 7 (3) and (4) Trade Act)

In Hungary the provisions of the Trade Act prohibiting abuse of SMP are applicable to all traders having SMP, whereas the Unfair Distributional Practices Act’s provisions are only applicable to traders active in the agricultural and food industry, regardless of the market power.

Rules on suppliers’ relations with large scale food retail chains, regulated under special legislation, are enforced by NFCSO, which limits the authority of the HCA to engage in enforcement action in the food retail sector, unless conducting an investigation whether a retail chain has a dominant position in the market. But the HCA has authority to conduct proceedings against retailers for cases of abuse with SMP. If an unfair business conduct falls under the Unfair Distributional Practices Act, the Trade Act cannot be applied. However, if the HCA conducts investigations in accordance with the abuse of dominance provision of the Competition Act, NFCSO has to suspend its proceedings which are related to the same conduct. *(Continued on next page)*

63 Section 13(2) Competition Law, March 2008.

The Trade Act provides a list of unfair business practices which qualify as abuses of SMP: unjustifiably discriminating against suppliers; unjustifiably restricting suppliers access to sales opportunities; imposing unfair conditions on suppliers; unjustifiably altering contractual terms to the detriment of suppliers; subjecting the future business relations of the dealer with the suppliers to conditions; charging fees one-sidedly to suppliers; threatening with delisting; unjustifiably forcing suppliers to avail themselves of third persons as suppliers or of an own service provider of the dealer; applying sales prices which are lower than the invoice prices determined in its contracts in cases in which the dealer is not the owner of the goods.

The Unfair Distributional Practices Act was adopted in 2010 following unsuccessful implementation of a non-binding code of conduct on the big retail chains. The Act covers all retailers and all types of food and agricultural product suppliers regardless of their size or bargaining power. The Act places additional requirements on traders whose annual net sales revenues exceeded 20 billion HUF (approximately EUR 67.1 million) in the preceding business year. Such larger traders are obliged to prepare and publish their business rules and submit them to the NFCSO. The rules must cover the services offered by the trader; the terms and conditions governing the provision of the services; the maximum prices that may be charged for the services; the calculation method used to set the prices; and the conditions of inclusion in and exclusion from the trader's suppliers list. Prohibited under the Act are unfair distribution practices such as: one-sided risk sharing to the detriment of suppliers; the application of contractual provisions which place a repurchase obligations on suppliers; cost externalisation towards suppliers; applying shelf prices, listing charges and extra charges for services not rendered; provisions containing payment deadlines exceeding 30 days; excluding interest for late payment, or penalty payment; a requirement regarding exclusive supply of suppliers without proportionate payment; an unjustified unilateral contract amendment by the trader; below cost pricing by the trader; applying discriminative customer prices with regard to equivalent products depending on the country of origin.

Under the Unfair Distributional Practices Act traders whose annual net sales revenues exceeded 20 billion HUF (approximately EUR 67.1 million) must publish their business rules and submit them to the NFCSO. These rules must cover the services offered by the trader; the terms and conditions governing the provision of the services; the maximum prices that may be charged for the services; the calculation method used to set the prices; and the conditions of inclusion in and exclusion from the trader's suppliers list.

Source: OECD (2013).

The underlying rationale for adopting specific rules on the 'abuse of economic dependence' in Germany⁶⁴ was to prevent big oil corporations from discriminating against small independent oil stations during the oil crisis and to protect other retailers from dependence on strong brands and the dependence that resulted from long-standing business relations.⁶⁵ In effect, the German approach is that dominance is present when large companies that have contracts with SMEs, hence abuse of superior bargaining position equates abuse of dominance: "*Paragraph 1 [dominance] shall also apply to undertakings and associations of undertakings insofar as small or medium-sized enterprises as suppliers or purchasers of certain kinds of goods or commercial services depend on them in such a way that sufficient and reasonable possibility of resorting to other undertakings does not exist. A supplier of a certain kind of goods or commercial services shall be*

64 Abuse of 'economic dependence' is a competition law concept from the late 1970s and early 1980s. It refers to the imposition of unfair purchase or selling prices/unfair trading conditions, limitation of production, markets, technical development to the prejudice of consumers, applying dissimilar conditions to equivalent transactions, making the conclusion of contracts subject to acceptance by other parties of supplementary obligations, etc. And for this reason it fully mirrors the rules under Art. 102 TFTU (Formerly Art. 82 EC Treaty.)

65 For detailed discussion see, Këllezi, P. (2008).

presumed to depend on a purchaser within the meaning of sentence 1 if this purchaser regularly obtains from this supplier, in addition to discounts customary in the trade or other remuneration, special benefits which are not granted to similar purchasers.”⁶⁶

Germany is a special case, as its national policies on establishing a “social market economy” have influenced the alignment of competition law and the political responsibility. The distinctive, characteristic features of Germany’s competition law system include a clear prohibition against horizontal cartels, moderated by rules that accommodate efficient co-operation, applied through legal analysis rather than administrative discretion, coupled with strong merger control and protection of small business interests (see, box 5).⁶⁷

Box 5: Use of abuse of economic dependence concept to protect smaller firms in Germany

Germany was among the first in Europe to adopt and develop the concept of abuse of economic dependence to protect smaller firms in their dealing with large customers and suppliers. German competition law pays special attention to protecting smaller firms against dominance in a bargaining relationship and to sales below cost as an abuse of superior market power in relation to SMEs. The enforcement record against abuse of dominance has been limited and mixed, perhaps because the German Competition Authority has concentrated more on the “cartel” issues that defined its original mission. A high priority now is network utility monopolies, as recent amendments eliminated exemptions and added a specific rule about access to essential facilities. In electric power, there have been dozens of investigations about network access charges. But enforcement against typical abuses in these industries has proved difficult. Methods developed for ex post enforcement through a quasi-judicial process against particular misconduct are not adapted for continuous administration based on detailed cost analysis in order to change sector-wide practices and conditions.

Source: OECD (2004).

France also extends the definition of abuse of dominant position to address economic dependence (see, box 6). The origin of the French rule on economic dependence is to be found in the development and the concentration of retail distribution. French law, conforming to EU competition rules under Article 102 TFEU, prohibits unilateral conduct: *“The abuse by an undertaking or group of undertakings of a dominant position . . . shall be prohibited . . . These abuses may in particular consist of refusals to sell, linked sales or discriminatory conditions of sale and the severance of established commercial relations solely because the partner refuses to submit to unjustified commercial conditions.”⁶⁸*

French law allows addressing UTP under both commercial law and competition law. Though French commercial law includes specific provisions on ‘abuse of superior bargaining position’, the French Competition Commission requested in 1985 the adoption of competition rules that would empower it to control the discriminatory behavior of firms imposing obligatory trading terms on suppliers or producers, even if they do not hold a dominant position in the market:⁶⁹ *“Also prohibited, whenever it is susceptible to affect the functioning or structure of competition, is the abusive exploitation, by a company or group of companies, of the condition of economic dependence in which a customer company or supplier finds itself vis-à-vis such company. These abuses may consist of the refusal of sale, tied sales or the discriminatory practices mentioned in article L 442-6.”⁷⁰*

⁶⁶ Section 20(1) of the German Act against Restraints of Competition.

⁶⁷ See, OECD (2004).

⁶⁸ Article L420-2 of the French Commercial Code; Book IV codifying the Competition Act of 1986.

⁶⁹ For detailed discussion see, Këllezi, P.(2008).

⁷⁰ Article L 420-2, Commercial Code, Amended by Law n ° 2010-874 of 27 July 2010 - art. 14 (V).

Box 6: Combining economic dependence with commercial law in France

Under French competition law economic dependence is described in terms of a buyer's ability to threaten or ruin its supplier, where the buyer represents more than a critical threshold of the supplier's business. Law based on this concept is designed to control consolidation in the distribution chain, to handicap large distributors and protect smaller retailers and suppliers. In 2001 the competition law was reformed to improve the processes of investigation, including defining in greater detail the rules related to the concept of abuse of economic dependence and aligning the treatment of "restrictive" with "anti-competitive" practices. Practices that "restrict" competition often have little effect on markets, though they could affect particular competitors' positions. For example, discrimination in price, delay in payment, or other conditions of sale or purchase that are listed in the part of the statute about unfair practices are all considered abuses of economic dependence if they have the requisite general effect on market competition. Economic dependence is no longer defined as a situation in which the customer or supplier has no equivalent alternative, but dependence is defined as relationship specific: whether a firm has enough coercive power to make its suppliers or customers vulnerable depends on how important the firm is to their business. There are 7 specific prohibitions against discrimination and extortion of unfair advantage, also prohibited as abuse of economic dependence if there is an adverse effect on market competition. The first is a general prohibition against granting or receiving discriminatory prices, payment terms, or conditions, if discrimination is not justified by compensation actually received and it creates a competitive advantage or disadvantage. The second, which was added in 2001, targets hidden rebates and discriminations involving promotional allowances or services. Other abuses that are specifically prohibited include obtaining or seeking unwritten advantages as a condition for transmitting orders, using the threat of termination to seek or obtain prices or terms that are "manifestly exceptional to general conditions of sale," terminating an established commercial relationship without prior written warning (except for breach of contract or force majeure), selling outside a contractually restricted distribution system (if the system is legal under the competition law), and abusive payment terms. Contracts may not envision retroactive benefit from rebates or discounts, demand payment for shelf-space access before transmitting orders, or prevent transferring bills due to third parties for collection. These practices affect the relative bargaining positions of buyers and sellers, and some may lead to secondary-line effects on rivalry.

Source: OECD (2003).

Other Member States prohibiting abuse of dominant position in relations based on economic dependence, including Italy (see, box 7), Portugal, Romania, Slovakia and Spain. For example Italian law prohibits "... any agreement between parties in commercial relation, which would determine an abuse of one party's economic dependence defines as excessive imbalance between the duties and obligations of the parties arising from that commercial relation."⁷¹

Box 7: Using economic dependence to apply rules on dominance in Italy

Italian Competition Law mirrors the EU rules on prohibited agreements and practices in restraint of competition, and abuses of market power, with the exception of the premise that these should have “effect on trade between Member States” (Article 102 TFEU). Protection of smaller undertakings is not a concern specifically addressed by the Competition Law; however, rules aimed at prohibiting abuses of dominant positions and anticompetitive mergers that result in the creation or strengthening of market dominance are normally addressed to large undertakings that enjoy significant market power. Accordingly, enforcement of those rules may indirectly result in the protection of smaller businesses. “Economic dependence” is defined by as “the situation in which an undertaking has the power to determine, in its commercial relationship with another undertaking, an excessive imbalance in the parties’ rights and obligations.” In implementing the rule Italian civil courts have noted that concept of economic dependence introduces a broader notion of abuse, under which a dominant position in the relevant market is not required for the prohibition to apply. Also civil courts have noted that although the language of economic dependence emphasizes the “excessive imbalance in the parties’ rights and obligations,” a situation of “economic dependence” (or “hold up” situation) exists, primarily, when an undertaking is the “mandatory” partner of another undertaking - that is, when the latter is forced to deal with the former where no satisfactory alternative commercial partner is available. (See, e.g., *Medical Sys. v. Eastman Chemical Italia*, 5 Jan. 2004 (Court of Catania), available at www.ilFallimento.it/giurisprudenza/117.htm; see also *Petosino v. Marini Bobini, Danno e Responsabilità*, 6 May 2002 (Court of Bari). Law No. 57/2001 introduced a new rule providing that any agreement resulting in an abuse of “economic dependence” is void and entrusted the Italian Competition Authority with the power to investigate any alleged violation of the rules on abuses of economic dependence and where necessary to impose fines.

Source: Siragusa, M., et al (2009).

The Czech and Hungarian competition authorities address UTP by enforcing sector-specific legislation on agriculture and food product retail that introduce the concept of ‘significant market power’ in B2B relations. Under Czech law (see box 8) SMP is defined as follows: “*Significant market power shall be deemed to be a relation between a buyer and a supplier ... and in which the buyer may impose unilaterally beneficial trade conditions on the supplier*”.⁷²

72 Art. 3(2) Act No. 395/2009 SMP in the Sale of Agricultural and Food Products.

Box 8: Introducing SMP through sector-specific legislation in the Czech Republic

In 2010 the Czech Republic adopted a special Act on Significant Market Power in Sale of Agricultural Products and Abuse thereof. This new Act introduced stricter national rules applicable to unilateral conduct in the food sector which go beyond the classical dominance test foreseen under Article 102 TFEU. Since 2010, the Competition Authority has also been enforcing the Act and has been engaged in monitoring the market of agricultural and food products, which includes conducting regular sector inquiries and collecting relevant information concerning supplier-retailer relationships and the process of negotiating delivery terms within the agricultural and food supply chain. The Act defines the concept of the significant market power and its abuse for the purposes of the protection of competition and to set up tools for assessment and avoidance of such behavior. The Act is applicable in cases concerning sale of agricultural products when an undertaking as a buyer abuses its significant market power towards other undertakings – its suppliers. SMP is defined by the Act as “the position of the buyer towards the supplier, whereas the supplier becomes dependent on the buyer in relation to delivery of goods to the customers as a result of the market situation and the market power enables the buyer to enforce unilaterally preferential terms”. There is a rebuttable presumption of SMP if the net turnover of the buyer exceeds 5 b. CZK (approx. EUR 200 m.) in the last accounting period in the region of the Czech Republic. It is prohibited to abuse the SMP to the detriment of suppliers; the abuse is to be understood as a systematic conduct which has as its object or effect significant distortion of competition in the relevant market. There is a list of conducts considered to be abusive in five annexes to the Act. The fines for breaching the Act can be imposed in amount of up to 10 m. CZK or up to 10 % of the net turnover. The application of the Act has been complicated since the beginning because of several ambiguous terms and definitions (including the term SMP) that were broadly criticized by law practitioners as well as stakeholders. In 2011, the Czech Government decided that the law should be abolished and some of its parts transferred to the Competition Act and to the Price Act. The Office has been entrusted with the task to draw an amendment in this respect. However, the discussions about the amended continued during 2012 and the overall concept has not been drafted.*

Source: OECD (2012).

* - See footnote ⁷³

⁷³ It is important to note that modern competition rules focus on the prohibition of ‘abuse of dominant position’ practices, while ‘significant market power’ holds an economic meaning and refers to the ability of a company to set the prices of its products independently above competitive levels

OPTIONS FOR BULGARIA

The World Bank analyzed EU Member State policies in addressing unfair trading practices against the following criteria: effectiveness, alignment with economic principles, adaptability, efficiency and timeliness, and analytically based, dependent, transparent, contestable and reversible practice with due process. Based on these criteria, the World Bank proposes six options, ordered by suitability:

The first and recommended option is to enrich Bulgaria's current commercial law with specific rules prohibiting UTP, following the French and Hungarian examples, where specific provisions addressing UTP in B2B relations are defined in legislation on commercial contracts and the CPC is tasked with enforcing these provisions in cases where business conduct affects competition.⁷⁴

The second preferred option would be to adopt national rules addressing UTP following the spirit of the current EU law and the experience of most other fellow Member States.⁷⁵ Implementation would entail amending the competition law framework to extend the authority of the CPC to apply the rules on 'abuse of market dominance', even in cases where dominance is not present, by leveraging the concept of 'economic dependence' in B2B relations, following the example of most other fellow Member States, spearheaded by Germany.⁷⁶ Under this option the CPC would be able to treat a large buyer that abuses its 'superior bargaining position' *vis a vis* economically dependent suppliers and producers the same as a dominant market player who abuses its position.

Addressing UTP through antitrust law enforcement is associated with significant risks that the work of the CPC would be politicized and may discredit the impartiality of the authority as it is likely that the CPC will be overburdened by a large number of cases requesting the attention of the authority to the practices 'abusive' large buyers that could backlog the systems and hamper enforcement.

The third option would be to enhance the authority of the CPC to apply available legal instruments on unfair competition practices.⁷⁷ Implementing this option would likely be associated with significant reform efforts, both in terms of associated legislative changes and in terms of enhancing the capacity of the CPC in the consumer protection area. In general, Bulgarian competition law provides recourse for unfair B2B practices; however, while the CPC has authority to address unfair competition practices that affect consumers, it is not directly tasked with consumer protection. Competition authorities in many countries have studied the competition conditions in the supply chain and have concluded that, in general, new rules are not necessary to address B2B relations from a consumer protection perspective; applying and strengthening 'unfair competition' rules would be enough. In the

74 Amending general commercial law to address UTP could include for example requirements on standardizing supplier agreements, prescription of uniform supplier conditions, uniform delivery and payment terms, etc.

75 For detailed discussion see, EC (2013 b) and European Competition Network (2012) .

76 And to a certain extent Latvia, which introduced the concept of 'dominance in retail' which is a 'variation' of the concept of applying the rules on abuse of dominance specifically tailored to cases of economic dependence in retailer-supplier relations.

77 Mr. Gianluca Sepe (Italian Competition Authority), strongly suggested expanding the authority of the CPC in the consumer protection area during the discussions of the Technical Workshop "Significant Market Power and Unfair Business Practices: Issues and Challenges" held in Sofia on January 28 2014. Mr. Sepe, as a competition expert, noted that the CPC could take advantage of the 'unfair competition' authority under the current competition framework, and that even if the CPC oversteps its mandate and encroaches on the authority of the Consumer Protection Agency in related actions, the CPC would be the 'best possible authority' capable of addressing unfair competition from a consumer protection perspective. Such comments reflect a long lasting debate whether competition authorities should be tasked with consumer protection.

Bulgarian context, however, such a discussion would require comprehensive analysis of CPC's authority *vis a vis* the Consumer Protection Commission.

The fourth option would be to promote codes of conduct applicable to B2B relations. Many jurisdictions, most notably the United Kingdom in Europe, have developed codes of conduct aimed at tackling imbalances in the supply chain, where the rules favor suppliers and prevent retailers from unduly shifting costs and risks onto suppliers. In general, the codes of conduct are voluntary and therefore, adhesion to the code by retailers/suppliers is required to ensure success of the instrument.⁷⁸

The fifth option for Bulgaria is to adopt national rules aligned with the debated EU-level rules on UTP. Such an option, however, would delay significantly designing a solution to address UTP in B2B relations in Bulgaria as it is unclear when (and whether) such EU-wide rules on UTP in B2B relations would be adopted.⁷⁹

The last, sixth option, also refers to adopting national rules following fellow Member State experience. Implementing this option would require adopting sector-specific legislation to task the CPC with enforcement of sector rules that introduce the concept of SMP in B2B relations, following the examples of the Czech Republic and Hungary.⁸⁰ It is important to note that this option, albeit introducing SMP, is distinctly different from the approach taken in Bulgaria. In the Bulgarian case, SMP is introduced as a competition law instrument applicable to all sectors and markets; while in the Czech and Hungarian cases SMP is introduced through sector legislation and the respective competition authorities enforcement role.

Introducing SMP through amendments to the LPC would be not only a unique application of the SMP concept in Europe, but will likely put significant strain on the CPC, both in terms of capacity and resources.

78 Such Codes include broad principles of business conduct or standards of behavior that should be followed by adhered firms. (see A. Tallontire, 2007, pp. 775-791). It is important also to note that examples of successfully addressing UTP through codes of business conduct come from the common law traditions such as Australia, UK, etc.

79 The issue is debated at the EU-level since 2005 when EU rules specifically addressing unfair commercial practices, i.e., business to consumer, were adopted

80 A key difference between the proposed amendments of the LPC in Bulgaria and the Czech and Hungarian examples is that the GoB contemplates introducing SMP in competition law, rather than in sector-specific legislation and entrusting the competition authority with enforcement.

CONCLUSION

UTP in business relations negatively impacts the abilities of some companies to invest, innovate, grow and export. For this reason solutions to address UTP would need to be designed more comprehensively, leveraging simultaneously government policies, econometric and legal tools. Legislation, addressing UTP could be an effective tool for limiting the abilities of companies for restricting competition and winning over customers through noncompetitive means.

Protecting consumers is the overarching rationale behind competition legislation. An underperforming market would have negative impact on consumers as competition within the supply chain has direct impact on them: *“suppliers (producers, traders) offer goods or services on the market in an endeavor to meet demand (from intermediate customers or consumers). Demand seeks the best combination of quality and price for the products it requires. Competition between suppliers leads to the most efficient response to demand.”* (EC, 2012).

Restricting opportunities for UTP in business relations would be best achieved through targeted amendments to general commercial law and allowing for parallel enforcement by the CPC in cases where business conduct harms competition. This can be achieved for example, through new provisions in commercial legislation defining requirements for standard agreements and uniform supplier conditions applicable for selected sectors, prescription of uniform delivery and payment terms, etc. This approach should allow unilateral actions on contractual issues through the courts, as well as affording the CPC enforcement responsibilities of commercial law provisions addressing UTP in cases where their prevalence could harm competition in the market.

Addressing UTP from a competition law perspective would require an in-depth discussion as to which legal instruments available under the EU competition doctrine would be most appropriate and successful in Bulgaria.

Most fellow Member States adopted provisions allowing the application of the rules on abuse of market dominance (in cases where dominance is not present) by leveraging the concept of ‘economic dependence.’ This approach allows the competition authority to treat an ‘abusive’ big buyer the same as a dominant market player who abuses its position.

An option that requires significant reform efforts is to expand the authorities of the CPC in the consumer protection area. This would require amending respective legislation governing consumer protection and competition, as well as significant reform efforts in terms of staffing and capacity building of the CPC. Such an approach, apart from requiring significant reform efforts, would likely overburden the CPC and remove its focus on core antitrust activities.

A ‘minority’ approach, taken by the Czech Republic and Hungary, is to expand the authority of the competition authority to enforce sector-specific legislation that defines SMP and prohibits its abuse. The proposed amendments to the Bulgarian LPC, does not follow this approach. The draft bill proposes SMP concept as generally applicable competition law instrument, not only applied to the food retail sector as in Hungary and the Czech Republic.

Treating UTP in the context of antitrust law enforcement or consumer protection could politicize the CPC and discredit it as an impartial agency. Given the large proportion of SMEs in Bulgaria, such approach would also likely overburden the CPC to review a large number of endless cases requesting the attention of the authority to the practices ‘abusive’ large buyers as well as complaints by consumers.

CHAPTER THREE

METHODOLOGICAL ISSUES: DETERMINATION OF SIGNIFICANT MARKET POWER

INTRODUCTION

The Government of Bulgaria is concerned that large retailers may be using their superior bargaining position to dictate the terms of contractual relations with their suppliers. The Bulgarian Commission on Protection of Competition (CPC) found some of these practices to seem unfair, but that it had no authority to fully address them under existing competition legislation. This lack of authority to act is based on the fact that European Union (EU) competition legislation, itself, is silent on the relations between businesses even if these are based on unfair terms. However, EU law does allow Member States, like Bulgaria to set national rules if they want to address unfair practices resulting from abuse of bargaining power.⁸¹ Using this authority to amend its competition framework, the Government of Bulgaria plans to introduce the concept of ‘significant market power’ in the competition legislation.

Purpose and scope

This chapter identifies and discusses some of the methods, data and analysis that The Bulgarian Commission on Protection of Competition could use to assess the existence of significant market power (SMP) in market assessments. Before introducing a discussion of these methods and analyses, the difficult issues that arise in making coherent economic arguments that would justify significant market power findings are discussed. The framework of the debate over these issues is provided by economic theory. Economic theory and an understanding of market competition are emphasized as an essential part of all competition policy market assessments in the guidelines provided to competition authorities of Member States by the European Commission (EC).⁸²

The EC Guidelines include a number of criteria that may be used in assessing market power. However, the Guidelines are not exhaustive. In fact, the EC Guidelines do not specifically mention how to assess SMP as opposed to dominance. To make an assessment of SMP, other criteria are considered.⁸³

This chapter is divided into three sections:

- *Section I* contains an introduction, background and a discussion of EC guidance on concepts of market power;
- *Section II* covers a discussion of the methodological issues that the CPC may want to address in identifying relevant markets, assessing the existence of SMP and barriers to entry in the retail sector; and
- *Section III* identifies data and market indicators that can inform market assessments in the retail sector.

81 Article 3 of EC Regulation 1/2003, in addressing the relationship between national competition laws and the EU competition rules, states that where national competition authorities or courts apply both European and national competition law in parallel, the application of the latter is subject to an obligation of convergence contained in Article 3(2).

82 Communication from the Commission—‘Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings.’, Official Journal C 045, 24/02/2009 P. 007–0020, [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009XC0224\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009XC0224(01):EN:HTML) (Last accessed January 21, 2014).

83 It is important to note that the EC Guidelines referred to here only address abusive exclusionary conduct from dominant undertakings. These guidelines are meant to address conduct that impairs genuine undistorted competition. Exclusionary conduct is when an undertaking with dominant position excludes its competitors by other means than on the merits of the products or services they provide. A dominant position may be held by one undertaking (single dominance) or by two or more undertakings (collective dominance). The document only relates to abuses committed by an undertaking holding a single dominant position.

Finally, the arguments and concepts used throughout this chapter address and are organized around the policy issue of most immediate concern to the authorities in Bulgaria; namely, instances of unfair trading practices in the retail sector. In addition, while there is a discussion of the economic arguments that may be used to identify 'superior bargaining power', 'unfair trading practices' and 'economic dependence', all terms associated with SMP in buyer-supplier economic relations, there is no discussion on how to identify, empirically, these terms.

GUIDANCE, CONCEPTS AND ISSUES

The Government's proposal to amend the competition policy framework presents a few challenges. It first relies on the concept of 'significant market power'. This term is not consistently well defined, especially within competition policy frameworks. Distinctions between 'significant' and other levels of market power need clarification if the concept is to be used in a non-arbitrary manner.

In addition, there are other concepts used to distinguish this type of market power significant market power from monopoly or dominance; namely essential facilities,⁸⁴ economic dependence and superior bargaining power. The task is also to ground all of these concepts in economic theory. The goal of this section is to provide some clarity to the following terms and concepts used to distinguish 'significant market power' from other market power concepts:

- Significant market power;
- Essential facility, economic dependence and superior bargaining power; and
- Unfair trading practices.

Rather than providing a definition for each, the section discusses the issues and challenges in clarifying the following term. For 'superior bargaining power', 'unfair trading practices' and 'economic dependence', discussion is theoretical in nature. There is no discussion here on how to identify these terms empirically.

Finally, the Government of Bulgaria is particularly interested in using the SMP concept, within the competition policy framework, to address sector-specific issues in the retail sector. This runs against the grain of sector-neutrality of competition policy. Sector neutrality is one of the tenets that of competition policy that distinguishes it from (sector-specific) regulation. So while discussions centered on changes to the competition policy framework are best kept independent of specific sector considerations, the particulars of the retail sector make it difficult to manage and organize a concise and coherent discussion of the SMP authority without confining it to the retail sector. In sum, to respond to the Government's interest in the retail sector, the discussion contained here is not generally applicable to sectors outside of retail.

The nature of competition and certain aspects of retail markets are not shared by many other sectors. For this reason, recommendations on the nature of analysis for this sector are adapted to fit these differences. For example, in retail markets location matters to a level of granularity that may not be the case for many other sectors. Being a corner store may put an undertaking in a different market than a supermarket with a large parking lot down the block. The type of retail establishment matters as well since some may offer the same products, but a different level of service, product selection, etc. Even operating hours of retail establishments may be of great importance since midnight shoppers may have different demand characteristics than ones that shop during the day.

⁸⁴ While essential facilities issues do arise in purely private, unregulated contexts, there is a tendency for them to arise more commonly in contexts where the owner/controller of the essential facility is subject to economic regulation or is State-owned or otherwise State-related. Hence, there is often a public policy choice to be made between the extension of economic regulation and an essential facilities concept under the competition laws. Further, the fact of regulation of pricing through economic regulation, State-control, or a prohibition of 'excessive pricing' in the competition law, has implications for the nature of an essential facilities concept. The US has increasingly restricted the concept to monopolies, while the EU is more liberal with the term and is prone to applying it in different market structures other than monopoly.

In sum, the discussion throughout this chapter is grounded on the guidance provided by the European Commission. EC guidance, however, does not address many of these concepts directly so these must be adapted to fit the purposes of the Government's policy goals. These guidelines are discussed next.

EC Guidance

Article 102 (formerly Article 82) of Treaty on the Functioning of the European Union is a fundamental part of the competition policy framework dealing with abuses of market power. This article, however, is silent on the conduct of entities that are non-dominant since these undertakings are not likely to have the capacity to 'behave independently of customers, and competitors and adopt conducts which will induce consumer harm.'

The European Union's top enforcement authority, the European Commission, issued a guidance paper on how to implement and enforce provisions under Article 102.⁸⁵ The EC Guidance Paper (2008) places significant emphasis on an 'effects-based approach' to identify which unilateral actions from dominant entities should be of concern to the competition authorities.

The effects-based approach emphasizes corrective action when abusive behavior harms consumers, not competitors. If a unilateral action is deemed to harm competitors, this may not be sufficient grounds on which to apply corrective measures. The analysis of harm must also show that this unilateral action negatively affects consumers, *present and future*, before the application of sanctions and remedies are justified.

Market power

The European Commission defines dominance but not significant market power. SMP is a market power threshold that is lower than and different from dominance. SMP is often seen as a case in which a firm is one of a handful of firms 'big enough' to independently affect the market and is 'unaffected' by the threat of competition from one of the other 'big' firms. As this informal definition illustrates, there are a set of not so well defined terms and many of these are similar to those used to define dominance. The issue, therefore, is how dominance and SMP are different. What economic theory and assumptions can competition authorities appeal to in order to support meaningful distinctions between the two concepts?

85 'Guidance on the Commission's Enforcement Priorities in Applying Article 102 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings.'

Dominance

Article 102 adopts an economic definition of dominance as an undertaking “...capable of profitably increasing prices above the competitive level for a significant period of time does not face sufficiently effective competitive constraints...” The Commission does not refer to a certain market share above which (or below which) dominance will be presumed (or excluded), but lists a number of factors that it will consider in its dominance assessment, including the presence of “constraints imposed by the existing supplies from, and the position on the market of, actual competitors (the market position of the dominant undertaking and its competitors); constraints imposed by the credible threat of future expansion by actual competitors or entry by potential competitors (expansion and entry); constraints imposed by the bargaining strength of the undertaking’s customers (countervailing buyer power).” Dominance exists when the undertaking is not be subject to competitive constraints.

The EC’s definition of dominance represents efforts to define that concept by behaviors and their consequences to consumer welfare rather than by market structure. The Economic Advisory Group on Competition, which influenced the design of the European Commission’s competition policy framework,⁸⁶ argued that the traditional means of establishing dominance by estimating market shares would only lead to proxies for the determination of dominance. Assessments of market structures provide information only about the ability and opportunity to exert power and impose abusive behavior on other market participants,⁸⁷ but are not evidence of abusive behavior itself. The Economic Advisory Group recommends additional evaluations of the alleged competitive harm on the basis of how competition in the particular market actually works. Most importantly, this approach argues that a determination of what the practice in question harms consumers is what matters most.⁸⁸

Significant market power

Based on the dominance definition that the Commission does provide, however, it can be argued that SMP is meant to refer to an entity’s capacity in a manner that is to some extent more sensitive to the reactions of its existing and potential competitors. Also, if the definition of SMP is a lighter variation of dominance, the ability to ‘substantially’ increase prices for a ‘significant’ period of time would be another reasonable area of inquiry. Would an entity with SMP raise prices, but not so ‘substantially’ as a dominant firm? Alternatively, would an SMP undertaking raise prices of a period of time that is something less than ‘significant’? In sum, as something less than dominant, an undertaking deemed to have SMP may imply that the competitive constraints are not completely ineffective over some period of time. This is problematic since even in dominance cases it is difficult to pin down what a ‘small but significant and nontransitory price increase’. Basing a less stringent definition of market power on what that is already difficult to define will unlikely lead to greater clarity.

86 The Report was written by Jordi Gual (IESE Business School and ‘la Caixa’, Barcelona), Martin Hellwig (Max Planck Institute for Research on Collective Goods, Bonn), Anne Perrot (University Paris I and Conseil de la Concurrence, Paris), Michele Polo (Bocconi University, Milan), Patrick Rey (Coordinator, University of Toulouse), Klaus Schmidt (University of Munich) and Rune Stenbacka (Swedish School of Economics, Helsinki and RUESG, University of Helsinki).

87 See Economic Advisory Group on Competition Policy Report, page 14.

88 The OECD policy brief on Substantial Market Power and Competition argued that single firm conduct provisions should also apply to firms with a high degree of market power. While there is no single, clear economic test that distinguishes between the market power of concern in unilateral conduct cases and the lesser degree of market power that should not be of concern, market power that may be harmful depends on the ability of undertakings to adversely influence competition. Thus, it is clear that non-dominant firms can also have an adverse impact on consumer welfare through unilateral acts. However, the dominance minimizes the probability of prohibiting procompetitive unilateral practices and thus reduces Type I errors (i.e. prohibiting conduct that is procompetitive).

Instead of conduct-based definitions, such as pricing behavior, the term ‘significant market power’ appears and is defined in the EC’s framework but it is a definition based on market structure, technological constraints and very particular cost functions (high fixed costs, economies of scale, and network effects). In the EC’s framework the term ‘significant market power’ is defined for the regulation of electronic communications networks and services.⁸⁹

To use a structurally-based definition of the SMP concept presents substantial challenges in its application to the competition policy. SMP is a regulatory concept not one commonly used in competition policy. It is used by regulators to regulate sectors characterized by network architectures. The structure of costs, the technological specificities, the large fixed costs which are sunk once assets are deployed, the large economies of scale and dynamic circumstances are not shared by many other industries outside of those for which SMP is used to regulate. Of course, the SMP concept may be applied without much problem within competition policy framework to sectors that share the particular characteristics. However, unregulated sectors with these characteristics are rare.

Irrespective of these challenges in implementation, proponents of amending competition policy frameworks to include SMP authority argue that some markets, in which no dominant firm is apparent, still have features similar to those where regulation under SMP has been applied.⁹⁰ Most importantly, features similar to essential facilities lead to market relations of dependence – some agents depend on access that another market entity controls. Economic dependence exposes the weaker agent to the dictates of the undertaking that controls the facility. This control leads to abuse and unfair trade practices. To address and remedy these abuses, SMP authority belongs within the competition policy framework.

Following this logic, it is important, therefore, to determine if an essential facility exists or some feature of the infrastructure in the market that is under inquiry. If such a facility or feature exists, does one market agent control or own it? Does another undertaking, which does not control that feature, depend on access to that facility or some aspect of the market infrastructure in a way that it has no other options than to have access to it?

While this chapter stops at these questions. However, it is important to point out that the competition authority is not done if it answers affirmatively to these questions before it should it act and apply remedies to rectify this abuse. The competition agency must also ask and answer whether the undertaking controlling that facility leverage that control to dictate ‘unfair’ terms of trade? Finally, if it is so, are these ‘unfair’ terms negatively affecting consumer welfare? If the answer to all of these is unequivocally yes, then the competition authority has grounds to act.

Economic dependence

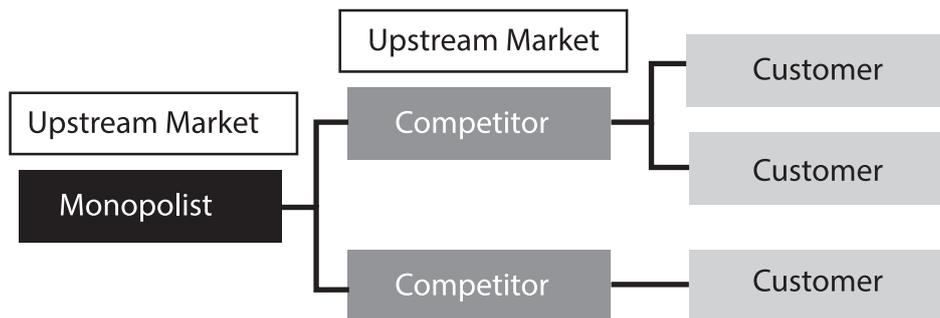
Some point out that controlling a large share of the market, or simply being big, may not be the only way to wield market power. If an undertaking had control of a crucial feature of a market, say infrastructure, which all other undertakings needed in order to participate in that market, the control of that feature may tempt that undertaking to bargain hard with

⁸⁹ Communication from the Commission — ‘Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services.’ (2002/C165/03). [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52002XC0711\(02\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52002XC0711(02):EN:HTML) (Last accessed January 12, 2014).

⁹⁰ More specifically, proponents point to the fact that the term ‘significant market power’ is associated to issues of ‘essential facilities’ and the leveraging of market power through the control of this type of facility to other related markets.

others over the use of that infrastructure to prevent them from competing too hard against him. More generally, what if a firm, not necessarily dominant, built contractual relations with another undertaking to an extent that the latter undertaking becomes dependent on the first firm. Would the imbalance in economic dependence not likely lead to abusive behavior and unfair trading practices? These scenarios are only meant to highlight that market power may not necessarily be associated with having a large share of a market. Rather control of something essential for others to participate in the market or economic dependence can also bestow superior bargaining power even on a non-dominant entity.

Figure 1: The blue monopolist controls an upstream market, essential facility and competes against the green company for customers in the downstream market.



An assessment of whether an undertaking is abusing its superior bargaining power may want to consider the features of a market described in the scenarios as well. This means going beyond the dominance test provided by the EC; namely, finding increases in prices above the competitive level for a significant period of time. What follows is a discussion of the theoretical basis for these concepts of superior bargaining position, abuse and even the 'unfair' in the term unfair trading practices. However, these are discussed in this section though issues of how to empirically identify these features of a market are not addressed here.

There are cases, of interest and study to economists, where agents have no (short-term) option other than to undertake a transaction with another particular agent; usually a monopolist. Knowing that no substitute exists; the monopolist can either extract a very high price for agreement or refuse to deal altogether. This may be considered to be an abuse of dominance which leads to unfair trading practices (dictating the terms of contract or refusing to deal). In this case, some economists argue that government intervention may be justified otherwise consumers would be harmed by a lack of choices, feeble competition and the resulting higher prices. It is instructive to understand the conditions in which this type of transaction can exist to ascertain whether similar conditions exist in other markets and economic arguments can be made to justify government intervention there as well.

Essential facility

The clearest example where agents have no option other than to undertake a transaction is when one market agent owns or controls an essential facility or aspect of the market infrastructure required to operate in that market. The price charged for the use of that essential facility or the refusal to allow access to it altogether distorts market competition. The term 'essential facility' is a regulatory term, not one that comes from competition policy. Under the essential facilities doctrine (EFD), governments set prices for access and compel the owner(s) of an 'essential' or 'bottleneck' facility to provide access to that facility. For example, such a doctrine may specify when a railroad must be made

available on reasonable terms to a rival rail company or an electricity transmission grid to a rival electricity generator. The concept of essential facilities requires there to be two markets, often expressed as an upstream market and a downstream market. Typically, one firm is active in both markets and other firms are active or wish to become active in the downstream market. A downstream competitor wishes to buy an input from the integrated firm, but is refused. An EFD defines those conditions under which the integrated firm will be mandated to supply access to the bottleneck facility.

Government intervention is justified in that it is believed that the owner of that bottleneck facility has superior bargaining power and will not negotiate in good faith. Furthermore, since the agent soliciting access to that facility is 'economically dependent' on its use, they may be willing to accept bargains that are economically unjustifiable and thwart their ability to compete on even footing with the undertaking that controls that facility.

While the arguments in favor of government intervention under the EFD are compelling, it is important to understand the narrow set of conditions that must exist before a facility is considered 'essential' and therefore justifies this intervention. Were a competition authority to justify application of remedies and sanctions based on control of an essential facility, or something like it, non-arbitrary enforcement under EFD would compel the authority to discover the following conditions:

- Control of a facility by an undertaking;
- Others cannot practically or reasonably duplicate this facility;
- The undertaking denies facility access to others; and
- Facility access to others is technically and economically feasible.

Superior bargaining power

The conditions listed above, to base non-arbitrary findings of an essential facility, are precise and unlikely to exist in many unregulated markets. The question then is: Can competition authorities justify findings of unfair trading practices based on essential facilities arguments? This is not straightforward. It is unclear that anyone has attempted to make an essential facilities argument as the basis for abuse and unfair trading practices to characterize economic relations between retailers with market power and their suppliers. However, rather viewing the issue of unfair trading practices stemming from abuse of the superior bargaining position control of an essential facility provides, arguments compelling access or contractual relations have been made by appealing to a doctrine of 'economic dependence' and superior bargaining power.

In the case of buyer-supplier relations, the main criterion for the finding of a situation of economic dependence consists in the absence, for the dependent undertaking, of alternative solutions to sell or to purchase its products in the market—in this way, the use of economic dependence is associated with 'essential facility'. The impossibility to find other sales outlets indicates that the undertaking is dependent on the buyer.⁹¹ The economic dependence in this case derives either from the high concentration of the market or from the special features of the bilateral relation between the undertaking and the buyer.

⁹¹ Of course, under franchise agreements, this is exactly what takes place, but the franchise is granted benefits for agreeing to this exclusivity and enters the contract voluntarily.

It must be noted that the existence of a dominant undertaking does not preclude other undertakings from being competitive and offering alternative deals to the dominant undertaking's customers or suppliers. In the absence of specific factors, be they contractual or technical, that impede the customer or supplier from switching, the former can replace the dominant firm as a business partner. It confirms the idea that economic dependence relates to a bilateral relationship between contractual parties.

If the dependence results only from the specificities of the relationship between the contracting parties, finding of economic dependence during market assessments does not relate to the market structure, or to the level of competition within a relevant market. Other factors are responsible for the economic dependence, such as the existence of specialized assets, lock-in and other forms of high switching costs.

However, switching costs are a short-term issue and possibly an issue of imperfect information. Once a deal has been struck and the cost of switching has been revealed, it is difficult to understand why an undertaking can be economically dependent on another in the long-term. These are issues that must be resolved before the concept of 'economic dependence' makes sense from an economics perspective. Economic dependence is based on the assertion that the buyer or supplier cannot be easily substituted or avoided. However, given a sufficiently long time horizon, it may be possible to avoid that economic relation and develop others. Once the door to this argument is opened, the standard of whether economic dependence exists no longer a matter of answering a 'yes' or 'no' question. Now, the answer may also have to include caveats such as 'it depends' and incorporate considerations about how long these economic relations have existed and how have they changed, if at all.

This insight is instructive. It can be reasonably argued that changing contracts with little notice can be seen as abusive and contract law does indeed address remedies to this when parties are subject to such unilateral behavior. A bargain which has been accepted by both parties, but when revealed is more costly than beneficial to one party is likely to only happen once (a one-shot deal). Alternatively, if a party, time and time again, enters a negotiation and accepts to bargain with an agent that they have previously considered abusive may be evidence that this is in fact not the case. The losing agent will either leave the bargaining table or refuse to even approach the table in the first place. The other agent's refusal to agree or to even bargain is unlikely to be a good long-term strategy for the agent that received all of the benefits and fewer of the costs in the previous round. The desire of wanting to negotiate in a subsequent round reveals that the 'winning' agent would benefit from what the 'losing' agent has to offer. In other words, competition authorities will have to address internally consistent models of abuse of superior bargaining power, from the perspective of the party in the superior position, in cases where the 'dependent' party loses, economically, as a result of the deal struck and agreed to. The competition authority, as well, will have to address the issue of why the 'dependent' or losing party continues to engage in bargaining with the agent with superior bargaining power more than once.

Taking an example from a monopsony buyer striking bargains with many competing suppliers, the ability of the buyer to reduce prices below a supplier's normal selling price, or more generally the ability to obtain terms of supply more favorable than a supplier's normal terms may seem to be an appealing way to define superior bargaining power, but calls into question the level of competition that existed in the retailer's market before the concession. The normal selling price, in turn, is defined as the supplier's profit-maximizing price in the absence of buyer power. In the case where there is perfect competition among suppliers, the normal selling price of a supplier is the competitive price. In a perfectly competitive market,

firms set prices equal to marginal costs. Prices lower than that are unacceptable and the firm exits the market. A deal that is accepted with a party abusing its superior bargaining position means that the buyer monopsonist is pushing supplier prices closer to competitive levels. If this is the case, it would be difficult to build an economically sensible model of this bargaining behavior in a way that elaborates how this conduct harms competition and consumers.

Unexpected losses is one instance where bargaining theory and concerns about superior bargaining power and dependence can be consistent with continual dealings between parties rather than a one-shot deal. In addition, unexpected losses may signal bargains about who takes on the risk when negative events take place. Rather than bargaining over price, the nature of bargains over risk can be an issue of concern to government authorities. The issue of public policy concern is most apparent if one party (the one with superior bargaining power) has better information about the likelihood of negative events and/or can affect the probability of these events but does not reveal or share that information to the 'dependent' party and this affects their willingness to agree on how to share that risk – favorably for the firm that has the information and unfavorably for the firm that does not. The manifestations of risk transference can be many. Delaying payments can be one. Cost sharing arrangements between parties for advertising can be another.

In sum, the term significant market power is a regulatory term based on the existence of an essential facility. Governments have extended that term into the area of competition policy and used it to describe bilateral relations of economic dependence and superior bargaining power. The concept of economic dependence makes sense as a short-term phenomenon but it is difficult to square as a long-term problem. Superior bargaining power can indeed explain the deals that are made once between an economically more powerful undertakings against less powerful ones. However, it would be an unlikely explanation for a continuous, long-term pattern of poor bargains in the view of the losing undertaking. Finally, the issue of economic dependence is based on the absence of no outside options. For suppliers, this means that they are forced to deal with the buyer with whom they established economic relations. To buttress arguments of economic dependence and superior bargaining power, however, the competition authority has to go beyond findings of 'significant market power' but also show that there are sufficient barriers to entry for an outside option to emerge. These are the issues discussed in the next section.

Conclusions

Significant market power is a concept that defines market power at a lower threshold than that of dominance. Significant market power characterizes situations several firms are big enough to affect market outcomes and act as if they were dominant players in the market. In presenting this concept as a way to address market power issues in the retail sector, many important questions are raised.

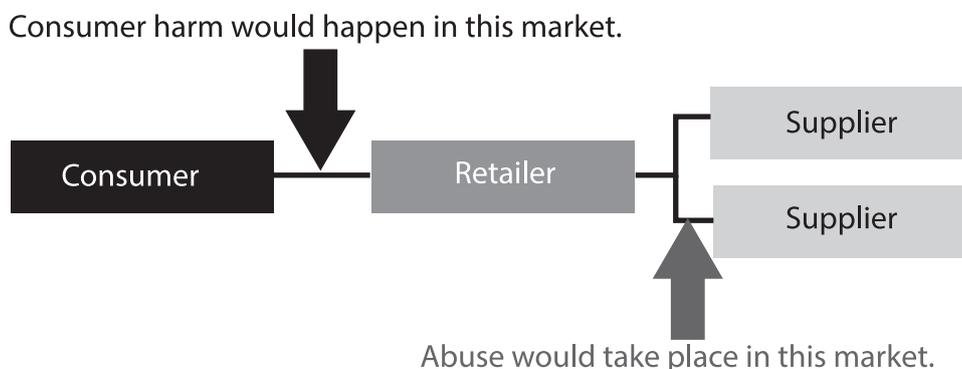
To address some of these open questions, some have proposed that significant market power in retail markets is exercised through the economic dependence suppliers have on large retailers. Large players can substantially affect the fortunes of their suppliers when they threaten not to buy or to reduce their purchases. When threatened this way, suppliers have few options other than to accept the terms dictated by these retailers. This superior bargaining position that results from economic dependence can be abused and lead to the unfair trading practices that the Government of Bulgaria aims to address.

While the introduction of these concepts of economic dependence and superior bargaining power fill in the gaps of how SMP authority may address unfair trading practices, these concepts are difficult to square with the EC Guideline emphasis on applying remedies where there is sufficient evidence of consumer, not supplier harm. Mapping SMP, economic dominance and superior bargaining power into the framework that the EC Guidelines provide is the task of the next section.

ASSESSING SMP

Appropriate, non-arbitrary enforcement of the SMP concept requires first a clear definition of the ‘relevant market’ in which market power can be exercised. One step ahead of that, however, is the need to understand the market and behavior of concern. In the case of public policy concern in Bulgaria, the issue is over unfair practices in the upstream market – the market in which the retailer buys from suppliers. However, the EC Guidelines emphasize harm to consumers, in the downstream market where the retailer sells in the downstream market. It is therefore unclear in which market the market power assessment is to be carried out. For the purposes of the discussion here, the downstream market will be assessed. It is assumed that if market power exists in the retail market, the retailer can ‘leverage’ that power into the upstream market. When pursuing a case, however, the competition authority will have to make and empirically support this argument explicitly.

Figure 2: Harm takes place in the downstream market but abuse allegedly takes place in the upstream market. Where to do the market power assessment?



Once the public policy questions establish the market and behavior in question, defining the relevant market begins by identifying the products and undertakings which are directly competing against each other. Once the relevant market is defined, the assessment of market power is confined within each market.

At present, the policy interest in Bulgaria is on assessing SMP in buyer-supplier relations in the retail sector. For this reason, these particular relations are the focus of the discussion here. However, for application of SMP in the competition policy framework should be market and sector neutral. The discussion here is not neutral in this way, and would have to be adapted for other sectors and markets.

With respect to buyer-supplier relations, the exercise of market power happens in the upstream market, where abuse is based on superior bargain position or economic dependence in that (upstream) market. The supposition is that market power is exercised by the buyer because the supplier has no option other than to deal with the buyer. However, the buyer is deemed to have significant market power in the retail (downstream) market but leverages that market power in another market; the upstream market against her suppliers. In the case of buyer-supplier relations, the alleged abuse takes place in a market different from the one in which an undertaking is deemed to have SMP.

An assessment of dominance or SMP must take into account the competitive structure of the market, and in particular the following factors:

- Constraints imposed by the existing supplies from, and the position on the market of, actual competitors (the market position of the dominant undertaking and its competitors);
- Constraints imposed by the credible threat of future expansion by actual competitors or entry by potential competitors (expansion and entry); and
- Constraints imposed by the bargaining strength of the undertaking's customers (countervailing buyer power).

Relevant market

Market definition in retailing tends to be more complicated than it is in manufacturing. The standard economic test for defining the 'relevant economic market' for a given product revolves around the ability of a 'hypothetical monopolist' to raise the price of that product by a small but significant amount, without losing so much custom to other products to make the move unprofitable. The general principle is that those substitute goods to which the consumers would switch, in the face of a price rise, should be considered part of the same economic market.

When examining competition in retailing considering the 'physical product' dimension is only part of the picture. For most categories of consumer goods, the retailing activity is also very important and is a constituent part of the end-product which consumers purchase. This means that retailer markets need to be defined in terms of both dimensions: the physical product and the retailing activity.

An additional difficulty exists in applying the standard market definition because retailers compete in many different dimensions, and not just price. This means that to focus on price alone distorts market definition, especially if the various economies of scale and scope that are common in retailing mean that competition between retailers occurs at different levels for the different dimensions of competition (or even at different levels at the same time for a single dimension of competition).

This section discusses these problems in some detail, and suggests some possible solutions. It is crucial to consider in any enquiry exactly what aspect of competition is important, and in what way competition is threatened by the behavior of the firms under scrutiny. It is best not to take market definitions in a vacuum. Indeed, there may be several possible market definitions, each of which is valid for looking at a particular issue.

The next section summarizes a well-used market definition methodology. Following that, comments on the nature of retail end-product suggest that it is important to consider market definition with respect to the retailing activity involved as well as the physical product. The discussion points out the need for more rigorous application the relevant market definition methodology to the retail sector, taking into account both the physical product dimension and the retailing activity dimension. Adding dimensions to the definition of what constitutes a relevant market is one way to address concerns about rigor.

Market definition

The most used methodology for defining the relevant economic market is based on the United States Department of Justice 'small but significant and non-transitory increase in price' (or SSNIP) test. Essentially, it defines the market by asking the following question:

Starting from prevailing price levels, what is the smallest set of goods or services and geographical area such that if the supply of these goods or services in this geographical area were to be in the hands of a single firm (or 'hypothetical monopolist') then they would be susceptible to a 'small but significant and non-transitory increase in price' (or SSNIP)?

The above is similar to the European Commission's market analysis procedure:

- Tentatively define the product market by determining whether two products belong in the same market.
- Tentatively define the geographic market in terms of competitors' market shares, prices, and price differentials.
- Conduct a more detailed analysis of demand-side and supply-side substitutability.
- Determine whether customers can switch to an alternate product or supplier in response to a small (5-10 percent) increase in price; the small but significant and non-transitory price increase" (SSNIP) test. If they can, the market definition is widened to include the alternatives.
- Determine whether other suppliers can readily switch to providing the alternate product in the relevant market.
- Further investigate the conditions in which competing firms operate. This may entail exploring the recent past activities of those firms, consumer behavior and preferences (through demand elasticities and other studies), regulatory or market barriers to entry, market segmentation and the viability of efficient price discrimination.
- Use consultations with firms and consumers and on-the-spot inspections to further inform and refine the market definition analysis.

A relevant market must be measured in terms of its participants and concentration. Participants include firms currently producing or selling the market's products in the market's geographic area. In addition, participants may include other firms depending on their likely supply responses to a SSNIP. A firm is viewed as a participant if, in response to SSNIP, it likely would enter rapidly into production or sale of a market product in the market's area, without incurring significant sunk costs of entry and exit. Firms likely to make any of these supply responses are considered to be "uncommitted" entrants because their supply response would create new production or sale in the relevant market and because that production or sale could be quickly terminated without significant loss. Uncommitted entrants are capable of making such quick and uncommitted supply responses that they likely influenced the market premerger, would influence it post-merger, and accordingly are considered as market participants at both times. This analysis of market definition and market measurement applies equally to foreign and domestic firms.

Finally, for the purposes of identifying the ‘relevant market’ in which a firm or undertaking exercises SMP, it is worth pointing out the Commission’s emphasis on consumer harm. To the point, if an undertaking is found to have SMP and the exercise of its market power damages competitors, not competition and not consumers, then the Commission advises that respective competition authorities proceed with caution. Alternatively, it would be best to show that the exercise of market power damages competition and in this way harms consumers, or more directly, that there is a straight line from the exercise of market power to consumer harm. The case of buyer-supplier relations that concerns policymakers in Bulgaria at present, it is not clear that this argument about consumer harm and its relation to the relevant market can be made directly. In fact, this requires arguments about the leveraging of market power in one market to affect the other market, where consumers interact with the entity with market power.

This methodology (both the US and EC) is now accepted by most competition authorities and it is well-known and used by the Bulgarian competition authority. However, there are some issues that are likely to make its application more difficult in the retail sector. Namely; (i) the methodology for market definition is product-, as opposed to activity-, based; (ii) the methodology is price-, as opposed to other dimensions of competition, based; and (iii) it takes insufficient account of the strategic and competitive behavior of companies in the face of economies of scale and scope across economic markets. These problems are not unique to retailing, but they are particularly prevalent in this sector.

Because this methodology for defining markets was designed with manufacturing industries in mind, it focuses on the physical product. In retailing, however, this can lead to problems. Two identical physical products may be defined as being in different retailer markets, because of differences in retail service, geographical location, time of purchase, product (even brand) selection or other differences in competitive strategy.

Within retailing, therefore, it is important to define markets both in terms of the physical product and in terms of the associated retailing activity. A more rigorous analysis of the retailing activity offered by each type of retailer may want to consider both:

- the transactions costs attached for the consumer of making the purchase (which must be considered part of the total cost of the purchase); and
- The nature of the buying decision which may render a particular channel inherently more suitable for selling certain products to certain consumers.

Because of these issues, it is particularly important to expand the dimensions by which a market is defined as one retail market. In retail, brand, service, the time of purchase, locations, choices, etc. are all important. These dimensions suggest that retail market may need to be defined with more dimensions than what would be appropriate for other sectors. New Zealand’s competition authority defines markets in terms of five dimensions (see Figure 3, below):

- The goods or services supplied and purchased (the product dimension);
- The geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic dimension);
- The level in the production or distribution chain (the functional dimension);
- The time frame or timing within which the market operates, where relevant (the temporal dimension); and
- The different customer types within a market, where relevant (the customer dimension).

Figure 3: New Zealand's definition of markets



Assessment of barriers to entry

Retail consumers tend to be relatively small, their search is costly and that costly search often leaves them imperfectly informed about prices, options, brands, quality, etc. This couple with the complex vertical nature of economic relations between retailers and their suppliers translates into markets that are unlikely to work perfectly and thus have some competition problems. However, the detrimental effects of such competition problems will depend on the size of the barriers to entry into the retail markets. If entry is easy, then the potential for retailers to exploit market imperfections will be limited. The assessment of barriers to entry in retailing is of particular importance when assessing the potential exercise of market power, since the ability of a dominant retailer to exploit its power will be strongly dependent on the height of barriers to entry into the market.

Identification of barriers to expansion or entry is important in determining whether market power can be exercised. As the EC states, “(b)arriers to expansion or entry can take various forms. They may be legal barriers, such as tariffs or quotas, or they may take the form of advantages specifically enjoyed by the dominant undertaking, such as economies of scale and scope, privileged access to essential inputs or natural resources, important technologies or an established distribution and sales network. They may also include costs and other impediments, for instance resulting from network effects, faced by customers in switching to a new supplier. The dominant undertaking's own conduct may also create barriers to entry, for example where it has made significant investments which entrants or competitors would have to match, or where it has concluded long-term contracts with its customers that have appreciable foreclosing effects. Persistently high market shares may be indicative of the existence of barriers to entry and expansion.”

No analysis of a market or industry; and in particular an assessment of market power and entry barriers, can avoid an analysis of strategic competition, because it is this that determines entrants’ expectations of the profitability of entry, and ultimately their entry decisions. The analysis of strategic interaction is necessary to an understanding of industry structure and concentration, and in particular analysis of post-entry competition is fundamental to an assessment of entry conditions.

The strategic interaction between agents is likely to be market specific; i.e., the characteristics of the market, technology, cost functions, customers and particulars of the products will largely determine the nature of competition. Since this document is concerned with the issues of identification of market power in the retail sector, it is best to limit the focus to that sector. The economic characteristics of retailing are sufficiently different to likely warrant a different approach by competition authorities where the importance of geographical location, product range, and retailer services/image (brand) is prominent. On the consumer side, issues of consumer information, search costs, and the quality of advertising and pricing are key and likely to be different from other sectors.

How is the issue of barriers to entry and/or expansion relevant to the issues of SMP and abuse of superior bargaining power that lead to unfair trading practices? The issue of economic dependence, the basis on which proponents of expanding SMP authority in competition policy frameworks, is based on the notion that the dependent entity has no option other than the deal or bargain presented to it by the agent with superior bargaining power. The notion of 'no other option' can only exist if there are barriers to entry which prevent that alternative option from emerging. Note that the entry can come from the weaker party itself into the market that the agent with superior bargaining power serves. In the case of buyer and supplier relations, the wholesaler would enter the retail market in response to the poor option that its current buyer presents it.

Barriers to entry considerations

In this section, the methodology developed by Harbord and Hoehn (1994)⁹² to assess barriers to entry is discussed. Where necessary, this methodology is adapted to address the particular issues of barriers to entry likely to be prominent in the retail sector.

The Harbord and Hoehn divide barriers to entry into a number of groups. Firstly, between:

- Entry barriers (which prevent entry); and
- Entry impediments (which delay entry).

Within the category of entry barriers, the methodology distinguishes between:

- Absolute advantages; and
- Strategic (first mover) advantages.⁹³

Within strategic (first mover) advantages, the authors distinguish five categories. These can be recast for the purposes of retailing as:

- Economies of scale and scope;
- Advertising and product/retailer differentiation
- Switching costs;
- Capital requirements;
- Vertical foreclosure and exclusion; and
- Predatory pricing.

⁹² Harbord, D. and T Hoehn (1994) 'Barriers to entry and exit in European competition policy,' *International Review of Law and Economics*, 14, 411-435.

⁹³ Bain (1956) thought it appropriate to distinguish between blocked and deterred entry. Blocked entry occurs where the incumbents behave exactly as they would if there were no threat of entry, but where, even so, the market is not attractive to entrants. Deterred entry, by contrast, involves the incumbent retailers modifying their behavior in order to thwart entry. This distinction is not followed here.

Altogether, Harbord and Hoehn distinguish seven categories of entry barriers/impediments, each of which must be examined in any competition enquiry.⁹⁴ For the purposes of this paper, predatory pricing and vertical issues are not considered since they are squarely competition issues.

Economies of scale and scope

Economies of scale and scope in retailing are rather different from those which exist in production, but they can act as barriers to entry in exactly the same way. This requires that investments, once deployed, are sunk. If investments are not sunk, an incumbent retailer faces a pre-commitment problem: it wants *ex ante* to threaten to compete vigorously to maintain its current sales levels after entry, in order to make entry seem unprofitable; but *ex post*, in the face of actual entry, it may have an incentive to accept lower sales and not fight. Fixed costs (economies of scale) *per se* are not enough to commit the incumbent to behaving aggressively post-entry (shops can be sold, for example). However, if these costs are sunk, the story changes. Because the costs are sunk, and not recoupable, it may be profitable, even *ex post*, for the incumbent to fight to maintain sales, and this means that entry can be deterred.

Examples of economies of scale and scope which may act as barriers to entry in retailing include:

- ***Economies of scope in floor space:*** The importance of one-stop shopping has increased the importance to retailers in some markets of stocking wide product ranges, which generally requires significant floor space;
- ***Economies of scale in logistics:*** There are many of these, from minimum delivery orders, to the ability to use sales staff efficiently, and to the ability to reduce inventories (as a proportion of turnover);
- ***Economies of scope in distribution:*** For some sorts of retailing (especially where fast and efficient delivery is crucial as with fresh foods and newspapers), it is important for retailers to control their own distribution networks. There may be significant sunk costs and economies of scale in establishing distribution systems. However, once a distribution system is set up, it can supply extra stores and extra products at minimal incremental cost;
- ***Economies of scope due to store networks:*** In some retail markets, consumers prefer to buy from chain stores, on the grounds that they know what to expect and sometimes because they can exchange inappropriate purchases (and gift tokens) elsewhere in the country; and
- ***Economies of scale due to retailer bargaining power:*** Larger retailers may be able to obtain better deals from upstream manufacturers than smaller retailers can.

In order to assess whether economies of scale and scope of these sorts provide a barrier to entry into any particular retail market, it is first necessary to determine the degree to which costs are sunk, which will in turn determine what would happen post-entry.

⁹⁴ Harbord and Hoehn (1994) also provide a seven step method of analyzing entry barriers, which groups together three of the above categories (economies of scale and scope; advertising, goodwill and market positioning; and capital requirements). However, for the purposes of this document, these various categories are kept separate.

After determining the extent to which fixed costs are sunk, it is necessary to compare these sunk costs with the size of the retailer market. In this regard, retailing has two important characteristics. On the one hand, the importance of geographical location means that many economic markets are relatively local, and thus fairly small. Thus, sunk costs need not be especially high in order to restrict entry. In fact, the sunk costs involved in setting up a single local retailer tend to be relatively low, and entry is relatively easy at the local level.

On the other hand, economies of scale and scope mean that many strategic markets are national (or at least regional), covering a number of local economic markets. Strategic retailer markets may also include a number of different economic product markets. The sunk costs involved in entering these strategic markets may be extremely high.

Strategic (first mover) advantages

The sunk costs involved in advertising, goodwill, and retailer differentiation provide a further source of barriers to entry in retailing, which work by shrinking the residual demand that a potential entrant would face, or by raising the sunk costs of entry.

Advertising

A retailer's image is important. In many retail markets, it is crucial. But retailer image can be promoted in other – generally less costly – ways than above-the-line advertising. Rather, the most important factors in promoting retailer image are product range and prices, store design and atmosphere, and the quality of service. These may act as barriers to entry, but given that they are part and parcel of the retailing activity, they are unlikely to keep out any retailers that stand to be successful.

The need to acquire a strong retailer image may deter some types of entry more easily than others. Firstly, economies of scale in advertising mean that, in those retail markets where advertising is important, effective small-scale entry may be difficult, with entry only possible by large entrants which can exploit these economies of scale, and which have sufficient capital to carry out large advertising campaigns.

Secondly, while the need to achieve a strong retailer image can clearly be a strong barrier to pure new entry, it may not prevent entry into a retail market by retailers from other markets, which already have a strong brand name in those markets (as long as the brand name is appropriate to the new market and is transferable). Indeed, strong retailer brand name can also allow them to enter into upstream product markets, as direct competition against branded manufacturers.

Switching costs

Switching costs cover a number of different costs which consumers may face in changing from one retailer to another. Some of these costs are natural in the sense that they may stem from the desire not to travel, the familiarity with a particular store's layout, or from the accumulated goodwill of the retailer. Alternatively, they can be strategic in the sense that they are based on free gift schemes, customer loyalty cards or bundling. In either case, they can be important barriers to entry.

To the extent that switching costs are natural, there may be little that the competition authorities can do to reduce them. Indeed, it is anyway not obvious that it would be desirable to reduce such switching costs.

Capital requirements

There is some debate about whether capital requirements really constitute barriers to entry. However, they can certainly be important in slowing entry. To the extent that large incumbent multiple retailers are able to raise capital more easily than subsequent entrants, this may be important. However, it is not clear that capital market imperfections are particularly problematic in the retail sector.

Entry impediments

Entry impediments are any factors which delay the process of entry into a market without increasing the (sunk) costs of entry, or creating an asymmetry between incumbents and entrants. They are not entry barriers, but they may be important to antitrust decisions, because they influence the amount of time that incumbents may exercise market power before entry occurs.

Good examples of entry impediments are licensing, certification or product registration requirements which involve little or no actual costs, but take significant amounts of time to satisfy. Other examples include the time required to obtain contracts (i.e. where the market's products are sold via long-term contracts) or gain a market share large enough to significantly influence the behavior of incumbents.

Certification requirements are only important in a few retail markets (pharmacies, for example). Planning permission may be more important as an entry impediment. However, the most important entry impediment in the retail sector is probably the time it takes for a new retailer to establish itself with customers, particularly if reputation is important

Conclusions

This section listed and reviewed the economic arguments that would support a finding of significant market power in a competition policy market assessment of the retail sector. Using the concepts that are often used to explain how significant market power is exercised – namely, through a superior bargaining position that stems from sufficiently large size in the relevant market – and what features markets would exhibit that supports this exercise of market power – namely, economic dependence, the task was to formulate coherent arguments that are in line with the EC Guidelines.

This review revealed that coherent and economically consistent arguments to tie these concepts together can be formulated for an extremely narrow set of circumstances; narrow with respect to the unlikelihood to exist for every bilateral relation between retailer and supplier, narrow in that the circumstances in which these circumstances can exist, and, finally, narrow in the window of opportunity in time that a retailer can continuously exploits supplier in the same way. With respect to the latter, the circumstances that would grant the chance to exploit a supplier, it is difficult to understand why suppliers would not shift strategies to change unfavorable conditions to ones that are more advantageous to them. Indeed, it is hard to see the advantage the retailers gain from running their suppliers out of business unless they are comparatively inefficient to other suppliers.

Based on this narrow and ephemeral set of circumstances that may provide retailers the opportunity to unfairly trade with their suppliers, the next section addresses the data, and some of the analyses, needed to discover if these circumstances do indeed exist.

INDICATORS AND DATA

The proposed changes to the competition policy were prompted by concerns with the functioning of retail markets in Bulgaria. While market power evaluations should not be sector-specific, the focus and discussion of the data and the techniques to analyze these data are based on the special features of retail markets; namely, the ready availability of retail and wholesale price data. Price data can be used to define the 'relevant market' and provide indications of possible market power by examination of pass-through between wholesale and retail markets.

Relevant market and price correlations

One important body of antitrust literature relies on the law of one price to develop price co-movement tests for market definition. Price elasticity estimates are the preferred tools for antitrust market definition as they provide direct evidence of market power. In many practical settings data and time constraints prevent estimation of price elasticity and force competition analysts to rely on less sophisticated tools. Tools for the analysis of price co-movement represent one such a set of alternative tools. Stigler and Sherwin (1985) represent an early attempt at formally investigating the use of the law of one price in delineating antitrust markets. The law of one price posits that prices within a single market should converge, allowing for some variability related to transport cost. Some authors applying the law of one price have argued for relative price convergence rather than the more stringent absolute price convergence as condition for market singularity: it is not that prices in two regions of the same market should be equal, but that price adjustments in one region should affect price adjustments in another region (Haldrup 2003). Regardless of the type of convergence, analysts have questioned whether a market defined by reference to prices and their statistical features is consistent with the concept of an *antitrust* market. However, the econometric tools used to define markets through the use of price correlation should be understood as exploratory tools not dispositive.

As discussed above, the relevant market is defined by the cross elasticity of demand or cross-price elasticity of demand. The elasticities measure the responsiveness of the demand for a good to a change in the price of another good.⁹⁵ To make the relevant market determination, however, consumption data are needed. Since it is assumed that this type of detailed consumption data are difficult to obtain, the proposed analysis make use of readily available retail and wholesale price data that governments are likely to already be collecting.

⁹⁵ It is measured as the percentage change in demand for the first good that occurs in response to a percentage change in price of the second good.

Figure 4: 36-month price trends for three markets, for the same good, in close geographic proximity

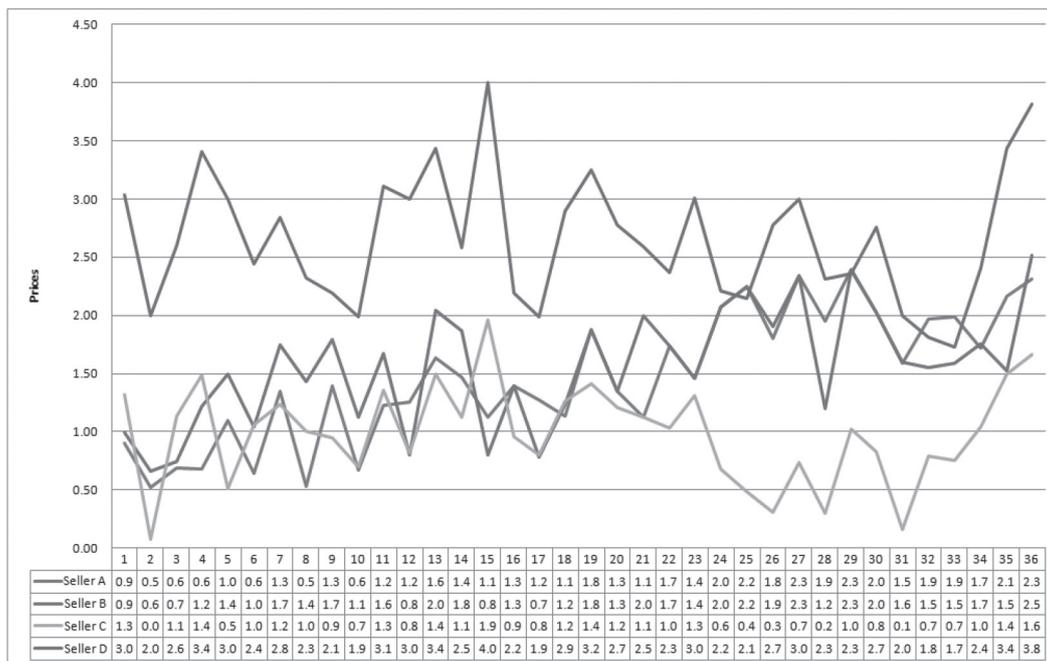


Table 1: 36-month time series correlations of prices for the same good across four outlets

	Retailer A	Retailer B	Retailer C	Retailer D
Retailer A	1.00	-	-	-
Retailer B	0.75	1.00	-	-
Retailer C	-0.07	0.03	1.00	-
Retailer D	0.03	0.09	0.73	1.00

To determine the boundaries of the relevant market using a time series of price data, the following example is provide looking at Retailer A, B, C and D all selling exactly the same product. The data are presented and graphed in Table 1. The goal is to determine the relative time series correlation of price across these retailers. The correlation between price movements in Retailer A and Retailer B is approximately 0.75. This is a fairly high correlation, indicating that price movements are not independent of each other. In comparison, Retailer A and Retailer C have a time series correlation of -0.07 and Retailer B and Retailer C a correlation of 0.03, suggesting that prices move independently of each other. It is important to know the relatively high time series correlation between Retailer C and Retailer D. As Table 1 (above) indicates, the price of the good in Retailer D is consistently higher than the price of the same good in Retailer C. Retailer D prices are also closer in level to prices in Retailer A and B most of the time in this series. Yet, the correlation is relatively higher for Retailers C and D. This demonstrates for estimating correlations of price movements across the price levels do not matter. Changes in prices across time, not levels, is what matters.

Economists, therefore, demarcate the boundaries of markets by studying the patterns of consumers' choices. One way to determine if two retailers are competing in the same market is to examine consumer choices between products when prices change. Two or more goods are said to be in the same market when the substitutability of each good is perfect or near perfect. That satisfies the homogenous goods criteria mentioned above and is based on the zero cost of information and transaction assumptions. When this is the case, prices for one retailer's goods will move in tandem with the prices of another retailer's prices. As discussed above, if this were not the case, the retailer charging the higher price will lose all customers.

Whenever the prices of two retailers do not move in tandem, economist can assume that the retailers are in different markets. This is how markets are demarcated using prices. It is expected that much of the market segmentation that exists when examining the movement of prices across locations is likely the result of physical barriers. Because larger markets are likely to be more efficient, eliminating market segmentation that is caused by physical isolation is a good policy objective. But there are few if any competition policy issues to address.

But not all retailers are within reach of all consumers. There are costs to getting to different retailers and to transacting (bargaining) with different vendors. Furthermore, these costs can vary by consumer, location or time in which a transaction is made. Consumers will go to retailers where they can minimize these costs as long as prices are sufficiently comparable across vendors. But market segmentation, also known as price discrimination, can be the result of anti-competitive behavior as well. Because all retailers are not as equally convenient to all consumers and because consumers' willingness to pay for the same good may varies as well, there are boundaries to markets.

However, the proposed analysis does exploit behaviors across commodities to identify where different goods, say rice compared to sugar, do exhibit different patterns of market segmentation. One would not expect that patterns of price movements between three retailers of sugar, whose prices behave in ways that lead to the conclusion that they are in different markets, would differ when looking at prices for rice. The physical barriers for rice and sugar should be the same across commodities. This expectation is explored to understand if some goods markets exhibit more market segmentation than others.

Pass-through and market power

Pass-through refers to that change in price that occurs in response to a change in wholesale price of a product. Conventional wisdom holds that increases in wholesale prices are passed through to retail prices. This is generally correct. However, the timing of the pass-through, from the time costs change to the time these changes are reflected in the retail price, nor about the extent of that pass-through; how much of these changes in costs are passed on to the consumer.

More importantly of interest to competition economists are interested in knowing whether a greater proportion of rising wholesale prices are passed on to the retail price than the proportion of costs reflected in retail prices when costs go down – what economists call asymmetric pass-through. These asymmetries may suggest some market power or collusion when prices indicate proportionately greater and earlier increases than decreases.⁹⁶

⁹⁶ The prices established will satisfy the equation $p(1 + (1/\eta)) = MR = MC$, where p = price, MR is marginal revenue, MC represents marginal costs and η = the elasticity of demand for the product in question. If elasticity is a constant, observing the change in marginal

Industrial organization research has been useful in examining the relationship between cost or quantity adjustments and retail prices paid (Sumner (1981); Bulow and Pfleiderer (1983); and Sullivan (1985)). If the pass-through of increasing producer or wholesale prices to the retail level is far from incomplete and associated with notable lags, this may be indicative of retailer buyer power and the likelihood of muted consumer harm.⁹⁷ However, these empirical tests, on their own, are not enough for any competition authority to use without any other supporting evidence. As always, caution and non-hasty conclusions are counseled before acting.

Extent of pass-through and market power

The timing and extent of this type of price pass-through can be another indication of market power. A market characterized with perfect price competition means that any exogenous change in the cost or wholesale price of a retail product, for example, will be passed on to the customer dollar for dollar, euro for euro, or lev for lev.⁹⁸ Because an individual retailer in a competitive market cannot affect the price by increasing or decreasing supply for goods it sells, it is said to face a horizontal, or perfectly elastic, demand curve.⁹⁹ A perfectly elastic demand curve means that if a retailer tries to raise its prices, even infinitesimally, all demand for that retailer's goods will shift to any retailer with lower prices. However, if changes in costs are felt by all retailers at the same time to the same extent, all retailers will pass on those costs to their buyers. In technical terms, because each retailer in a competitive market faces an infinitely elastic demand curve, 100 percent (and not more) of a change in costs will effectively be passed on to the price. For the case of a price increase, for example, if increases in the costs of a good are not fully reflected in the retail price, the market was not fully competitive to begin with. Retailers in a competitive market operate where economic profits are zero. If they do not pass on 100 percent of the cost increase to the consumer, it implies that retailers absorbed these costs increases, prices were therefore set above marginal costs before the cost increase; violating the definition of a purely competitive market since prices were above marginal costs, even if infinitesimally so.

However, and unfortunately, there are markets in which a monopolist passes on 100 percent of the changes in costs to their customers. In comparison, in market where there is no price competition and one retailer monopolizes the market, only 50 percent of any cost increase is passed on to the customer.¹⁰⁰

Unfortunately, a 100 percent rate of pass-through may also be the case for a monopoly, the opposite of a competitive market.

cost and the change in price enables one to infer the elasticity of demand perceived by the firm. Elasticity could then be used as a proxy for the firm's market power. But this technique turns out to be of very limited applicability, however, because it is extremely sensitive to the functional form assumed for the demand curve (see Bulow, J.I and P. Pfleiderer (1983) "A note on the effect of cost changes on prices", *Journal of Political Economy*, Vol. 91, No. 1: pp. 182-185.

97 An assessment of consumer welfare effects is rather complicated. Favorable effects can be the countervailing of upstream market power, the pass-through of the achieved cost reductions to the end consumers, the increasing of the price elasticity of demand due to stronger incentives to provide wider scope of products and to pursue intensive advertising by the buyer or the stronger incentives for suppliers and/or competitors to adopt more efficient methods. There can be negative effects as well, but these are not so straightforward and are harder to prove. First, if the buyer power raised the barriers to entry and/or to expansion, the incentives to improve quality and to innovate can be diminished. Second, the asymmetric distribution of downstream market power can weaken the above mentioned pass-through effect.

98 In a competitive market, each retailer faces an infinitely elastic demand curve. This means that all changes in the cost of the product to the retailer will be passed on to the consumer.

99 A monopolist's markup at its profit-maximizing price always equals the reciprocal of the elasticity of demand, times negative one.

100 This level of pass-through assumes a linear demand schedule.

Admittedly, in rare cases will a change in price of the wholesale or international price be reflected 100 percent in a change in price, so economists will rarely face the issue of indeterminacy between a competitive or monopolistic market based on analysis of pass-through. However, this issue illustrates the point that demand and supply elasticities determine the rate of pass-through and it is important to demonstrate how this is the case.¹⁰¹

The point of the above exercise was to rigorously demonstrate how the nature of the demand and supply curves will affect the amount of pass-through to retail prices that may result from change in wholesale or international prices.

Timing of pass-through and market power

Theory would lead us to expect that price changes in one retailer would be met with an instantaneous response in the same direction by competitors. This is not always so. In fact, price reductions and price increases that result from changes in wholesale prices may signal market power. Questions about when changes in wholesale price of products are reflected in retail prices gets at issues of market power; specifically when there is asymmetry – price increases are consistently reflected in retail prices faster than price reductions. When retail outlets are fierce competitors, the prices charged for the same good sold across retailers will be expected to move together over time through arbitrage or substitution or both.¹⁰²

Asymmetric price responses and market power

Asymmetric price responses – when upward price response are less immediate than the downward price response¹⁰³ – has been used as a measure of market power as well. However, the phenomenon has been many explanations so care is counseled in making conclusions too quickly with this type of measure. Whereas some have claimed that this phenomenon is more likely to be observed amongst firms with market power, recent theoretical literature has shown that search costs may explain this occurrence in competitive environments as well. These developments in theory and empirics have proposed and tested three explanations for the asymmetry: namely, (i) oligopolistic market power and coordination; (ii) the production and inventory cost of adjustment; and (iii) costly search theory imperfect information and monopolistic competition.

Other explanations for asymmetric price changes include the cost of adjustment of production and inventory that cause the asymmetric response in retail prices. Other explanations point to the fact that search models with Bayesian updating can generate asymmetric price responses. According to this theory, an increase in the retail price raises incentives to search for a lower priced retail outlet, while a decrease in the price lowers the incentive to search. Different search rules of consumers influence the elasticity of a retailer's demand and this leads to the asymmetric response of retail prices. Others argue that market power is not responsible for the asymmetry in price response. Any effect of market power attributed to search costs and locational advantages may be viewed as the costs of product differentiation under monopolistic competition.

¹⁰¹ See the Annex 4 for a technical explanation of why this is so.

¹⁰² From an econometric point of view, this would imply that prices of the commodity should be cointegrated.

¹⁰³ There has been a lot of attention to the asymmetric response of prices to changes in input or wholesale prices—mostly in the gasoline and agricultural product markets.

Competition authority may want to see if the observed asymmetric response to prices as a possible exercise of market that harms consumers. The econometric issues required to do so are difficult. But while the analytical techniques have grown in complexity, they have also improved in quality. An analysis of asymmetric can be an effective way to identify market power, but caution is counseled in drawing quick conclusions. The econometric literature is wide and developing on these techniques. A competition authority wanting to use these types of price responses to detect the exercise of market power will require high levels of specialized expertise in time series econometrics to do so. Finally, it is recommended that this analysis is confirmed by other features of the market and that competition authorities not rely solely on this evidence to act; no matter how robust the results of the analysis may be.

Data

The proposed analysis is based on data of retail and wholesale prices at the establishment level. Geographic data elements are added to these monthly price data and so is information on the type of outlet from where these prices are collected. Analyzing the functioning of markets through time by outlet, location-specific and commodity characteristics yield important patterns and clues about how much competition there is in markets.

Retail and wholesale price data are central to this diagnostic work. In order to carry out the analysis, a database of several months of time series retail and wholesale price data is best. The goal is to have a database that contains the data elements listed below.

Commodity. The five digit class and subclass central product classification number for the product. One example of this is provided by the United Nations, United Nations Statistics Division, Central Product Classification, Ver.2.¹⁰⁴ For best results, the commodity must be classified in the Group, Class, and Subclass level (5-digit CPC).

In addition to the purchase price of each good by establishment, the data must also have the following elements:

- *Quantity.* The quantity of the good observed or purchased is required.
- *Unit of measurement.* The unit of measurement used and the quantity observed. It can be a unit of volume like liters or quarts, of weight or mass such as pounds (lbs.) or grams, or a count such as 1, 2 or 10 bolts.
- *Date.* The day, month and year in which the price data was collected. The periodicity of the data collection is important. Breaks in data are important to document and compensate for in the analysis.
- *GPS coordinate.* The geographic location of the retailer/establishment from which the price was obtained can often be found and then recorded using a Global Positioning System (GPS) coordinate code. For example, this field will contain coordinate information to at least three digit second; for example; N 23°43'691", E 92°28'376".

104 Detailed structure and correspondences of CPC Ver. 2 http://unstats.un.org/unsd/cr/registry/docs/CPCv2_structure.pdf

• *Retailer.* It is important to have coding for type of point of sale establishment from which the price point was received. With respect to the type of establishment, the list could include the following:

- Department store;
- Supermarket;
- Wholesale store;
- Discount store;
- Mini-market;
- Service station shop;
- Kiosk;
- Neighborhood shop;
- Market;
- Specialty shop;
- Publicly-owned shop; or
- Household.

Goods that are commonly traded, where markets are thick with numerous consumers and retailers, will be easier to analysis with more robust and conclusive results than commodities that are not traded often.

The market assessment must be aware of the complication of non-linear prices and pro-competitive price discrimination and compensate for these. The market assessment must also be cognizant of non-linearities such as increasing returns to scale, network effects (the utility of each consumer increases as more consumers demand the same good or service) or a high degree of good differentiation to avoid biases and inconsistencies in the results of the calculated margins (these could be higher not because of collusion or market power but because of economies scale, fixed costs and branding).

Finally, there will be a need to consider consumer search costs in the empirical strategy if the commodity has quality variations that are not easily discernible to the consumer. Alternatively, even in commodities with few quality variations, if the search costs are substantial in comparison to the cost of the final good (gasoline, is a good example), then this must also be considered in the market assessment. Where search costs are high, there is competition (monopolistic competition) *for* the market but not *in* the market.

Conclusions

The data and analysis presented in this section are most appropriate to assess market power issues for the retail sector. The concept of significant market power, as applied through the competition policy framework, presents some difficult conceptual and empirical challenges. Overall, the refined economic analysis that this concept will require is likely to lead to indeterminacy and indicative, not conclusive, evidence.

CONCLUSION

Discussions during a technical workshop held in January 2014 revealed that EU Member States apply different approaches to address UTP. Some Member States address Unfair Trading Practices (UTP) outside their competition framework. In some, commercial law or sector-specific legislation was designed to protect the weaker parties in the contractual relationship¹⁰⁵. In these cases, national competition authorities are given a mandate to intervene in cases where sufficient public interest is affected by the respective behavior of abusive market players. Other Member States do address UTP within the competition policy framework, but not by introducing Significant Market Power (SMP), but rather by applying the rules on ‘abuse of dominant market position’ to ‘economically dependent’ relationships between buyers and their suppliers. It is unclear whether this way of addressing UTP forces competition authorities to forgo addressing more compelling and damaging competition issues. In the case of Bulgaria, however, treating UTP in the context of antitrust law enforcement could politicize the work of the CPC, discredit it as an impartial agency and would likely overburden it.

UTP may be best understood and addressed as a contractual issue, requiring targeted changes to commercial laws. Amending commercial laws, viewing UTP as violation of contracts, and having the courts settle these would likely be a more effective and direct remedy and would allow the Commission for Protection of Competition (CPC) to focus on enforcement only in cases where the prevalence of UTP harms competition in the market. In comparison, addressing UTP through the competition law framework leaves unclear which legal instruments would be available to Bulgarian authorities and in line with EU competition directives.

The SMP concept, as applied through the competition policy framework, presents some difficult conceptual and empirical challenges. Overall, the refined economic analysis that this concept will require is likely to lead to indeterminacy and indicative, not conclusive, evidence. While the introduction of the concept of ‘economic dependence’ and ‘superior bargaining power’ fill in the gaps of how to employ the SMP concept to address UTP, these concepts are difficult to square with the EC Guideline emphasis on applying remedies where there is sufficient evidence of consumer, not supplier harm. The task was to formulate coherent arguments that are in line with the EC Guidelines using the concepts to explain how SMP is exercised, namely, through a superior bargaining position. It stems from sufficiently large size in the relevant market – and what features markets would exhibit to support such exercise of market power i.e., economic dependence. Coherent and economically consistent arguments to tie these concepts together can be formulated only for an extremely narrow set of circumstances, meaning, narrow with respect to the low probability to exist for every bilateral relation between retailer and supplier; narrow in the sense that these circumstances are unlikely to exist; and, finally, narrow in the window of opportunity in time that a retailer can continuously exploit a supplier in the same way.

¹⁰⁵ The Czech Republic and Hungary adopted sector-specific legislation that defines SMP and prohibits its abuse, granting certain enforcement authorities to their national competition agencies. The proposed amendments to the Bulgarian Law on Protection of Competition does not follow this approach. The draft bill proposes SMP concept as generally applicable competition law instrument, not only applied to the food retail sector as in Hungary and the Czech Republic.

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ANNEXES

ANNEX I

SIGNIFICANT MARKET POWER AND UNFAIR BUSINESS PRACTICES: ISSUES AND CHALLENGES INTERNATIONAL WORKSHOP AGENDA

Boyana Residence, Sofia, Bulgaria - Tuesday, January 28, 2014

09:00 – 09:30 am	Registration
09:30 – 10:00 am	<p>WELCOMING REMARKS H.E. Daniela Bobeva, Deputy Prime Minister for Economic Development H.E. Markus Repnik, Country Manager for Bulgaria, Slovakia and the Czech Rep., The World Bank Mr. Petko Nikolov, Chairman of the Bulgarian Commission for Protection of Competition</p>
10:00 – 10:45 am	<p>OPENING PANEL Goals of the workshop Mr. Alvaro Gonzalez, Lead Economist, World Bank Issues in Business-to-business relationship in the Food Supply Chain: The Case of Bulgaria Mr. Evgeni Evgeniev, Private Sector Development Specialist, The World Bank Options for Bulgaria to address Unfair B2B Trading Practices Mr. Christian Filipov, Private Sector Development Specialist, The World Bank Discussion, moderated by Mr. Darin Stankov, Director of Antitrust and Concentrations Directorate at the Bulgarian CPC</p>
10:45 am – 12:45 pm	<p>PANEL ON EUROPEAN PRACTICES Antitrust and new forms of control of market power Mr. Gianluca Sepe, EU Affairs Unit, Italian Competition Authority Significant Market Power from the Czech perspective Mr. Petr Gajdušek, Head of Chairman’s Section, Office for the Protection of Competition, Czech Republic Buyer power – legal background and case law in Hungary Mr. Márton Kocsis, Case Handler, Antitrust Section, Hungarian Competition Authority The perspective of UNCTAD on the experience of some countries in application of rules regarding significant market power Mr. Hassan Qaqaya, Head of Competition Law and Consumer Policies Branch, UNCTAD Discussion, moderated by Mr. Kiril Pangelov, Director of Legal Analyses and Competition Policy Directorate at the BCPC</p>
12:45 – 02:00 pm	Lunch
02:00 – 04:30 pm	<p>PANEL ON TECHNICAL ISSUES ON SMP AND DEFINITIONS Concepts and Determinants of Market Power Assessment Ms. Sabine Zigelski, Sr. Competition Expert, Competition Division, Directorate for Financial and Enterprise Affairs, OECD Significant Market Power Determination Prof. Ioannis Kokkoris, University of Reading, UK The Economic Perspective: Unfair Trading Practices Mr. Alvaro Gonzalez, Lead Economist, The World Bank</p>
	Discussion, moderated by Ms. Boriana Shotekova, Head of Antitrust Department, BCPC
03:30 – 04:30 pm	Coffee and Networking Break
04:30 – 05:15 pm	SUMMARY OF WORKSHOP FINDINGS & CLOSING REMARKS

ANNEX II**LIST OF PARTICIPANTS****SIGNIFICANT MARKET POWER AND UNFAIR BUSINESS PRACTICES:
ISSUES AND CHALLENGES****International Workshop, 28 January 2014****GOVERNMENT OFFICIALS**

1. H.E. Daniela Bobeva, Deputy Prime Minister for Economic Development
2. Ms. Temenuzka Yankova, Advisor to DPM, CoM
3. Ms. Emilia Petkova, Advisor to DPM, CoM
4. Ms. Anelia Baklova, Advisor to DPM for Economic Development
5. Mr. Petar Nachev, Advisor to DPM for Economic Development
6. Mr. Ivaylo Yankov, Advisor to DPM for Economic Development
7. Mr. Dimitar Danchev, Advisor to Minister of Economy and Energy
8. Mr. Pavel Ivanov, Secretary of the Administrative Reform Council
9. Ms. Ivet Baeva, State expert, Economic and Social Policy Directorate, CoM
10. Mr. Ivan Nikolov, State expert, Economic and Social Policy Directorate, CoM
11. Ms. Desislava Lazova, State expert, International Financial Institutions and cooperation Directorate, Ministry of Finance
12. Ms. Teodora Zlateva, chief expert, Macroeconomic Analysis and Forecast Department, Ministry of Finance
13. Ms. Dessilava Vassileva, Ministry of Agriculture and Food
14. Ms. Mariana Marinova, Ministry of Agriculture and Food
15. Ms. Maya Lulcheva, Ministry of Economy and Energy
16. Ms. Svetoslava Malcheva, Ministry of Economy and Energy

BULGARIAN COMMISSION FOR PROTECTION OF COMPETITION

17. Mr. Petko Nikolov, Chairman
18. Mr. Darin Stankov, Director of „Antitrust and Concentrations“ Directorate
19. Mr. Kiril Pangelov, Director of „Legal Analyses and Competition Policy“ Directorate
20. Ms. Borianna Shotekova, Head of „Antitrust“ Department

INTERNATIONAL INSTITUTIONS

21. Mr. Hassan Qaqaya, Head of Competition Law and Consumer Policies, UNCTAD
22. Ms. Sabine Zigelski, Senior Competition Expert, OECD
23. Mr. Markus Repnik, Country Manager for Bulgaria, World Bank
24. Mr. Alvaro Gonzalez, Lead Economist, World Bank
25. Ms. Stella Ilieva, Senior Economist, World Bank
26. Mr. Evgeni Evgeniev, Private Sector Development Specialist, World Bank
27. Mr. Christian Filipov, Private Sector Development Specialist, World Bank
28. Ms. Ivelina Taushanova, Communications, World Bank
29. Ms. Adela Delcheva, Assistant, World Bank

ITALIAN COMPETITION AUTHORITY

30. Mr. Gianluca Sepe, EU Affairs Unit

OFFICE FOR THE PROTECTION OF COMPETITION OF CZECH REPUBLIC

31. Mr. Petr Gajdušek, Head of Chairman's Section

HUNGARIAN COMPETITION AUTHORITY

32. Mr. Márton Kocsis, Case Handler, Antitrust Section

ACADEMIA/THINK TANKS

33. Mr. Tony Dimov, Center for Impact Assessment of Legislation, Bulgaria
34. Prof. Ioannis Kokkoris, University of Reading, United Kingdom

ANNEX III
PROPOSED DRAFT BILL FOR
AMENDING THE LAW ON PROTECTION OF COMPETITION
/OF MARCH 7, 2014/

§ 1. In Article 1 (2) “abuse of significant market power” is added after the words “position on the market“.

§ 2 Amend the heading of Chapter 4 to include at the end “or with significant market power”

§ 3. Article 20a is created:

“Article 20a. (1) Significant market power has an undertaking which is not dominant, but in consideration of its market share, financial resources, opportunities for market access, technological development and commercial relations with other undertakings, could prevent competition on the respective market, when its suppliers or customers are depended on it.”

(2) Criteria for identifying and assessing the market position of the undertakings under paragraph 1 shall be defined in the methodology under Article 44 paragraph 3, which the Commission shall publish on its internet page.“

§ 4. The following amendments are made in Article 21:

In the title “or with significant market power” is added at the end.

The present text becomes paragraph 1 and in it before item after the words „dominant position “ is added „or significant market position “;

§ 5. Item 4 is created in Article 28:

„4. draft standard forms of contracts and/or general terms and conditions for the supply of goods and services of undertakings with annual turnover for the previous year of over 50 million leva, as well as proposals for their revision”

§ 6. Paragraph 4 is created in Article 38

“(4) In cases where proceedings are initiated under Chapter 4 and 7 upon the request of a person defined in para 1 item 3, its identity shall not be disclosed if so requested by the petitioner.”

§ 7. Add to the text of Article 60, para. 1, item 20 „or draft standard forms of contracts and/or terms and conditions for the supply of goods under Art. 28 item 4 well as under projects for revisions of standard forms of contract or general terms and conditions”.

§ 8. Article 92 is amended as follows:

1. At the end of para. 1 is added: “as well as in the cases under Art. 28, item 4, the undertakings shall submit to the Commission the draft standard forms of contract and/or general terms and conditions of sale of goods”

2. In para. 5 a new item 3 is created:

„3. Defined a timeline for the undertakings under Art.28 item 4 to revise standard forms of contract and/or general terms and conditions of sale of goods where necessary to bring them into line with the rules of competition”

3. A new para. 7 is created:

“(7) Undertaking that have received and opinion under para. 5 item 1, including is cases of revisions under para. 5 item 3, shall maintain on their websites published the approved standard forms of contracts and/or general terms and conditions for sale of goods and to apply them in contracts for periodic supply”.

§ 9 In Art. 100, para. 6 a new item 4 is created:

“(4) not submitting for evaluation the standard forms of contract and/or general terms and conditions of sale of goods or not publishing on the internet page of the undertaking of the evaluated for conformity, or revised standard forms of contract and/or general terms and conditions of sale of goods, or revising these without an evaluation for conformity or concluding supply contracts in violation of standard forms of contract and/or general terms and conditions of sale of goods evaluated for conformity”

TRANSITIONAL AND FINAL PROVISIONS

§ 10. (1) Within 3 months of coming into force of this Law, the Commission for Protection of Competition shall adopt amendments of its organizational charter;

shall prepare and publish on its website for public comment the draft methods referred to in Article 44, para. 3 on determining undertakings with significant market power, for which opinions can be presented within not less than 14 days, and shall publish on its website the methodology with the adopted revisions.

§ 11 Within 3 months of coming into force of this Law, undertakings with an annual turnover for the previous year

of 50 million leva, shall submit to the Commission for Protection of Competition drafts of standard forms of contract and/or general terms and conditions of sale of goods and:

in evaluation of conformity shall publish these on its website and offer their suppliers revisions to bring concluded contracts in compliance within 2 months of the opinion of the Commission under Art. 92, para.5 item 1;

in cases under Art. 92, para. 5, item 3, shall present these for repeated evaluation and in case of a positive opinion follow the rules under item 1”

§ 12. In the Law on Foods (Promulgated SG, issue 90 of 1999 amended SG, issue 102 of 2003, issue 70/2004, issues 87, 99 and 105 of 2005, issues 30, 31, 34, 51, 55 and 96 of 2006, issues 31 and 51 of 2007, issues 36 and 69 of 2008, issues 23, 41, 74, 82 and 93 of 2009, issues 23, 25, 59, 80 and 98 of 2010, issue 8 of 2011 amended SG, issues 54 and 77 of 2012, amended issue 68 of 2013) the following amendments are made:

New Article 19 is created:

„Art. 19. (1) for periodic supply of foods to establishments under Art. 12, when the buyers have an annual turnover for the previous year over 50 million leva, written contracts shall be concluded corresponding to the standard forms of contract and/or general terms and conditions of sale of goods under Art. 28, item 4 of the Law on Protection of Competition and rules on fair trading.

(2) The contracts under para. 1 cannot include:

(2) Contracts under paragraph 1 cannot include:

1. provision of services by the buyer to the seller, whether or not related with the subject of sale or their implementation should not be bound with the conclusion of other agreements for such services;

2. prohibitions or restrictions for the provision of goods from the seller to other buyers;

3. restrictions on supply or refusal to offer to consumers of good under the registered and trademarked brand of the producer in cases where the retailer under para. 1 offers the same product under its own brand.

4. fees and other services not based on fair commercial practices:

- unrelated to the service actually provided;

- with disproportional and excessive price or when the cost of the service is calculated in a non-transparent manner, preventing the successful planning of the results of the performance bond relationship.”

5. preventing trade partners to offer the same or better terms and condition to third persons, including imposing penalties in such cases.”

In Article 20b the present text becomes para. 1 and para. 2 is created:

“(2) Persons engaged in the retailing of food shall not be allowed to transfer to the suppliers the risk, including imposing penalties for:

1. expired effective date for foods that have been delivered before the effective date and the delivery is accepted;

2. Wasted foods except for shortcomings that could not be seen in plain view and have been established during the term specified in the contract.”

3. In Art. 26. Para. 1 a new item 12 is created:

”12. Contracts under Art. 19 and in conformity with the requirements under Art. 20b, para. 2”

4. In Art. 27, para.4 item 6, after “documentation” is added “including concluded contracts”.

5. In Art. 43, paragraph 1, the words “and Article 18, paragraph 1” are replaced with “Article 18, paragraph 1, Article 19 and Article 20b, paragraph 2”.

§ 13. Signed contracts shall be brought in compliance with § 12 items 1 and 2 within 3 months after the entry into force of this Law.”

Draft submitted by Members of Parliament:

Rumen Getchev Yordan Tsonev

Kornelia Ninova Petar Kanev

Zhelio Boychev Yavor Kuymdjiev

ANNEX IV

TECHNICAL NOTE

To understand why pass-through can lead to indeterminate results, this requires some calculus and familiarity with derivatives.

In maximizing profits the firm solves:

$$\max_q [p(q) - c]q, \quad (1)$$

where q = quantity sold and $p(q)$ = price.

The optimal output level solves:

$$qp'(q) + p(q) - c = 0 \quad (2)$$

From (2), solving for c and taking the first derivative, an expression for the rate at which price is changed to accommodate changes in marginal cost can be obtained in the following way:

$$\begin{aligned} p'(c) &= \frac{p'(q)}{2p'(q) + qp''(q)} \quad (3) \\ &= \frac{\text{slope of the demand curve}}{\text{slope of the marginal revenue curve}} \end{aligned}$$

This can be written in terms of elasticities as:

$$\begin{aligned} p'(c) &= \frac{1}{(1+(1/\eta)+[(p-c)/\eta](\partial\eta/\partial p)} \quad (3') \\ &= \frac{\eta}{\eta + 1 + \left(\frac{p}{\eta}\right)(\partial\eta/\partial p)} \end{aligned}$$

Equation (3) has a simple intuitive explanation. For a given increase in marginal cost, the monopolist will contract output so that marginal revenue increases by the same amount. Price will rise by an amount equal to the ratio of the slope of the demand curve to the slope of the marginal revenue curve times the amount of the cost change. For a constant elasticity demand curve,

$$p = \beta q^{\frac{1}{\eta}} \quad (4)$$

marginal revenue will equal $\left[\frac{(1+\eta)}{\eta}\right]p$, and since η is constant, $\frac{\eta}{\eta+1} > 1$ for $-\infty < \eta < -1$. However, for a demand curve of the form of:

$$p = \alpha - \beta q^{\delta} \text{ where } (\delta > 0), \quad (5)$$

marginal revenue will equal $\alpha - \beta(\delta + 1)q^{\delta}$ and $p'(c) = 1/(1 + \delta)$, which is always less than unity. In the special case where $\delta = 1$ this is a linear demand curve and $p'(c) = \frac{1}{2}$. Price always rises by one-half the increase in constant marginal costs. Finally, for purposes of illustration, consider a demand schedule with the following functional form:

$$p = \alpha - \beta \ln q \quad \text{where } \alpha, \beta > 0, 0 < q < \exp\left(\frac{\alpha}{\beta}\right) \quad (6)$$

Marginal revenue is equal to $p - \beta$ so $p'(c) = 1$. Price will rise by the same amount costs rise, which is exactly how much price would rise in a perfectly competitive market.