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RBB response to the EC's updated Article 102 TFEU Guidance and Policy Brief

RBB Economics, 24 April 2023

1 Introduction

1 The 2008 Guidance paper on enforcement priorities ("**the Guidance**") served an important purpose.[1] It signalled the European Commission's ("**the Commission**") intent to pursue a "*more economic approach*" to Article 102 TFEU enforcement. The Commission has recently updated this Guidance in light of subsequent case law.[2] It has also instigated a Call for Evidence, which will lead to the adoption of Guidelines on exclusionary abuses ("**the Forthcoming Guidelines**"), which will replace the Guidance. The Commission has additionally published a Policy Brief ("**the Policy Brief**"), explaining the background to these initiatives.[3] This note provides our comments on these developments.

2 Our main point in response to this call for evidence is as follows. Whilst we welcome the Commission's desire to maintain an effects-based approach, the "*dynamic and workable effects-based approach*" set out in the Policy Brief does not currently meet that objective due to the watering down of certain effects-based principles.

3 To address this, we believe that the Forthcoming Guidelines should make clear that the Commission will primarily pursue cases where harmful effects are most likely to arise, and, relatedly, set out not only where intervention is possible, but also where it is *most likely* to occur and where intervention is *unlikely to be warranted*.[4] This would reduce the risk that

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1 *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, OJ C 45, 24.02.2009, pp. 7-20. This version will be referred to as "**the original Guidance**".

2 The revised version of the Guidance ("**the revised Guidance**"), highlighting updates to the original Guidance, is accessible at "https://competition-policy.ec.europa.eu/system/files/2023-03/guidance_paper_article_102_redline_post_amending_communication.pdf".

3 *A dynamic and workable effects-based approach to Article 102 TFEU*, DG COMP Competition Policy Brief, March 2023. Accessible at: "https://competition-policy.ec.europa.eu/system/files/2023-03/kdak23001enn_competition_policy_brief_1_2023_Article102_0.pdf".

4 For example, whilst we agree that intervention to protect less efficient competitors can be warranted to protect consumer interests in specific circumstances, protecting such competitors can also harm consumers by deterring procompetitive behaviour by both dominant firms and their rivals. We therefore urge the Commission to set out clearly

dominant firms (and firms without substantial market power that fear being found to be dominant) refrain from procompetitive behaviour.

4 We explain these views in the remainder of this note.

- **Section 2** provides our definition of a true effects-based approach and why adhering to it matters from a policy perspective.
- **Section 3** discusses the importance of retaining the as efficient competitor *principle* ("**the AEC principle**") and warns that a "not-(yet)-AEC" standard should be applied only in clearly defined special cases.
- **Section 4** sets out why the price-cost test ("**the AEC test**") associated with the AEC principle remains valuable and urges the Commission not to downplay its importance in its Forthcoming Guidelines.
- **Section 5** explains how the Policy Brief advocates an inconsistent approach to the application of the Bronner Criteria in access cases, notably as regards the indispensability criterion (which relates to what we shall call the "**limited duty to supply principle**").
- **Section 6** concludes.

2 A true effects-based approach

5 In our view, a true effects-based approach to the assessment of exclusionary behaviour means the following.[5]

- Assessing conduct according to its (likely) effects on competition, and ultimately consumers, as opposed to its form.
- Adopting a consistent approach to the meaning and assessment of anti-competitive foreclosure, namely one based on coherent economic theories of harm to competition and consumers that are supported by facts and empirical evidence.
- Acknowledging that many commercial practices that potentially have exclusionary effects also have efficiency-enhancing properties or direct benefits for consumers, even when undertaken by dominant firms.
- Giving the same weight to evidence on the beneficial features of any conduct under investigation as is given to its potential negative effects, not least because these effects often have the same source.[6]

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the limited cases where protecting less efficient competitors is worthwhile and, crucially, the more common scenarios where it is inappropriate.

[5] See also *Selective Price Cuts and Fidelity Rebates*, Economic Discussion Paper, an RBB report prepared for the Office of Fair Trading, 2005.

[6] For example, even a predatory price benefits consumers over some time horizon. Indeed, the potentially abusive practice in a predatory pricing claim boils down to a price reduction, which generates an immediate (short-term) benefit for consumers that is hard to distinguish from procompetitive behaviour. Paradoxically, predation cases tend to focus

- Intervening only when there is compelling evidence that harmful effects are likely to outweigh beneficial outcomes arising from the impugned conduct.

6 The above provides an overall framework for assessing claims of abuse. It can be summarised as saying that intervention should take place only when a coherent, fact-based theory of harm demonstrates that harmful effects are more likely than not.

7 We acknowledge that legal judgments do not always align with the preceding effects-based approach and that the Forthcoming Guidelines must reflect the state of the law. Nonetheless, the Commission has discretion in respect of which cases it takes forward and, in our view, a commitment to pursuing cases where harmful outcomes for consumers are *likely* (as opposed to merely capable of arising) makes good sense from a policy perspective. It may also serve to influence courts (which from time to time refer to Guidelines) to adopt a more effects-based approach when making future judgments that clarify the law.

8 Therefore, whilst we appreciate that the Forthcoming Guidelines will explain where the Commission *can* intervene, we urge the Commission also to clarify the circumstances where harmful exclusionary effects are most likely to dominate any beneficial effects, and hence where intervention is most likely.[7] We also encourage the Commission to explain where intervention is less likely or even unwarranted. This would not only provide valuable guidance to firms seeking to self-assess whether their practices comply with competition law but, more importantly, reduce the risk that procompetitive behaviour is deterred.

9 Moreover, we consider it essential to maintain the integrity of critical safeguards, namely the AEC principle, the AEC test, and the limited duty to supply principle that assist in aligning enforcement with an effects-based approach. We discuss our concerns in relation to each of these safeguards below.

3 Safeguard the AEC *principle*

10 The original Guidance set out that *"the Commission will normally only intervene where the conduct concerned has already been or is capable of harming competition from competitors which are considered to be* ***as efficient as*** *the dominant undertaking*".[8] We refer to this as the AEC *principle* described above. Meanwhile, the AEC *test* refers to the quantitative application of the AEC principle to pricing abuses.

11 The AEC principle is one part of an effects-based framework. It seeks to balance the risks of over- and underenforcement by interpreting competitive harm to be that which excludes competitors as efficient as the dominant firm. It encompasses the idea that competition is a process that selects the most efficient firms and that such firms are the most effective

on how low the price is relative to some benchmark as opposed to what really matters, namely whether, as a result of the low price, there will be long-term detriment to consumers, once rivals have been excluded.

7 We provide specific examples of where such clarity would be welcomed below, focussing on the issues discussed in the Policy Brief.

8 Original Guidance, para. 23 (emphasis added).

competitors (and hence most worthy of protection under competition law). The AEC principle aims to foster innovation and efficiency, whilst focussing enforcement on conduct most likely to give rise to consumer harm.

12 We welcome the fact that the revised Guidance retains the main elements of the AEC principle. We note, however, that the Policy Brief highlights conduct which may lead to the potential foreclosure of "not-yet" AECs.[9] Whilst we acknowledge this possibility, in our view (as we explain below) there are only limited circumstances in which the exclusion of a competitor less efficient than the dominant firm would harm consumers. It is therefore important that the Forthcoming Guidelines make this clear, so as to "ringfence" the use of the not-(yet)-AEC standard and to avoid the unintended consequence that procompetitive conduct is deterred and hence consumer welfare harmed.[10]

13 For instance, competition from a less efficient competitor can be worth protecting where there is compelling evidence that (if not foreclosed) the rival in question is *uniquely* well-placed on a timely basis: (i) to become *as* or *more* efficient than the dominant firm; or (ii) to constrain the dominant firm (even if the rival would remain less efficient) so as to deliver better outcomes for consumers, notably via lower prices or increased innovation.[11]

14 We emphasise that scenarios (i) and/or (ii) should not be claimed lightly. Indeed, to justify intervention, they require considerable evidential support and an assessment of whether such intervention would create adverse precedent that might give rise to perverse pricing outcomes or harm future innovation.[12] Moreover, they are not sufficient to justify recourse to the not-(yet)-AEC standard. *Additionally*, the Commission should have to demonstrate that the impugned conduct is the *cause* of harm to competition and consumers because it, as opposed to one or more structural obstacles to expansion, is responsible for the lack of development of the not-(yet)-AEC. Furthermore, because harm to a less efficient rival may arise from a dominant firm passing on the benefits of its lower costs or greater quality, intervention must be grounded in firm evidence that any such benefits are clearly outweighed by harm arising from the impact on the not-(yet)-AEC's future ability to expand and constrain the dominant firm further.

15 Such ringfencing of the not-(yet)-AEC standard is important. Without it, perverse outcomes may arise where, for example, dominant firms are deterred from cutting prices even where those prices would be substantially above cost and not-(yet)-AECs seek competition law protection as a substitute for improving their own levels of efficiency.

16 Consider a dominant firm seeking to set a low price (albeit one above its own costs) to prevent losing volumes to rivals. Absent clear guidance on when intervention to protect less efficient firms would take place, the dominant firm would face antitrust risk if it priced below

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9 Original Guidance, paragraph 24.

10 In a regulated industry, for example, intervention may be warranted to protect less efficient competitors where a regulator has an objective to promote competition. If so, precedent from intervention can be ringfenced by a clear statement that intervention relates to this particular regulatory objective and so is industry specific.

11 We refer to uniqueness because, if the conduct forecloses one not-(yet)-AEC but leaves others unimpaired, the competitive process is not likely to be diminished, and it is unnecessary to risk the harms that come with moving away from the AEC principle.

12 See paragraph 15 et seq. for some examples of adverse precedent that may be created.

the cost of an (unspecified) set of less efficient rivals. Not only does this make compliance difficult (since a dominant firm should not know its rivals' costs), it also limits the scope of such firms to implement rational price reductions in response to competition or customers' demands.[13] This cannot be the intention of competition law.

17 Importantly, the same would apply for non-dominant firms that fear being found to be dominant. Such firms do not have substantial market power but would nonetheless be deterred from competing effectively. Again, this cannot be the intention of competition law.

18 Further, if less efficient competitors understand that dominant firm pricing will be benchmarked against their own costs (as opposed to the dominant firm's own costs), they have a reduced incentive to pursue efficiency. That is, an increase in their own costs would make it more likely that competition law thresholds would be breached by the dominant firm (potentially requiring it to increase its prices to avoid claims of predation). Put differently, rather than investing in lower costs and passing-on lower prices to gain volumes vis-à-vis the dominant firm, rivals could keep their costs high so that the dominant firm must increase its price to reduce the risk of intervention. Such an outcome would be perverse.

19 In our view, significant further clarity is required to avoid these unintended consequences. The Commission should identify precisely in which circumstances it will look to protect not-(yet)-AECs. This clarification should go beyond a mere discussion of the existence of network effects or scale efficiencies in industries (which will apply in most cases that the Commission assesses) and should explain the specific features of firms that it will seek to protect and that it will only intervene when there is a coherent theory of harm supported by considerable evidence. As noted above, the Commission should also be clear on the circumstances in which conducts are *unlikely* to breach competition law. In our view, this is important to avoid deterring firms from strong price competition.

4 Avoid discarding the AEC test on formalistic grounds

20 One element of the AEC principle is the AEC test, which is applied when assessing alleged exclusionary pricing. Conceptually, if a dominant firm prices above an appropriate measure of its own cost, then a firm as efficient could profitably match that price (and so would not likely be foreclosed).[14] Further, because the cost benchmarks relate to the dominant firm's own costs (which the dominant firm should know), they facilitate self-assessment. An AEC test, therefore, is a price-cost screen that seeks to facilitate compliance by providing clear guidance on the difference between pricing unlikely to be harmful (i.e., unlikely to foreclose as efficient competitors) and that which may have adverse competitive effects. We emphasise that failing the test (i.e., pricing below cost) does not imply competitive harm

[13] The Policy Brief leaves the notion of not-(yet)-AECs open, such that it is unlikely that a dominant firm will know the extent to which its pricing must take into account the likely costs of its competitors. This ambiguity may incentivise dominant firms to price above the expected costs of their main competitors (even if the latter are perceived to be much less efficient) so as to avoid the risk of an abuse of dominance investigation.

[14] In this regard, the Commission indicates that the likely cost benchmarks are average avoidable costs and long-run average incremental costs. Original Guidance, para. 26.

(e.g., where below cost pricing relates to a small share of a relevant market). Rather, it means that further investigation is merited.

21 As regards the AEC test, the Policy Brief highlights that the Court of Justice has indicated this test to be "*warranted*" in predatory pricing and margin squeeze cases, and merely "*possible but not required*" in other cases, such as those relating to rebates.[15] The Commission further considers that, for rebate cases, the AEC test's likely "*suitability*" depends on "*the type of rebates at stake"*, concluding that the AEC test is only "*appropriate*" in "*exceptional*" cases when assessing exclusivity rebates.[16]

22 This framework closely resembles the formalistic approach that the Commission aims to be "*moving away*" from.[17] Indeed, the Commission's disregard of the AEC test in the case of exclusivity rebates is based on the premise that such rebates are "*by their very nature capable*" of adversely affecting competition and therefore have a "*high anticompetitive potential*".[18] This applies when a rebate is conditional on "*all or most*" of a customer's purchasing, even if (without further clarity) "most" could mean just 50% of its requirements.[19]

23 However, and importantly, whilst exclusivity rebates may be "*capable*" of harming competition, they are also *capable of delivering procompetitive effects*.[20]

24 The AEC test is a useful screen which helps distinguish between outcomes which are harmful and those which are benign or beneficial.[21] It offers a clear methodology for competition authorities to distinguish aggressive but legitimate competition from anticompetitive foreclosure (and to help firms self-assess).[22]

25 We acknowledge, nonetheless, that the value of an AEC test will vary depending on the case. For example, it may be that a conditional discount scheme covers such a small share of the market that it would be unlikely to foreclose an AEC, irrespective of whether the scheme would pass or fail an AEC test. In such cases, an AEC test is not required because other evidence, consistent with an effects-based approach, is sufficient to rule out likely harm to competition and consumers.

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15 Policy Brief, pp. 6-7.

16 The Commission denotes exclusivity rebates as "*retroactive rebates conditional on a customer purchasing all or most of its requirements from the dominant firm*". Policy Brief, p. 6.

17 Policy Brief, p. 2.

18 Policy Brief, p. 7.

19 Policy Brief, p. 7.

20 See, for example, *Selective Price Cuts and Fidelity Rebates*, Economic Discussion Paper, an RBB report prepared for the Office of Fair Trading, 2005.

21 The Commission's approach also seems to run counter to the Court's judgments in Intel and Unilever. Indeed, in its Unilever judgment, the Court clearly specifies that "*even in the case of non-pricing practices, the relevance of such a test cannot be ruled out*", especially so in the case of exclusivity clauses. As a result, the Court ruled that "*if the results of such a test are submitted by the undertaking concerned during the administrative procedure, the competition authority is required to assess the probative value of those results*". See the Court of Justice's judgment in proceedings between Unilever and AGCM (the national competition commission of Italy) (the "Unilever Judgment"), paragraphs 59 and 62. Accessible at: "https://curia.europa.eu/juris/document/document.jsf?text=&docid=269403&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=9100743".

22 Implementing the test requires sufficient data on the relevant parameters to be available. However, even if some parameters (such as the contestable share in the case of exclusivity rebates) can be hard to assess empirically, the test can still be implemented by comparing the "critical values" of these parameters with a pragmatic assessment of their likely real values.

26 In summary, the potential value of the AEC test in antitrust analysis should not be downplayed, especially on the basis of form-based distinctions, such as that exposed in the Policy Brief between exclusivity rebates and non-exclusivity rebates.[23] Doing so would shift the focus of the assessment away from the effects-based approach which the Commission itself promotes. In our view, the Commission should make clear in its Forthcoming Guidelines that this prioritisation of effect over form will be implemented across all cases.

5 Retain standards in access cases which are coherent and protect innovation

27 Turning to access cases, the Policy Brief draws into focus a distinction in the case law between the treatment of constructive refusal to supply and outright refusal to supply, and emphasises that margin squeeze cases constitute a separate type of abuse. Specifically, it indicates the following.

- **Constructive refusal to supply** can be distinguished from **outright refusal to supply** given access has already been granted in the former case. The Bronner criteria, and in particular the criterion of indispensability,[24] do not apply to constructive refusal to supply cases.[25]

- **Margin squeeze** cases should not only be pursued where indispensability can be established. Rather, margin squeeze should be treated as a separate form of abuse and should not be subject to the indispensability criterion set out in *Bronner*.

28 Just as the AEC principle seeks to balance the risks of over- and underenforcement in pricing cases, an equivalent principle is required in access cases. For example, where innovators are confident that access to their assets, once developed, will remain under their control, they are likely to have stronger incentives to develop those assets.[26] For this reason, the original Guidance has rightly recognised the following:[27]

[23] Policy Brief, pp. 6-7.
[24] See Court of Justice's judgment on the Oscar Bronner GmbH & Co. KG's abuse of dominance finding (the "Bronner Judgment"), paragraph 41. Accessible at: "https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:61997CJ0007&from=IT".
[25] The Policy Brief further clarifies that the changes to the original Guidance do not imply that constructive refusal to supply is not a priority, but rather that the changes only imply that the indispensability standard should not apply to such cases.
[26] Limited intervention also protects firms' property rights and their freedom to contract.
[27] Original Guidance, para. 75.

> *The knowledge that they may have a duty to supply against their will may lead dominant undertakings — or undertakings who anticipate that they may become dominant — not to invest, or to invest less, in the activity in question. Also, competitors may be tempted to free ride on investments made by the dominant undertaking instead of investing themselves. Neither of these consequences would, in the long run, be in the interest of consumers.*

29 We welcome the preceding statement, which reflects what we shall refer to as a "limited duty to supply principle", and its retention in the revised Guidance. In our view, the *Bronner* criterion of indispensability is an important safeguard of this principle because it restricts the cases in which a dominant firm must provide access to its assets.[28]

30 We are therefore concerned that, by emphasising that the *Bronner* criterion of indispensability will only apply to cases of outright refusal to supply (and not to cases where products are supplied but on terms which may make it hard for rivals to obtain them), the Commission appears to advocate a peculiar aspect of the case law: i.e., a lower bar for intervention for less restrictive conduct.[29]

31 In our view, not only does this approach potentially jeopardise investment incentives, it also lacks coherence and risks creating perverse incentives for firms. For example, consider a firm that is considering making a (non-indispensable) input available for the first time to third parties. The firm would be willing to make the product available at a high price only. However, from a compliance perspective, the safest strategy might be not to supply the input at all. This is because supplying at a high price might be deemed constructive refusal to supply (even if there were some demand for the product) leading to intervention which results in a lower price (at which the dominant firm would prefer not to supply). On the other hand, outright refusal to supply would *not* lead to intervention, because the input is not indispensable.

32 The preceding example highlights how it would be perverse if competition law made outright refusal to supply a safer strategy for dominant firms than offering high-priced access, not least because the former is a special case of the latter. Moreover, the outcome would be worse for customers (since some supply would be better than none).

33 Regarding margin squeeze cases, whilst we welcome the retention of the AEC test, we note that by presenting margin squeeze as a separate abuse (as opposed to an alternative to refusal to supply), the Commission seems to provide itself with scope to intervene more easily. However, from an economics perspective, failing the AEC test is insufficient to prove harm from margin squeeze. What also matters, inter alia, is the importance of the input

[28] Broadly speaking, this means that refusal to supply access to an input would not be an abuse if there are sufficient actual or potential substitutes for the input in question or the input is not essential for production.

[29] Alternatively, the Brief may be suggesting that constructive refusal to supply is somehow a worse conduct than outright refusal to supply, and therefore it warrants a lower standard for intervention. This view, if held, would need explanation as it is not intuitively correct; outright refusal to supply is an extreme form of constructive refusal to supply (i.e., supply at a price equal to infinity) and so constructive refusal to supply does not seem worse than outright refusal to supply.

whose wholesale price is part of the “squeeze” and the importance of the “squeezed” firms as competitors in the downstream market.

34 In summary, unlike the original Guidance, which sought to bring economic logic to bear at a time when this had been lacking in the case law, the Policy Brief seems to accept an apparent inconsistency in the case law. Moreover, it uses this discrepancy to emphasise the significant leeway the Commission has in pursuing cases involving partial (but not complete) restrictions on access to a firm’s assets by competitors. This is not a welcome development. We therefore encourage the Commission to reassess this lowering of the threshold for intervention and to adopt a more consistent and economically coherent framework in its Forthcoming Guidelines (e.g., by reaffirming that intervention will be based on likely economic effect, also taking into account likely efficiencies resulting from the conduct under investigation).

6 Conclusion

35 In conclusion, we urge the Commission to ensure that the Forthcoming Guidelines (i) maintain a reasonable and internally consistent standard for intervention aligned with a true effects-based approach and (ii) ensure that firms are not discouraged from procompetitive behaviour.

36 This requires being clear on the circumstances in which conduct is unlikely to breach the law and providing more clarity on the specific (and what we advocate should be limited) circumstances in which the Commission will apply the not-(yet)-AEC standard or depart from the Bronner criteria. We urge the Commission to make these changes in its Forthcoming Guidelines.

37 If the Commission considers that the legal precedent currently constrains the extent to which a true effects-based approach is consistent with competition law, we emphasise that its Forthcoming Guidelines should explain that intervention will nonetheless be based on economic effect. Not only would this be sensible as a matter of policy, it may also serve to influence courts to adopt a more effects-based approach when making future judgments which clarify the law.