Economics and the enforcement of exclusionary abuses (The EC's Draft Guidelines on Art. 102)

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A necessary foreword

Disclosure

- I have served as Chief Competition Economist at the EC, 2013-2016 – and in that capacity worked on several abuse cases
- In the last twenty years, I have advised several competition and regulatory agencies, never defendants, on exclusionary abuse cases

Acknowledgments

- This presentation builds on works and reflections with Chiara Fumagalli, esp.:
  a) "The use of economics in the enforcement of abuse of dominance provisions" *Journal of Competition Law & Economics*, March 2024, 10.1093.
  b) *Exclusionary practices. The Economics of Monopolisation and Abuse of Dominance* (also with Claudio Calcagno), Cambridge University Press, 2018
  c) In these works you will find all references that I omit in these slides

- Thanks also to Pinar Akman and Giulio Federico (without implicating them, of course)

Outline

1. **The Draft Guidelines, in a nutshell**
2. **General principles**
    a) The objective of enforcement
    b) The definition of abuse
3. **Predation, rebates and exclusive contracts**
    a) Rebuttable presumptions for conduct which reference rivals
    b) Predation, and the role of the As-Efficient Competitor (AEC) test
    c) Safe harbours, and the as-efficient competitor principle
4. **Tying and bundling**
5. **Vertical foreclosure** (outright refusal to supply, margin squeeze, self-preferencing…)
    a) Back to a form-based approach?
    b) On the indispensability condition

The Draft Guidelines, in a nutshell

- Definition Exclusionary abuse refers to dominant firm's conduct that:
  1. departs from *competition on the merits* and
  2. is capable of having exclusionary effects
  - ➢ 1. is unclear concept; 2. not 'effects on consumers' (or 'anti-competitive effects')
- Aims Enhance legal certainty, help firms self-assess, guide NCAs and National Courts
  - ➢ Too much discretion, little guidance, no safe harbours
- Basis Case law of the EU Courts
  - ➢ Selective interpretation of case law? (Where is the as-efficient competitor principle…?)
  - ➢ Little economics: abandonment of concepts of theory of harm and anti-competitive foreclosure; few references to economic principles and theories; practices with similar effects treated differently: back to a form-based approach?
- Role of presumptions Three categories with different 'levels' of presumption → *next slide*
  - ➢ Helpful, but: (i) some presumptions not grounded in economics; (ii) clarify they really are rebuttable (iii) will the Courts accept a *de facto* reversal of burden of proof?

Categorisation of exclusionary abuses

	Type of conduct	Presumption of exclusionary effects	Need to demonstrate exclusionary effects	Does it amount to competition on the merits?
Specific legal test	**Naked restrictions**	✓ ✓		No
	Exclusive dealing (including exclusivity rebates)	✓		No
	Predatory pricing	✓		No
	Some tying (*Hilti, Tetrapak*?)	✓		No
	Other tying (*Microsoft, Android*?)		✓	No
	Margin squeeze (negative spread: $p<w$)	✓		No
	Margin squeeze (positive spread: $p-w<c$)		✓	No
	Refusal to deal		✓	No
No specific test	**Other access restrictions**		✓	To be assessed
	Conditional rebates (other than exclusivity rebates)		✓	To be assessed
	Self-preferencing		✓	To be assessed

General Principles

Objective of enforcement

- In line with EU competition law, it should be **consumer welfare**.
  - Interpreted broadly (i.e., including innovation, quality, variety, etc.)
  - Forward-looking perspective
  - Balance of harm approach

➢ In the DG, the concept is largely ignored (exceptions: paragraphs 5 and 51)

Definition of abuse

«Lack of competition on the merits»: what does it mean?

- **A conduct that involves sacrifice of profits?**
  - Economic theory shows that there are anti-competitive practices that do not involve profit sacrifice
- **A conduct that does not make sense taking as given the existence of competitors?**
  - Some practices are detrimental to consumers without aiming at excluding rivals (foreclosure being a side-product).
- **Absence of a «level playing field»?**
  - AA cannot intervene whenever there exist asymmetries.
- **A conduct that «automatically» excludes rivals?**
  - But what if it generates efficiency gains and benefits consumers?

«Capability of producing exclusionary effects»

- Ok for *capability* rather than *actual* effects
- For the conduct to be abusive, effects should be assessed on *consumer welfare*, *not on rivals*.
- Effects should be **appreciable** (DG say no need – but this contradicts case-law, esp. on exclusivities)

Practices:
exclusive dealing, rebates, predation

Exclusive dealing and 'exclusivity rebates'

- Contracts and rebates **conditional on buyers purchasing a large proportion** of their needs (**practices that reference rivals**) from the dominant firm have a strong anti-competitive potential
  - Exclusive dealing contracts and market share contracts allow a dominant firm to exploit a **first-mover** advantage and deter entry.
  - Practices that reference rivals can manipulate the buyer-rival relationship, allowing the dominant firm to extract rents from rivals → foreclosure due to uncertainty.
  - Practices that reference rivals can be used by a dominant firm to generate a demand-boosting effect and raise its prices → foreclosure is a side-effect.
  - ➢ **Price-cost tests do not help assess these practices** (they do not involve profit sacrifice, or high prices might be their goal)

- In some particular cases they might exert beneficial effects on consumers
  - by promoting relation-specific investments (or by intensifying competition, if not much asymmetry)

➢ **Sensible to establish a rebuttable presumption**: abusive unless the dominant firm proves otherwise.

➢ The standard of proof for rebuttal should be higher the stronger the extent of dominance.

Predation and the role of price-cost tests

- **Price-cost tests are informative evidence for predation and rebate schemes that do not reference rivals** (selective price cuts, quantity rebates, etc.).
- The test should complement a *theory of harm*: a well-specified mechanism that rationalises the incentive to exclude and is consistent with the facts of the case.
- In line with the current case-law approach, for *predation*:
  - prices > LRAIC/ATC: lawful
  - prices< AAC/AVC: strong presumption of abuse
  - In between: abuse if evidence of intent (supporting the theory of harm!)
- *Selective price cuts and quantity rebates* allow the dominant firm to target aggressive price offers to specific customers or specific portion of customers' demand to facilitate exclusion
  - Evidence that the price *averaged across all customers or all units* purchased by a given customer is above costs does not allow us to conclude a lack of abuse!
  - When rebates are *retroactive*, the discounted price to compare with costs requires an estimation of the *contestable* part of the demand.

On the price-cost (or as-efficient competitor) test

- In some economic theories there might be predation even at above-cost prices: there is still profit sacrifice, but with respect to a hypothetical counterfactual
  - Estimating *actual* costs and prices help administrablity
  - Prices below costs are an administrable proxy of profit sacrifice (not a replicability test).
  - **A safe harbour for prices above costs avoids the risk of chilling legitimate competition,**
  - **It would be in line with the as-efficient competitor principle stressed by the EU Courts**
  - ➢ *Why does the DG consider that above-cost pricing may be abusive?*

- This interpretation of the price-cost test:
  - **Guarantees legal certainty** (it is based on information available to the dominant firm).
  - **The actual efficiency of the rival is irrelevant** (the EC should not be required to prove the rival is as-efficient!).

Practices:
tying and bundling

Tying

- A growing literature points to the anti-competitive effects of tying:
    - To **exclude** (partially or totally) rivals from the tied market and possibly from the tying market
        - Imperfect rent extraction
        - Scale economies in the tied market
        - Commitment to aggressive behaviour in case of entry
    - To **increase prices** in the tied market (softening of competition)

- However, tying is also a way through which firms innovate and produce significant improvements for consumers.

➢ I am not persuaded that tying should be subject to a rebuttable presumption of harm

➢ Unclear from the DG under what circumstances tying would be presumed to be abusive

Practices: vertical foreclosure

Back to a form-based approach?

- An integrated firm might resort to different practices that are to some extent substitutable and might foreclose (totally or partially) access
  - Outright refusal to supply
  - Degradation of access, or other forms of partial foreclosure
  - Margin squeeze
  - Tying of vertically-related goods
  - Self-preferencing…
- However, the DG put some of these practices (sometimes even the same type of conduct, e.g., tying or margin squeeze) in different baskets, despite having similar effects.
- The *2008 Guidance Paper* (and the move towards an *effects-based approach*, never really endorsed and adopted by the Commission) was motivated by the dissatisfaction with the inconsistencies created by the form-based approach.

➢ *Back to square one?*

Indispensability

- The economic literature does not show that indispensability of the input is a necessary condition for a dominant firm to engage in vertical foreclosure
- Therefore,
  - For *any* vertical foreclosure conduct, the input at issue should be a crucial asset but not an *indispensable* one (within the *Bronner* meaning)
  - The case-law requires indispensability for outright refusal to deal, but not for margin squeeze, self-preferencing, or cases where the dominant firm has already given access (even partial)
    - Protection of property rights of the dominant firm
    - Avoid the disincentive effect that may result from giving access to rivals
  - ➢ This may also discourage dominant firms from giving access in the first place
  - The DG accept this inconsistency (admittedly, little chance that the Courts might follow)
  - But perhaps the Courts themselves will expand the range of vertical foreclosure conduct for which there is no requirement of indispensability

  → watch out for the preliminary ruling on Android Auto (*Google v EnelX*)

Draft Guidelines: Suggestions for improvement

- Define competition *off* the merits as conduct which harms consumer welfare, or clarify that 'capable of exclusionary effects' refer to consumers, not only rivals
  → operational meaning to the concept (= anti-competitive foreclosure)
  → more aligned to an effects-based approach (and sound economics)
- Provide more guidance and enhance legal certainty
  - Specify practices are to be assessed for effects on consumers (AEC principle)
  - Provide clear examples of abusive conduct and of efficiencies to be accepted
  - Give safe harbours (e.g., price-above LRIC/ATC not a problem)
- Acknowledge the importance of theories of harm
- Role of presumptions
  - Good for some conduct, where justified by sound economics
  - Stress presumptions are rebuttable
  - For the Courts to accept a reversal of burden of proof, economics might help

THANKS FOR YOUR ATTENTION!