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Conference on Pricing Abuses in the new EC Guidance on Article 82

"What does it change for Conditional Rebates and Predatory Prices?"

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Keynote Speaker

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Panel Members

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Panel 1
– Some Comments on the Art. 82 Guidance's treatment of Predation

After a short introduction by the moderator, the panelists were asked to individually present their views on the treatment of Predation by the Art. 82 Guidance.[1]

As a starting point, the moderator referred to the *France Télécom*[2] judgment of the European Court of Justice in which it was made clear that recoupment was not a necessary condition to prove predation. He further stated that it was unfortunate the ECJ did not take the opportunity to answer a couple of important questions, namely:

- what happens in the event that the incumbent can prove that recoupment is not possible; and
- what happens if the incumbent aligns its prices to those of his competitors.

From an economist's perspective, three conditions need to be fulfilled for a finding of predation. First, the firm must be dominant. Paragraph 14 of the Guidance paper adopts a market share threshold of at least 40 % for a finding of dominance. The speaker underlined the fact that this deviation from the 25% threshold proposed in the Discussion Paper constitutes a significant improvement in the position of the Commission which should be welcomed. Although there might be some cases where market power already arises in the case of low market share levels, the total number of such cases can be said to be small. Therefore, a higher threshold considerably reduces the danger of legal uncertainty. This is particularly true given the problems of market definition in dominance cases.

Second, the predating firm must have engaged in profit sacrifice. The panel member briefly explained that average avoidable cost ("AAC") is the cost benchmark used to determine whether or not conduct leads to profit sacrifice and long run average incremental cost ("LRAIC") is used to assess whether an as efficient competitor could be foreclosed. Although AAC is a suitable cost benchmark and is to be preferred to Average Variable Cost (because "AVC" does not distinguish between common costs, and variable / fixed costs), in order to avoid risks of prosecution, it would seem that dominant firms are required to price above LRAIC. According to the panel member the new LRAIC R average total cost ("ATC") test should be welcomed because it does not include common costs. All other foreseeable solutions would have been arbitrary.

The third and final criterion is that the conduct must be likely to result in consumer harm. The panelist noted that paragraph 6 of the Guidance introduces a very interesting distinction between foreclosure and anticompetitive foreclosure. The "as efficient competitor test" in paragraph 22 deserves full support as this is a good benchmark to distinguish between harm to competitors that arises from competition on the merits and from anti-competitive foreclosure. Therefore, this test reduces uncertainty for dominant firms, since the test is based on its own costs and prices.

1 Guidance of the Commission's Enforcement Priorities in applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, C(2009) 864 final, 9 February 2009.
2 Case C-202/07 P, *France Telecom v Commission*, 2 April 2009.

Unfortunately, however, it seems that the "as efficient competitor test" in paragraph 22 of the Guidance is undermined in the following paragraph. This is highly unsatisfactory as it decreases the level of legal certainty.

Although the affirmation that the key objective of the Guidance is to "protect competition, not competitors" should be appreciated, and it should be recognized that the Guidance moves away from *form-based rules*, signaling a departure from legal precedents, it should nonetheless be noted that the Guidance leaves too many caveats and too much discretion to the European Commission. In support of his point of view, another panel member referred to some concrete examples:

Firstly, dominance can also be found under a 40% market share threshold. Secondly, footnote 18 in the Guidance states that, contrary to the principle set out in paragraph 26, there might be certain cases where common costs may nevertheless be taken into account. By opening the door to this possibility, advising in this field becomes a very complicated task for legal and economic professionals, creating further legal uncertainty. Thirdly, the Guidance raises considerable questions when in paragraph 23 it states that inefficient competitors may have to be protected. Finally, in paragraph 64, the Commission reserves the possibility that even if pricing is above AAC, there may be profit sacrifice.

In conclusion, the Guidance paper does not significantly reduce uncertainty in the assessment of predation and other abusive practices. Underlined by a virtual/notional example, a panel member demonstrated that the Guidance does not eliminate the risk that legitimate pricing policies could be deemed anti-competitive. There is enough room for the Commission to capture conduct which in principle should be permissible.

Another panel member first stated that from his point of view, the Guidance paper has been carefully written, but in order to understand it fully one must read between the lines. He noted that there are no rules concerning the burden of proof in the Guidance, making it very difficult for companies and their advisors to defend a case.

He then turned the attention of the audience to the recent *Glaxo* case brought by the French competition authority.[3] He underlined than these cases concerning predation are very rare. An important question that arises in connection with predation cases is whether they should be assessed *ex ante*, because there is always the possibility that predation fails, for example because a competition authority has intervened. In his view, there are three lessons to be learnt from the outcome of the French *Glaxo* case: first, recoupment can in principle happen on a market other than the one where the practices took place; second, it may prove difficult to counter the defendants' claim that recoupment was unlikely; and third, in this respect, there is no good substitute for hard evidence.

3 Décision no 07-D-09 du 14 mars 2007 relative à des pratiques mises en oeuvre par le laboratoire GlaxoSmithKline France

An EU Member State competition authority official expressed the view that there is a link between market power and predation, but stressed that this link is not an automatic one. He added that, in his view, proving that no recoupment is possible is both more important and harder to do than proving market power.

On the question of consumer harm, an economist noted that the issue with the Guidance is that although it sets out many principles, at the same time it invariably leaves room for interpretation and exceptions.

From the perspective of a national competition authority, reference was made to the fact that, on the one hand, competition authorities are often accused that by fighting against predation they deprive consumers of lower prices. On the other hand, one of the main concerns of competition authorities is the creation of "false negatives". Additionally, in his view, an authority loses predictability if it does not fight against predation. From this perspective the Guidance did a good job by striking an appropriate balance to reach both goals.

Concerning the cost benchmarks proposed by the Guidance paper, it was stated that some national competition authorities observed that his authority agrees with these benchmarks because they define what is meant by sacrifice. Nevertheless, it should be questioned if competition authorities have the duty, in finding the appropriate counterfactual, to examine every possible alternative. There are national competition authorities which clearly take the view that they are not obliged to examine every possible alternative.

Concerning margin squeeze, one of the panelists pointed to the interesting fact that there are considerable differences between the approach to margin squeeze in the EU and in the US. The US Supreme Court has taken the view that margin squeeze has no basis in competition law, suggesting that it is a question of regulation. Therefore, the US is one of the rare jurisdictions without margin squeeze. A possible explanation for this fundamental divergence might be the fact that in the EU, a considerable amount of markets are still in the process of deregulation. Therefore, if margin squeeze could not be found to be anticompetitive, the goals of deregulation would be frustrated.

As a conclusion, each of the panel members presented their personal impression on the debate, focusing particularly on how the Guidance helps advisors and companies deal with predation. A panel member concluded that a certain number of trade-offs which are embodied in the Guidance are inevitable in the drafting of such a document and that the Guidance can be seen as a consistent and reasonable paper overall. Another panel member underlined again that although it is necessary to read between the lines in order to understand all the principles in the Guidance, in general it offers a positive and reasonable assessment. A third member of the panel agreed with the main principles, but felt the need to criticize the fact that there are many caveats and exceptions to the rules.

Panel 2 – Some Comments on the Article 82 Guidance's treatment of single-product conditional rebates

This panel was opened by the moderator by addressing the following question to a panel member with an economic background:

"Does the quantitative test in the Guidance document for retro-active rebates match the tests identified in previous Commission Decisions and Court Cases?"

From an economist's point of view, although the Guidance paper departs from the traditional form-based view on rebates, it nevertheless fails to propose a sound economic approach. It has to be noted as an advantage that the Guidance treats single-product conditional rebates under exclusive dealing. Furthermore, its focus on price-cost comparison and anticompetitive foreclosure as opposed to the suction effect is to be welcomed. However, there are also negative aspects, such as the fact that there is no guidance on how to compute the contestable share for the price-cost comparison of retroactive rebates. This is due to the fact that the effective price varies within the relevant range. Given the uncertainty regarding how to calculate the relevant range, it would be desirable for the Commission to improve this test in the future.

Additionally, there is no clear reference to economic theories of exclusive dealing, with price-cost comparisons seemingly not sufficient to prove consumer harm. The Guidance should therefore be seen as incomplete. To say that prices below AAC are always bad is an oversimplification. The Guidance is too brief and unclear on this point. The Commission should therefore have introduced criteria indicating the direction it plans to take in the future. The Commission did a commendable job on the vertical and horizontal Guidelines in this respect. It should be encouraged to replicate its efforts with regard to the application of Article 82 EC.

A further point which another panel member identified is that a rational customer will not want to lock itself into inefficient exclusive dealing. In general, customers understand any downsides of being locked-in and therefore will try to protect themselves against such an occurrence.

The second question was addressed to an official from DG Competition: "Noting that the subject of intermediation was present in the *BA*[4] and *Michelin*[5] cases, is intermediation important for the qualitative and quantitative assessment of conditional rebates?"

The panel member replied that the reason why intermediation is not mentioned in the Guidance is down to the fact that in *BA* and *Michelin* the rebates in question were part of very complex schemes. The Guidance, however, applies mainly to single-product rebate schemes. Furthermore, the main aim of the rebate schemes in *BA* and *Michelin*

4 Case C-95/04 P, *British Airways v Commission*, 15 March 2007.
5 Case T-203/01 P, *Michelin v Commission*, 30 September 2003.

was to attain a certain level of supply, an issue which is not addressed in the Guidance at all. BA and Michelin were in a strong dominant position, offering rebates over a long period of time which were far greater than those of their competitors. Intermediaries were selling at a loss but were able to re-establish their profit margin as soon as the dominant suppliers repaid the rebates. In these two cases, the fact that intermediation was present was determinant in the findings that the rebate schemes were unlawful: with intermediation, competitors were not able to offer the same rebates BA and Michelin were offering.

The moderator then asked the following question: "What particular challenges do you see in the Guidance's consideration of multi-product rebates?". From the perspective of an in-house competition counsel, it was first mentioned that multi-product rebates are a very common practice, which can, as a matter of principle, be pro- and anti-competitive. In most cases, offering only some of these products could never be competitive. It follows that for multi-product rebates to be illegal, four conditions must be fulfilled: first, dominance on a market; second, different products must be concerned; third, a foreclosure effect must be present; and fourth, no efficiencies should be present. In order to find mixed bundling unlawful, the Guidance proposes two main tests. The first test can be found in paragraphs 60. However, this test raises some, for example, difficulties because it addresses neither the question of the reasonable payback period, nor the complexity of applying the test to multi-product rebates.

The second test proposed by the Guidance can be found in Paragraph 61 read in conjunction with paragraph 54. In the panel member's view, this test is to be preferred to the first one. There are nonetheless difficulties regarding the interpretation of terms such as "identical". Products and bundles are never identical in practice in the purest sense of the word. Unfortunately, however, the Guidance does not address the important question of how to deal with situations in which the price of the bundle is above the price of competitors' bundles. In this case, there is simply no foreclosure. In addition, it is very difficult to prove efficiencies. The test in the Guidance is taken directly from Article 81(3) EC and is very difficult to apply. The panel member added that the evidential burden should fall on the European Commission as opposed to the dominant undertaking.

The next question sought the US perspective on the following question: "Do you consider the EU approach diverging or converging with the US approach?" In response, it was mentioned that the two approaches are directionally converging. Although there are still some differences, the overall evolution is very encouraging. A key divergence concerning rebates is on cost benchmarks: while the European Commission uses AVC, the trend in the US favours use of AAC. Furthermore, the US case law is still developing in certain fields. For example, concerning single product loyalty discounts: the state of the law is still unclear, with little case law to serve as guidance.

The next question was addressed to an in-house competition counsel: "Per the Guidance, identification of the contestable market share is key to rebates analysis. What practical use is such a concept for a corporation?"

In the opinion of the panel member, this concept does not have a useful practical meaning. It is even hard to explain where the concept comes from, and it can only be applied poorly and/or very rarely.

A further question was addressed to a panel member with an economic background: "The efficiencies defence is stated in the Guidance. Is this a realistic or a theoretical defence?"

The economist responded by stating that in general, the efficiency defence is a realistic one although it is not easy to reverse the burden of proof in practice. While the efficiency defence is mentioned, the Guidance's silence on intermediation is problematic. This problem should not be underestimated as intermediation almost always produces efficiencies.

The penultimate question related to the last paragraph of Damien Geradin's December 2008 paper entitled "A proposed test for separating pro-competitive conditional rebates from anti-competitive ones". Quoting the author, the moderator stated that "[t]he application of such effects-based tests, which are now applied by most of the world's leading competition authorities, require complex assessments and thus the investment of significant resources both for the competition authority which decides to investigate a given rebate scheme and for the dominant firm which is investigated. Because resources are generally scarce, competition authorities should not initiate investigations into conditional rebates lightly". He then asked whether it is feasible for a corporation that is not being investigated to devote the resources necessary to determine with sufficient comfort that the corporation's rebates scheme is not abusive, addressing the question to the two in-house competition counsel present on the panel. The panel members stated that the devotion of such resources is not possible and often does not lead to concrete determinations. Companies price all the time, and it is impossible to check all the rebates all of the time as they simply lack the resources to do so. Not only is it expensive, but also time consuming and not realistic. Only few price offers require deeper analysis.

The final question of the conference was: "In the US there seem to be safe harbours for rebates, although this is not the case for every area of US antitrust law. Why do the authorities consider safe harbours appropriate or necessary for rebates?"

A panel member with significant US experience responded that safe harbours have been viewed as particularly important where the type of conduct at issue is likely to have pro-competitive benefits that could be chilled by the threat of antitrust condemnation. He also noted that for many firms the definition of dominance may offer more promise of providing certainty than the creation of safe harbours.

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