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ASSESSMENT OF BUYER POWER IN COMPETITION LAW: A BOON OR A THREAT¹

AUTHORED BY - DR. GAGAN DEEP KOUR

1. INTRODUCTION

The fundamental idea behind buyer power is that by utilising the power they have in terms of bargaining as a powerful buyer, customers can urge a seller to offer lower selling prices and favourable terms. This works as a more intense force in business to business transactions (B2B) because of the size or extent of the deals.² Along these lines, buyer power can be recognized as, “a bilateral connection between retailer and supplier, driving from the capacity of leading retailers to obtain from suppliers more favourable terms than those available to other buyers, or which would be expected under normal competitive conditions”,³ i.e. these competitive conditions do not depend on efficiency related to size or other variable factors (Dobson, 2005).

Be that as it may, this buyer power can all the while be a boon and a hazard for competition and for markets. Firstly, it might bestow countervailing force to the seller power, which might lead to lower prices in the downstream market (unless it leads to a consecutive power).⁴ However, when buyer power does not exist in the presence of a strong seller power to counter it, it may prove to be socially adverse. It might chip away the willingness of the suppliers to invest, innovate and also stifles their long-term feasibility.⁵ Therefore, the impact of buyer power in the economy is uncertain. So, the researcher attempts to look at the following specific research questions:

- i. What are the various notions and effects of buyer power on competition?
- ii. Can buyer power be termed as per se infringing competition law i.e. is it a menace for competition law?
- iii. How the buyer power has been assessed by various Competition authorities?

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² William Lovejoy, Bargaining Chains, 56 Management Science, 2282, 2291(2010)

³ Gordon Mills, Buyer Power of Supermarkets, 10 Agenda, 145 (2003)

⁴ David E. Mills, Countervailing Power and Chain Stores, Economics Virginia at 4; retrieved from <http://economics.virginia.edu/sites/economics.virginia.edu/files/Countervailing%20Power%20and%20Chain%20Stores4.pdf>.

⁵ Inderst & C.Wey, Countervailing Power And Dynamic Efficiency, 9 Journal of the European Economic Association, 702, 703(2011).

2. DIFFERENT DIMENSIONS OF BUYER POWER

2.1. Conventional vs. Modern:

There are diverse definitions of buyer power yet every definition of “buyer power” or “buying power” have compliance that the concept of buyer power is about “ the market power that is practised by buyers, but here distinction lies in the particular meaning of the market power in question.”

- (i) Conventional definition - One way to define the buyer power with the help of customary meaning of market power, i.e. market power on the seller side, and then overturn the explanation to define the buyer power or the power on the buyer side.⁶ The market power on the seller side, also known as monopoly power can be defined as, “the capability of a firm to set prices profitably above competitive levels.”⁷ Going by the above statement, and reversing this definition, buyer power could be defined as the ability of a buyer to set prices profitably below competitive levels.

Roger G. Noll defines buyer power as: “A buyer has market power if the buyer can force sellers to reduce price below the level that would emerge in a competitive market. Here, the demand side of market is sufficiently concentrated. Thus, a buyer power arises from monopsony or oligopsony (a few buyers), and can be termed as the parallel image of monopoly or oligopoly.”⁸

- (ii) Broader Definition - A wider definition of buyer power includes the notion of “bargaining power” or “countervailing power”. As defined by Zhiqi Chen: “Buyer power is the ability of a buyer to reduce the price, profitably below a supplier’s normal selling price, or (more generally) the ability of buyer to obtain terms of supply more favourable than a supplier’s normal terms. A seller’s profit maximising i.e. the normal selling price prevails in the absence of buyer power. This buyer power is known as monopsony power in case of a situation of perfect competition amongst suppliers and in the case of imperfect competition, this normal selling price stands above the competitive price, and the buyer power in such a case is known as countervailing power.”⁹

⁶ Zhiqi Chen; “Defining buyer power”, 53 *Antitrust Bulletin*, 241, 242(2008).

⁷ W. Kip Viscusi, Joseph E. Harrington, Jr., & John M. Vernon; “Economics of Regulation and Antitrust”; 2005 at 294.

⁸ Roger G. Noll; “Buyer Power and Economic Policy”, 72 *Antitrust Law J.* 589; 2005.

⁹ Zhiqi Chen ; Defining buyer power, 53 *Antitrust Bulletin*, 241, 245(2008)

2.2 Difference between countervailing buyer power and buyer market:

The term “buyer power” when used generally, may refer to two different concepts:

- (i) Countervailing buyer power- It is the power of a buyer to create competition between its supplier and its potential suppliers; or a to generate new competition on its own, or bargaining strength that buyer holds in reference to seller in the negotiations or transactions that are commercial in nature, because of its size, significance and its ability to switch to alternatives of that particular seller; ¹⁰and
- (ii) Buyer market power- It is a market power in buying , that emerges from the lack of effective competition between buyers or in other words, a power that is derived from a lack of competition.

Therefore, the buyer market power is an outcome of the effective competition in the supply, and the countervailing buyer power can be referred to as a factor that contributes to such competition.¹¹

3. EFFECT OF BUYER POWER ON COMPETITION

Unlike the exercise of seller power, which generally leads to outcomes such as higher prices, which directly affects the consumers in a negative manner, the exercise of buyer power or presence of large number of buyers with power may have positive or negative outcome. ¹²

1. Positive effects of buyer power:

Presence of powerful buyers has the effect of an effective bargain over price and quality of the products and services. The usage of buyer power is likely to counter any anticompetitive conduct in the upstream seller market (countervailing buyer power) by preventing any increase in price above the competitive level. Infact, a large number of buyers can make seller’s cartels unsuccessful and less stable as the proposal of significant orders to some of the sellers who are participants to the cartel, creates a great incentive to deviate from the cartel or the collusive strategy.¹³ As a result the competition authorities and courts have attached a little importance to the issue of the abuse of buyer power.¹⁴

¹⁰ Abir Roy, Competition Law in India (2008) at 150.

¹¹ Franck Latremoiere, Countervailing buyer power and buyer market power, Reckon Open, June 2005; retrieved from <http://www.reckon.co.uk/headlines-franckblog>.

¹² Chloe Binet, “Buyer Power in EU Competition Law A boon or impediment to consumer welfare?”, Université Catholique de Louvain, 2014

¹³ R.Inderst & G.Shaffer, Buyer power in merger control; Antitrust Handbook: Issues in competition law and policy; 2007, Chapter XX, at 18.

¹⁴ In this scenario, it is assumed that lower prices negotiated upstream are passed on to consumers

2. Negative effects of buyer power:

The exercise of buyer power may result in some different adverse effects.

First, if buyer power is combined with seller power in the downstream market and is utilised to increase such power, it is not necessary that the consumers will reap benefits from the presence of large buyers as the seller will not be motivated to pass through these cost-savings to their own customers.

Second, it is not always the case that the consumers are allowed to share the benefits that result because of the pressure exerted by the buyers in the upstream market.

Thirdly, large buyers' market power may also harm market participants in the up- and downstream markets. Small suppliers are on the risk line, which are forced to absorb the revenue loss and a very low return on capital. This may consequently lower the incentives of the former to invest in product quality and innovation to the detriment of consumers.

Fourthly, excessive pressures exerted on sellers may generate additional costs that society will have to bear such as taxpayer-funded subsidies granted to farmers in order, among other things, to provide them with a reasonable standard of living.¹⁵

4. ASSESSMENT OF BUYER POWER UNDER COMPETITION LAW

Traditionally, bilateral relations are considered under competition law only to the extent they have an effect on the market and an impact on the welfare of consumers. Therefore, only when buyer power is associated with market power on selling side, it is likely to have effects on the final market.

Buyer power is dependent on the market share of each retailer in regard to the goods belonging to each product category in the market. The antitrust authorities consider that a state of economic dependence is created when a retailer has a market share of above 22 % in a particular category. In such a situation, suppliers of the product cannot abandon them or refuse to supply them. The second scenario is when retailers have shares between 10 to 20%. This scenario provides them with a strong negotiating power.

In third scenario, where retailers have shares below 10 %, the situation would not be an

¹⁵John B. Kirkwood, Powerful Buyers And Merger Enforcement, 92 Boston University Law Rev. 1485, 1550(2012)

asymmetric one. In its report on Groceries (2000), the UK Competition Commission laid down that for economic dependence, a threshold of 8% of purchases for resale for a certain retail channel is required. There have been some other sector enquiries in various other jurisdictions, which have been discussed further in the research paper.

4.1 ASSESSMENT OF BUYER POWER IN MERGER CASES:

The phrase "buyer power" has been mostly used in merger control in "Substantial lessening of competition" (SLC) Test. It relates to a proposed merger that has a risk of a substantial lessening of competition in a market between suppliers. Such a merger may be allowed because the customers or the buyers hold the countervailing buyer power in that market.

The European Commission and the other antitrust Authorities have held investigations on the effects of mergers in the retail market. Other than their effects on the concentration the investigation is also based on the way in which the barriers to entry would be raised because of the increase in buying power shooting from the merger.

(i) Kesko/Tuko¹⁶(Nov 1996):

This case relates to merger of two supermarket chains- Kesko and Tuko having 60 % share in the market of daily consumer products. The two supermarkets were based in Finland and most of the suppliers were dependent on them for their 50-75% of their sales in the national market. This was the first case in which the European Commission came up with the concept of "*spiral effect*"¹⁷ The Commission had prohibited the merger, considering the high market share of the two merging entities, which would eventually result in a high buying power.

The two large players, when merged, would be able to obtain such level of lower input prices that no competitor will be able to match. This would make any new entry very difficult.

So taking into consideration, the already high level of concentration in the market in Finland, the commission did not permit the said merger¹⁸

¹⁶ Commission's decision of 20 November 1996, Case IV/M.784.

¹⁷ Spiral effect refers to continuous strengthening of a firm. If the size of a merged firm is bigger, it would lead to a larger volume-related discount. This would enable such firm to undercut prices offered by its rivals and offer lower prices. This would eventually increase its market share. A greater market share would in turn raise the degree of its purchases, which would increase its buyer power, and it will go on in this manner.

¹⁸ Lars-Hendrik Roller; "Buyer Power in the EU" ; American Antitrust Institute Conference on "Buyer Power and Antitrust"; June 2004; retrieved from http://ec.europa.eu/dgs/competition/economist/buyer_power.

(ii) Rewe/Meinl ¹⁹(Feb 1999)

In this case, two firm retailers in Australia applied for merger clearance, which held 30% market share in market for food retail sales. The Commission observed that if the merger will be allowed, it will affect 19 food categories in the market, out of which 10 will be in state of dependence. This will lead to a “spiral effect”, i.e. dominance into retail market would give rise to huge buyer power in procurement market. So some steps had to be taken to reduce the buyer power of the new entity.

Hence, the Commission approved the merger subjected to some conditions. The firms were to retrench it to 162 outlets, out of 341 outlets.

(iii) Blokker/Toys “R” Us (June 1997)²⁰

The case relates to merger of two Dutch toy retailers, which had 50-60% market share in toy sales in Dutch Market. The commission observed that firms had a buyer power over suppliers, which will be further enhanced by unparalleled economies of scale in purchasing. This case is an example where buyers form a powerful collusion on not to supply to certain retailers,(in this case discounters.)²¹

4.2 The Assessment of Buyer Power in Sector Inquiries / Market Inquiries-**(i) The Report on Food Distribution Sector of the Austrian Competition Authority, ²²**

This report was particularly focused on buyer power in a highly concentrated retail market of food distribution.²³ It was found that retailers negotiate a number of conditions once a year. But in addition to the negotiations done yearly, the retailers also imposed some retroactive rebates. It was found that such “*ex-post* negotiations” may affect the business strategies of the suppliers and chip away their willingness to innovate and invest without objective justifications. Considering these factors and negotiations, BWB concluded that there were indications of the existence of strong buyer power in the food distribution sector.

¹⁹ COMMISSION DECISION of 3 February 1999;Case No IV/M.1221

²⁰ 126 F.T.C. 415, 592–96 (1998)

²¹ OECD Policy discussion on Monopsony and Buyer Power; 2008; retrieved from <https://www.oecd.org/daf/competition/44445750>.

²² Hanns Peter Nehl, Branchenuntersuchung Lebensmittelhandel -The Austrian competition authority concludes inquiry in food distribution sector highlighting indications of strong buyer power ;Concurrences Antitrust Publications, June 2007; retrieved from <https://www.concurrences.com/en/bulletin/news-issues/june-2007/The-Austrian-competition-authority-13981>.

²³ Two largest retail groups had a combined market share of 57% in 2005

(ii) Avis of the French Competition Council concerning the conditions of competition in large retail distribution²⁴

In this enquiry, the presence of buyer power had been inferred by FCC from the relative behaviour of prices and discounts.

The time period of 1998 to 2003 was taken up. According to the facts, in 5 years, the retail prices of large retailers increased by 11%, while the price of discounts decreased by the same percentage. Margins that were reflected from invoices decreased by 9 % (from 44 per cent to 35 per cent); but, margins not reflected in invoices increased by 10% (from 22 to 32 per cent). Therefore, it was concluded that this increase in prices was the result of the increase in margins of the retailers. Here, the retailers' buyer power is reflected by the extensive use of out of invoice discounts. The FCC envisaged that a two-party cooperative game was there among all market players, and buyer power was playing a significant role.

(iii) UK - Competition Commission Groceries Market Investigation Final Report, April 2008²⁵

The commission in its report, Para 41 says, "We found that the exercise of buyer power by certain grocery retailers with respect to their suppliers of groceries, which prevents or distorts competition in connection with the acquisition of groceries by large grocery retailers, some wholesalers and buying groups."²⁶

This enquiry by the UK Competition Commission was initiated on request of OFT, after receiving various complaints regarding use of buyer power by large retailers, which resulted in higher costs and entry barriers for small retailers and new players. The enquiry was concerned with the situation of the groceries market.

After holding around 80 hearings, the Commission recognized that as substantiated in a number of prevailing practices, the UK groceries markets are characterized by the existence of buyer power, which increased the margin of the retailers but supplier had to bear the risk.

However, there was no sign that the benefits from the buyer power does not pass on to the consumer. Also, the Commission was unable to find evidence of any activities relating to

²⁴ Lucio Tome Feteira; Insights on Superior Bargaining Power; 64 International Competition Law Series 251.

²⁵ The supply of groceries in the UK market investigation; 30-04-2008; retrieved from <http://www.ias.org.uk/uploads/pdf/Price%20docs/538.pdf>

²⁶ The supply of groceries in the UK market investigation; 30-04-2008; Para 41; retrieved from <http://www.ias.org.uk/uploads/pdf/Price%20docs/538.pdf>.

predatory pricing. In fact, the commission observed that amongst the main retailers in groceries market, there appears to be competition despite the very high level of concentration. Although it might be true that larger retailers are able to mince better conditions from the suppliers, but in no way this transforms into a higher cost for smaller retailers or new entrants. The commission observed that inspite of the buyer power of major retailers; the smaller players can still improve their position in respect of purchasing power, by joining the larger buying groups in the market. Therefore in its findings, it said that “in many important respects, competition in the UK groceries industry is effective and delivers good outcomes for consumers.”²⁷

(iv) Report of the Nordic competition authorities “Nordic Food Markets - a taste for competition” – November 2005²⁸

This Report of the NCC dealt with the markets where the prices and the concentration of both retail and supply of foodstuff were very high.²⁹

It was found that retailers in the market were exploiting their power by practicing predatory pricing and were also obtaining marketing allowances. The NCC found that this resulted in entry barriers for new suppliers. Also, the smaller players were put at disadvantage. The commission inferred that this can be a major reason for the supply side concentration in the procurement market.

(v) The Report of the Italian Competition Authority on the distribution of fruit and vegetables, June 2007

The Italian retail market falls under the less concentrated markets. This Report of the Italian Competition Authority relates to the distribution network of fresh food and vegetables.

It identified that the organisation of the trade has been affected by the very slow switch towards a modern distribution system. As a result, the modern distribution chains are at unfavourable position because of lack of any vital trading mechanism which was centralised from the supply side and also due to a higher flexibility of small retailers. So the commission concluded that in such a very specific field, the presence of any buyer power is not likely to be of any relevance for the Italian market.

²⁷ *Id.* at Para 10.1.

²⁸ “Nordic Food Markets - a taste for competition”; November 2005; retrieved from https://www.kkv.fi/globalassets/kkv-suomi/julkaisut/pm-yhteisraportit/nordic_food_markets.pdf.

²⁹ It varies between 82-90 per cent depending on the country.

5. CONCLUSION

From majority of the market investigations, cases and enquiries carried out by competition authorities, the practices that have come into picture demonstrate that retailers in a particular market have buyer power in one or the other form, e.g. higher discounts for powerful retailers which are not based on any efficiency or costs; most favourable treatment clause; modified and unusual negotiated conditions, etc. Nevertheless, whether the harm caused to the suppliers due to exercise of the powerful buyer power also results in equal harm to the competition and the market structure or not, is a debatable issue. Traditionally, these bilateral relations are taken into account by the antitrust authorities; to the extent they have an impact on “consumer welfare and the market”. Therefore, the commission and other agencies have tended to downplay the anti-competitive effects of buyer power, unless on the selling side, it is associated with market power. The reason behind this is that if such power would have been absent, the retailers will be compelled to transfer the benefits to the consumers. Therefore, the effect of buyer power should be examined from both sides i.e. retail market and procurement markets.

In context of sector enquiries, most of the investigations done by the commission have been focused on the effect that buyer power has on risk sharing between retailers and suppliers, and also on R&D (innovation and investment). The evaluations as to whether the buyer power might affect consumer welfare negatively in the short run, differs from case to case. The FCC has noticed in many cases that public intervention through the prohibition of sale below cost with the aim of safeguarding small retailers may facilitate collusion and in such cases it may negatively affect consumer welfare. Although UK Competition Commission argues that the existing small retailers and the new entrants in the market may join buyers’ group and hence improve the bargaining conditions, but still most of the other reports, foresee the subsistence of comparatively negative effects on small retailers and new entrants. Except the Italian inquiry, most of the above mentioned inquiries demonstrate that buyer power exists in one or the other form in markets.

In the context of mergers, the antitrust Authorities have examined whether it will create a “Spiral effect”.

So, it can be concluded that the buyer power can be both a boon and a threat for competition. On the one hand, buyer power may enhance seller power by providing a countervailing force and on the other hand, it may lead to decrease in prices in the downstream market. However, when buyer

power exists in absence of a strong seller power, it may turn out to be a menace and socially detrimental, because in such a situation, it may demoralize the willingness, profitability and practical capability of suppliers and hence undermine their willingness and incentive to invest in innovation. Therefore, it can be said that the impact of buyer power may vary according to market conditions, and hence no straight jacket formula can be tailored but a “case-by-case analysis” approach should be adopted.

