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Monopolisation, Moat Building and Entrenchment Strategies – Note by Spain

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More documents related to this discussion can be found at
www.oecd.org/competition/monopolisation-moat-building-and-entrenchment-strategies.htm

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1. Introduction

1. Economic moats or entrenchment strategies are becoming increasingly important for competition authorities, especially in terms of assessing market power and abuse thereof.
2. The concept of “economic moat” is associated with conditions or features that allow a company to achieve a stronger market position than its competitors’, hindering other players from replicating its success. Some of the most common competitive advantages that enable companies to build moats are, among others: economies of scale and scope, network effects, the ownership of property rights, brand recognition or brand loyalty, cost advantages and regulatory barriers.
3. Entrenchment strategies involve actions undertaken by firms in order to strengthen their competitive edges and safeguard their market standing. Some of the strategic actions associated with the entrenchment of market power (making it daunting for competitors to challenge a firm’s dominance) may entail vertical integration, exclusive contracts, tying and bundling, discrimination, lack of transparency, etc.
4. Both economic moats and entrenchment strategies are concepts closely related to the level of market power firms exhibit. Although they can enhance a firm's competitive position and profitability, they may also raise concerns about the exercise of market power that may involve a potential harm to competition. Consequently, competition authorities should carefully assess the competitive perspective of firms' strategies and undertake enforcement actions where necessary to protect competition.
5. Even if progressively gaining prominence in the digital field, economic moats and entrenchment strategies are not new and they have also been analysed in traditional sectors. For instance, the Spanish CNMC has analysed these dynamics in intellectual property and rail freight transport cases.
6. In this respect, although some types of moats are broadly applicable to any sector (such as switching costs or brand loyalty), other may be more specific to some industries (like network effects, patents or regulatory barriers). This underlines the relevance of understanding the dynamics of each sector from the competition authorities’ standpoint.
7. After this first introductory section, Section 2 describes CNMC’s general approach when assessing economic moats, entrenchment strategies and monopolization. Section 3 refers to CNMC’s practical experience in analysing cases in different sectors. Section 4 concludes with some takeaways.

2. CNMC’s general approach when assessing economic moats, entrenchment and monopolization

8. The Spanish competition framework is flexible enough to address the challenges posed by economic moats, entrenchment strategies and monopolization.
9. Article 2 of the Spanish Competition Act (and Article 102 of the Treaty on the Functioning of the European Union, TFEU) prohibits the abuse of a dominant position. Abusive practices may consist in

1. The direct or indirect imposition of prices or other unfair trading or services conditions.
 2. The limitation of production, distribution or technical development to the unjustified prejudice of undertakings or consumers.
 3. The unjustified refusal to satisfy the demands of purchase of products or provision of services.
 4. The application, in trading or service relationships, of dissimilar conditions to equivalent transactions, thereby placing some competitors at a disadvantage compared with others.
 5. The subordination of the conclusion of contracts to acceptance of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of these contracts.
10. Abusive conduct is forbidden irrespective of whether the undertaking's dominant position has been established by legal provisions or not.
11. When applying the legal standard to find dominance and abuse, the Spanish CNMC relies on Spanish and EU case law. Guidelines may be of relevance to help framing the concepts of abuse and dominant positions¹. The assessment of dominance typically starts with the calculation of market shares², next to other factors, such as countervailing buyer power and barriers to market entry and expansion³.
12. The assessment of moats would be carried out at this point, when analysing barriers to entry and expansion (considering "moat" as competitive, durable and sustainable advantages such as network effects, economies of scale and scope or regulatory barriers).
13. Companies may contribute to create and perpetuate these moats to preserve their market power, maintaining their monopoly or dominant position by preventing other players from entering or gaining presence on a relevant market.
14. The assessment of entrenchment strategies is part of the legal and economic assessment. Entrenchment strategies may be typically analysed in the framework of potential exclusionary abuses of a dominant position, restrict rivals' competition resorting to strategies other than competition on the merits.
15. It is relevant to recall that the Spanish competition framework has another tool to address unilateral conducts, which is Article 3 of the Competition Act. This provision prohibits unfair acts (violations of the unfair competition act) that affect the public interest by distorting competition. National case law is relevant to assess these elements.

¹ See 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

² See 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 (paragraphs 13 and 15)

³ See 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 (paragraphs 16 and 17), and Judgment of the CJEU of February 14, 1978, United Brands. C-27/76, ECLI:EU:C:1978:22 (paragraphs 91 and 122) and Judgment of the CJEU of February 13, 1979, Hoffman-La Roche, C-85/76, ECLI:EU:C:1979:36 (paragraph 48)

16. One of the unfair acts that could be of relevance when assessing moats and entrenchment may be the abuse of economic dependence. There are also other possible unfair acts (e.g. legal breach to obtain a significant economic advantage).

17. The Spanish Competition authority can rely on a wide array of investigative tools, mostly inspections, requests for information and interviews to detect and investigate potential anticompetitive practices related to economic moats and entrenchment strategies in a timely manner. For instance, access to internal documents (through inspections and/or requests for information) may offer insights into a company's strategic actions or intentions, market power, efforts to maintain market dominance (e.g. through anticompetitive means) and market definition.

18. Interviews may also shed light on market definition and dominance. And requests for information are essential for market tests inquiring about market definition and dominance. The CNMC conducts market tests with a notable degree of granularity (testing different agents in terms of size and position along the value chain). Besides, these tools are also valuable in terms of elaborating theories of harm, when assessing (among other aspects) the ability and incentive to engage in exclusionary conduct, entrenching the dominant position of the investigated firm.

3. CNMC's practical experience

3.1. Intellectual property

19. The CNMC's experience in cases involving intellectual property rights concern mainly unilateral conducts, and more specifically abuse of dominance due to legal and economic factors inherent in this type of rights.

20. The CNMC has conducted several investigations concerning collective intellectual property rights management organizations. In Spain those collective management organizations⁴ have in many cases operated historically as legal monopolies on behalf of multiple rights holders within a particular sector (such as music, audiovisual, literature and visual arts, among others).

21. The most recent decision dates from 2019, DAMA VS SGAE⁵. SGAE is the main collecting society for songwriters, composers and music publishers in Spain, representing as well audiovisual authors such as directors and screenwriters. It was fined €2.95 for an abuse of dominant position (violation of Article 2 of the Spanish Competition Act and Article 102 of TFEU).

⁴ Currently, the Spanish Ministry of Culture has authorised the creation of 9 collective management organizations (five collecting societies for authors' intellectual property rights (Sociedad General de Autores y Editores (SGAE), Centro Español de Derechos Reprográficos (CEDRO), Visual, Entidad de Gestión de Artistas Plásticos (VEGAP), Derechos de Autor de Medios Audiovisuales (DAMA) and Sociedad Española de Derechos de Autor (SEDA)); two performing artists' copyright collecting societies (Artistas Intérpretes o Ejecutantes, Sociedad de Gestión de España (AIE) and Artistas Intérpretes, Sociedad de Gestión (AISGE)); and two producers' copyright collecting societies (Asociación de Gestión de Derechos Intelectuales (AGEDI) and Entidad de Gestión de Derechos de los Productores Audiovisuales (EGEDA)).

⁵ S/DC/0590/16.

22. As far as economic moats are concerned, the decision DAMA VS SGAE⁶ bases the assessment of its dominant position on market shares, relevant barriers to entry and insufficient countervailing power⁷.

23. Barriers to entry⁸ in sectors subject to intellectual property rights arise mainly from network economies: the wider the repertoire, the higher the ability to attract users upstream; the higher the userbase, the easier to attract authors. But there are also scale economies (decreasing average costs the wider the repertoire) and scope economies (complementarities in managing different rights). Companies with a wider inventory and different rights can have a cost advantage due to subdued transaction costs (management, negotiation, monitoring and supervision). This provides a competitive advantage *vis-à-vis* smaller competitors (disincentivizing their entry and expansion), constituting another pillar of fortification of the moat.

24. Barriers to entry also arise due to legal barriers. In Spain some rights are reserved for specific entities and there are "mandatory collective management rights", for which the Spanish sectorial legislation of intellectual property⁹ commands exclusive management through an intellectual property rights entity. There are other specific legal requirements (the compulsory need of authorisation by the Ministry of Culture and the requisite of non-profit entity status).

25. Insufficient countervailing power is felt both upstream (one or few collecting societies deal with thousands of authors) and downstream (in this case, affected users were hotels and restaurants, which exhibit also very low concentration even if there are also contracts with associations). This insufficient countervailing power is also due to the lack of alternatives explained by economic factors (direct negotiation is not efficient for authors and users and most competitors are not developed enough to be a viable alternative) and legal issues (some rights have to be collectively negotiated in Spain, as mentioned above).

26. In terms of entrenchment strategies, the decision DAMA V. SGAE¹⁰ establishes that the collecting society SGAE abused its dominant position in two ways:

27. First, SGAE was imposing limitations on authors' freedom to partially or totally allocate his/her rights to a different entity. This had the effect of hindering competitors' entry and growth.

28. Second, SGAE was imposing the bundling of (audiovisual and musical) repertoires for users (hotels and restaurants). This was limiting the ability of alternative operators to exert competitive pressure since SGAE is the only entity with simultaneous presence in both rights and was dominant in both.

29. Some of these economic moats and entrenchment strategies have also been addressed by the Spanish Competition Authority in a report carried out within its

⁶ This contribution only summarizes the latest CNMC decision in this sector (see footnote 41 of the decision S/DC/0590/16 for other cases where dominant positions have been found) <https://www.cnmc.es/expedientes/sdc059016>

⁷ Page 43 of the decision S/DC/0590/16

⁸ Page 19 of the decision S/DC/0590/16

⁹ Real Decreto Legislativo 1/1996, de 12 de abril, por el que se aprueba el texto refundido de la Ley de Propiedad Intelectual, regularizando, aclarando y armonizando las disposiciones legales vigentes sobre la materia

¹⁰ Page 50-74 of the decision S/DC/0590/16

competition advocacy function¹¹. Its section III.3 considers as strategic barriers to entry the application of fees unrelated to the actual use of rights and the lack of transparency regarding the repertoires actually managed.

30. While the DAMA V. SGAE decision was recently (in December 2023) annulled¹² by the Spanish first instance court arguing that SGAE had no dominant position on the upstream markets for audiovisual authors in 2018, the CNMC has appealed to the Supreme Court because its decision did not actually state that SGAE had a dominant position on the upstream markets for audiovisual authors in 2018 (actually, the decision recognises that there is a strong competitor upstream from 2018 onwards), while at the same time applies the theory of associated markets¹³ to conclude that SGAE's abuse of dominant position took place on a market (upstream) different from (but associated with) the one where SGAE was dominant downstream.

31. Finally, the CNMC is currently investigating a case¹⁴ concerning two possible abuses of SGAE's dominant position, following complaints from two competitors. The alleged anticompetitive conducts would concern the design and application of averaged availability tariffs (unrelated to the actual use of the repertoire) in the television and radio markets, as well as licensing its repertoire to users pretending that it is universal. The final decision should be adopted and made public in 2024.

3.2. Railway sector

32. In 2017¹⁵ Renfe (the rail incumbent in Spain) and Deutsche Bahn (the rail incumbent in Germany and the second player in Spain at that time) were fined respectively €64.2 million and €10.5 million for their infringement of Article 1 of the Spanish Competition Act and Article 101 TFEU) by means of concerted practices, and, Renfe also infringed Article 2 of the Spanish Competition Act and Article 102 TFEU abusing its dominant position on the Spanish market for traction used in rail freight transport.

33. Such dominant position required the analysis of economic moats¹⁶ taking into account Renfe's market share, and other factors. Barriers to entry included the legal requirements to access the market (e.g. certification of locomotives and drivers), as well as economic factors such as fixed costs and scale economies; rental or maintenance costs of locomotives, staff training costs, etc. For Spain an additional issue is relevant in the analysis: the scarcity of locomotives adapted to the Iberian gauge (the gauge of railways in

¹¹ CNC (2009), *Report-on-the-Collective-Management-of-Intellectual-Property-Rights*. <https://www.cnmc.es/expedientes/e-2008-04>

¹²

<https://diariolaley.laleynext.es/content/Documento.aspx?params=H4sIAAAAAAAAAEAMtMSbHICjUwMLA0tLQwNDZUK0stKs7Mz7Mty0xPzStJbFz0ypd8pNDKgtSbdMSc4pT1RKtIvNzSktSQ4sybUOKSIMBn81aG0UAAAA=WKE>

¹³ Judgment of the Court (Fifth Chamber) of 14 November 1996, Tetra Pak International SA v Commission, C-333/94, ECLI:EU:C:1996:436. Judgment of the Court (First Chamber) of 17 February 2011, Konkurrensverket v TeliaSonera Sverige, C-52/09, AB. ECLI:EU:C:2011:83.

¹⁴ S/0641/18 DAMA-UNISON RIGHTS VS SGAE <https://www.cnmc.es/expedientes/s064118>

¹⁵ <https://www.cnmc.es/2017-03-06-la-cnmc-sanciona-renfe-deutsche-bahn-y-varias-empresas-ferroviarias-de-ambos-grupos-por>

¹⁶ Pages 39-40 and 64 of the decision <https://www.cnmc.es/expedientes/sdc051114>

Spain and Portugal, different from the rest of Europe). Finally, the sector exhibits network economies, e.g. cost optimization by having a wider presence across the national market.

34. In terms of entrenchment strategies, Renfe discriminated third operators requesting rail traction services (in particular, undertakings members of the railway association where most Renfe's competitors were present), compared to the commercial conditions offered to DEUTSCHE BAHN (for instance, in terms of price and the possibility to cancel any service without penalty). As a result of this commercial discrimination, third operators were limited in their ability to compete on the Spanish rail freight market without an objective justification.

35. The CNMC carried out dawn raids in October 2023 to investigate indicia of a possible breach of the 2017 Decision¹⁷.

3.3. Digital markets

36. The CNMC is currently conducting investigations concerning Booking.com¹⁸ and Google¹⁹ for possible abuses of dominant position (Article 102 TFEU and Article 2 of the Spanish Competition Act) and unfair acts (violations of the unfair competition act) that affect the public interest by distorting competition (Article 3 of the Spanish Competition Act)

37. The case "Booking.com" concerns alleged exclusionary and exploitative abuses of a dominant position on the provision of intermediation services to hotels by online travel agencies (OTAs) by imposing inequitable trading conditions on hotels and commercial policies on OTAs and other online sales channels that may have exclusionary effects, together with alleged abuses of hotels' economic dependence.

38. In the case "Google related rights", the CNMC is looking into a possible abuse of Google's alleged dominant position by imposing unfair commercial conditions on press publishers and news agencies regarding copyrighted content, eventually infringing also the intellectual property act and allegedly abusing their counterparties' economic dependence.

39. Economic moats are very relevant in digital markets since static scale economies, dynamic learning effects and multi-sidedness may be more present and more disruptive. In terms of entrenchment strategies, the relevance of ecosystems, big data and network effects poses additional challenges regarding theories of harm.

4. Main conclusions

40. The Spanish competition framework is flexible enough to address economic moats and entrenchment strategies even if there are not explicit mentions in national or EU law, case-law or reference guidelines. But the CNMC has been ready to apply this analytical toolkit in traditional sectors (such as intellectual property or railway) and is aware of the relevance of these concepts in digital markets (where it has two ongoing investigations).

¹⁷ <https://www.cnmc.es/prensa/inspeccion-sector-ferroviario-mercancias-20231027>

¹⁸ More information on this ongoing case can be found on the CNMC's website: [S/0005/21:BOOKING](https://www.cnmc.es/expedientes/s0005/21:BOOKING)

¹⁹ More information on this ongoing case can be found on the CNMC's website <https://www.cnmc.es/expedientes/s001322>.