CPI's Europe Column Presents:

Coercive mediation - why it is a way of life for bilateral monopolies in Russia?

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CPI COMPETITION POLICY INTERNATIONAL

March 2019

Introduction

The simple model of an abstract market, where only one buyer and one seller are present, considers the internal conflict of a bilateral monopoly. It is shown in this article how to solve the problem of confrontation between a monopolist and a monopsonist with the help of mediation, which is carried out by the antimonopoly body in Russia. A prospective option of such a procedure has been proposed, which will allow the parties to reach a mutually beneficial compromise and avoid sanctions for violating competition law, while the regulator would not only restore the balance of interests between market participants but also defend the public interest of the state and society.

The nature of conflict

During 2015-2018, in the Russian Federation, the Federal Antimonopoly Service ("FAS Russia") has been confronted with a number of cases related to conflicts between a monopolist and a monopsonist in the markets of metal, petrochemistry, coal and many others. The '90s economic reforms and the dismantling of the USSR led to a one-time establishment of enormous market concentration and predetermined a monopoly (or oligopoly) position for the overwhelming majority of large enterprises, passing the baton of a planned economy to big business, which today is the main engine of Russia's economic growth.

The seller's monopolistic position is a consequence of the high switching costs for the buyer. Restrictions on the substitutability of goods create negotiating advantages for the seller. Conversely, if the buyer has a monopsony position, he will have a stronger position in the negotiations.

Bilateral monopoly is a market phenomenon. It consists in the fact that the seller and the buyer, on the one hand, have diametrically opposite interests, and on the other hand, they must achieve a balance of these interests. The monopsonist seeks to buy cheap, the monopolist seeks to sell expensive, but the key to successful business for both is reaching a balance of interests reflected in a "win-win" model. At the same time, as a rule, both the seller and the buyer are well aware of who they are dealing with, since they understand the economic and technological aspects of their own and others' business functioning.

Problems arise when neither the buyer nor the seller can determine the conditions of sale, including the price of goods and the volume of demand (supply), by standard market methods, and go beyond what is permissible. For example, instead of fair negotiation and exchanging draft contracts, the buyer and seller abuse their rights: they stop shipping goods, impose unprofitable and discriminatory conditions, send false information to each other, etc. This creates uncertainty and threatens the entire market.

The content of contracts between the seller and the buyer is determined by their ability to rationally negotiate a mutually beneficial agreement. Possessing market power, both seek to achieve such conditions under which everyone will have the maximum profit, but in essence, these are mutually exclusive goals. In addition, based on their significant market power, dominant firms are prone to abuse it in their own interests.

The conflict between the monopolist and monopsonist in the opportunistic phase threatens not only bilateral monopoly, but also society as a whole, because it leads to a decrease in public welfare and an imbalance in the adjacent commodity markets. For example, the conflict of a bilateral monopoly in the metal-roll market leads to a breakdown in the supply

of metal to other processing enterprises and so on the chain to the manufacturer of the final product - cars, medical equipment, food packaging etc. As can be seen, this is damage to both the businesses and the public. At this point, there is a public interest in the protection of public welfare through the mechanisms of antitrust regulation.

Both sides at the stage of local war often cannot return to the rationality or do it only when they realize that conflict requires too many different expenses from them. A striking example of such a local war can serve the conflict in Pikalevo (industrial site for the production of alumina near St. Petersburg, Russia) in 2009 between Basic Element Ltd. (it was known as Siberian Aluminum until 2001, Oleg Deripaska is its beneficiary) and PhosAgro Plc.. PhosAgro Plc. traditionally supplied Basic Element with nepheline concentrate, from which then alumina is produced. The price of the nepheline concentrate has become a stumbling block. The owners of the plants could not agree on the purchase prices for raw materials. This led to massive workers cuts and plant shutdowns. More than 20% of Pikalyovo citizens were left without work. In despair, they blocked the federal highway. Only Vladimir Putin was able to solve the problem of Pikalevo – only after his personal intervention, the Basic Element Ltd. and PhosAgro Plc. agreed on a compromise price.

Ordinary civil dispute between the dominant monopolist and monopsonist can not be resolved in all cases using standard tools provided for by the current regulatory framework. This pushes both sides to go beyond the legal field.

Often, submitting a complaint to the Russian anti-monopoly body against the actions of the opponent in a bilateral monopoly suggests that the parties have finally exhausted their opportunities to reach an agreement.

However, is the state entitled to withdraw from the moderation of the monopoly – monopsony connection, in fact sacrificing the public interest in favor of the private one? After all, the antimonopoly authority does not fulfill the functions of a court and does not resolve disputes about the law, but protects the public interest and public welfare. The main task of the FAS Russia in matters relating to bilateral monopolies is to establish a balance of private interests between dominant firms and to observe the public interest of the state and society. The outcome of the proceedings should be a decision of the antimonopoly authority, which will restore the balance of the market and level the monopoly and monopsonist market power, as well as assess how much the parties have abused their dominant position and have gone beyond what is acceptable from the point of view of competition law.

Regulator Tasks

The task of the state in this case is to apply all means of administrative pressure on the parties in order to force them to come to a mutually beneficial position. Such mutually beneficial conditions most closely match the public interest, as they allow the market forces to balance in a bilateral monopoly, a result that will contribute to safeguarding public welfare.

The decision of the antimonopoly service should contribute to leveling the market situation and eliminate the imbalance in the degree of influence on the market of each of the parties. Being “above the fray”, the regulator by the threat of fines[2] pushes the conflict participants to come to a compromise on their own. And when an agreement on all the essential terms of the transaction has been reached, it is being tested as to how it will affect social welfare. And if the transaction does not meet the interests of society, the antimonopoly authority should

have the right to adjust the monopolist and monopsonist relations so that the balance is not upset and the public interest is satisfied.

The problem can also be considered in the context of the theory of transaction costs, given the existence of external effects from the failure to achieve an optimal solution in the market for a bilateral monopoly both up and down the value chain. From this point of view, the intervention of the antimonopoly authority is one of the structural alternatives to internalizing external effects by creating incentives to develop a hybrid mechanism for managing transactions between the parties of a relationship characterized by very high switching costs.

Such a mechanism for resolving cases before antitrust authorities has all the features of mediation procedures.

The Latin *mediare* is translated as "to mediate". In this case, it is the mediation of the relevant administrative authority, as a result of which the monopolist and monopsonist independently come to a mutually beneficial solution. The fundamental difference between this procedure and conventional mediation lies in the fact that the state represented by the FAS Russia acts as an interested person with an independent position, and also has the opportunity to apply sanction methods of influencing the parties, indirectly "forcing" them to reach an agreement.

What the settlement mechanism should be

The monopolist and monopsonist relationships can be successfully described through a theoretical model of the transaction ("transaction") proposed by the American economist J. R. Commons.

Theory includes three elements:

- opposition between the interests of the parties to the transaction (conflict);
- identification of mutual dependence or interconnection of interests of the parties to the conflict;
- ordering interests and the end of the conflict (the conclusion of the transaction).

Commons identified three types of transactions. **A trade transaction** implies an equal legal status of its parties; the exchange of property rights is based on the voluntary agreement of the participants. **A management transaction** suggests the advantage of one of the counterparties with the right to administer and make management decisions. The structures used are characterized by a clear hierarchy: supervisor above worker, master above apprentice, etc. **The normalizing transaction** also implies the asymmetry of the legal status of the participants, and the exclusive authority of the state to administer the property. Examples of its functioning are the fiscal system or decisions of courts and government agencies that redistribute benefits from one participant in economic relations to another. In the case of bilateral monopolies, the normalizing transaction will be an agreement between monopolist and monopsonist through the mechanism of forced mediation implemented by anti-monopoly authorities.

Practical understanding and implementation of this triad can serve as a key to the solution of the question about what mechanism to use for forcing a bilateral monopoly to balance.

Bringing a monopolist and monopsonist to agreement and balance will be supported by the possibility of:

- resumption of the case regarding the violation of antitrust laws without a guarantee that the actions and behavior of the applicant in the case will remain without a proper assessment in the event that an agreement has not been reached (with the consequence of multi-million fines);
- the antimonopoly authority making such decision that does not satisfy either the monopolist or the monopsonist but suits the FAS Russia.

Thus, each of the parties will understand that regardless of who filed a complaint with the anti-monopoly authority first, its actions can also be assessed in terms of compliance with the Law on Protection of Competition and sanctions can be applied to it. In addition, they will not be interested to leave the dialogue either with each other or with the regulator but rather to behave rationally and constructively. The last word will still remain to the state and how the FAS Russia evaluates their behavior in the negotiations will depend on whether they will work with a mutually beneficial business model that is consistent with each other or the business model will be dictated to them by the FAS Russia on behalf of the state.

The most important element of the mediation procedure is comprehension of the conflict between the interests of the monopolist and the monopsonist, and also their interconnection. **This paradox must be understood by the seller, the buyer and the regulator.**

The mediation procedure should be brief, so as to reduce transaction costs to a minimum, as well as serve as an additional incentive to conduct the most effective and constructive negotiations.

The term “compulsory mediation”, itself may seem an oxymoron, since any enforcement does not fit into the concept of mediation. But what if the destructive behavior of the two major economic agents threatens social wealth, they do not want to enter into negotiations, and mediation is the most rational way to resolve the conflict?

An interesting experience from the United States and Europe, where widely used, is the Med-Arb procedure (a hybrid of mediation and arbitration): the parties try to resolve the conflict through the mediation, and then, if this does not lead to the desired results for all, they proceed to arbitration. For a monopolist and monopsonist in Russia the antitrust authority will be such an arbitrator with punitive powers.

Mixing styles and forms is also permissible in the field of antitrust regulation. The solution to the paradox of a bilateral monopoly is possible only through the hybridization of imperative and dispositive procedures. In other words, in the Law on Protection of Competition it is necessary to provide a specific procedure for dealing with bilateral monopolies, which would allow not only to remedy violations and punish them, but to restore market balance with minimal administrative and management costs.

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[2] Penalties as a percentage of revenue