Blame it on the economists – Did the AEC make a difference?

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Guidance 2009 on abusive exclusionary conduct by domco's

- ”Price-based” exclusionary conduct”

  23: ”*With a view to preventing anti-competitive foreclosure, the Commission will normally only intervene where the conduct concerned has already been or is capable of hampering competition from competitors which are considered to be as efficient as the dominant undertaking*.”

- ”Conditional rebates”

  41: ”*When applying the methodology explained in paragraphs 23 to 27, the Commission intends to investigate, to the extent that the data are available and reliable, whether the rebate system is capable of hindering expansion or entry even by competitors that are equally efficient by making it more difficult for them to supply part of the requirements of individual customers.”*

  43: ”*However, as long as the effective price remains consistently above the LRAIC of the dominant undertaking, this would normally allow an equally efficient competitor to compete profitably notwithstanding the rebate. In those circumstances the rebate is normally not capable of foreclosing in an anti-competitive way”*

AEC – a necessary and decisive test in conditional rebates cases?

- A welcome and fresh initiative
- An objectified approach
- Replacement of the former form-based approach based on more or less theoretical concerns regarding foreclousure effects
- Binding for the authorities
- Based on fairly understandable calculations
- Like everything new – a little bit scary (and what about lawyers' market share in future cases about abuse behavior?) – but also a prospect for new angles in the abuse cases

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The reality…

- A hot air balloon
- The NCA and the Commission didn’t follow the guidelines in the subsequent cases
- The guidelines were not adopted in member states
- The AEC principle was not taken into account by the national courts
- Where the AEC could have contributed to predictability and a safe harbour, it ended where it all started: The overall suitability test bases on more or less theoretical arguments prevailed

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The Lauritz Knudsen case (2008): Background

- Probably the first time a national court heard about AEC

- Background:
    - LK had a strong market position in Denmark (on electrical sockets and switches)
    - Sales system: LK => wholesalers => installers => end customers
    - The wholesaler agreements:
        - Pre-order rebate
        - Reference period: 1 year
        - Binding
        - Discount span: Max. 9.8 % - (16.7 % / 42 million DKK – 26.6 % / 325 million DKK) - progressive
        - Retroactive
        - No exclusivity clauses

The Lauritz Knudsen case (2008): Case history

- NCA 2000 and CAT 2002: Abuse

- Danish High Court 2005:
    - LK presented a very detailed cost justification prepared by LK, a report from Copenhagen Economics justifying the cost justification and a statement from the external accountant confirming the relevant figures.
    - Bindig pre-orders enabled LK to reduce cost (purchase + production + logistics) and the large pre-orders gave reassurance on the volume which enabled a more effective organisation of LK's production.

- The High Court ruling (our translation): *The Court does not find it documented or substantiated by the presented cost justification, auditor's statement, report from Copenhagen Economics or the witness statements that LK's rebate system is justified by differences in the cost savings that LK achieves by pre-ordering from a large and a small wholesaler respectively. The High Court has emphasised, among other things, that LK has not been able to explain why a pre-order from a large wholesaler is of greater value to LK than a pre-order of the same quantity from two smaller wholesalers, or why the delivery discount is dependent on the pre-ordered quantity.*

The Lauritz Knudsen case (2008): Supreme court

- Appeal to the Danish Supreme Court
- Based on the 2005-discussion paper, LK provided a detailed AEC calculation in which measurements tool from the discussion paper was used.
  - Conclusion: An AEC could compete with LK's pre-order rebate. Deduction of lost rebates did not result in negative earnings

- LK argued: "*LK has contested before the Supreme Court that the pre-order and delivery rebates in the notified wholesale agreement were suitable to bind the wholesalers to Lauritz Knudsen A/S (LK). Schneider Electric has further stated that a discount system does not have an exclusionary effect if the marginal price is not at any time below the average total costs for each unit produced, as equally efficient competitors will then always be able to match the marginal price*."

- Supreme Court (our translation): "*The Supreme Court therefore agrees with the Competition Council that the rebate system has a significant locking-in effect, i.e. it is to a significant extent suitable for tying-in wholesalers to LK. What Schneider Electric has stated before the Supreme Court cannot lead to a different asses*."

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The Lauritz Knudsen case (2008): Comments

- AEC argument dismissed – without any explanation
- Probably, the Supreme Court needed a more safe and well-known source than a discussion paper
- The Supreme Court allowed the new AEC argument in the appeal case – but showed no real interest at all in adopting it
- LK did not posses a legal monopoly. Competitors were present and entry was possible => an as-efficient competitor was clearly not impossible to imagine.
- Protection of inefficient competitors?

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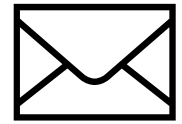
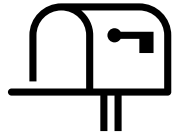
ECJ 2012 – Post Danmark I

- Selective pricing/predatory pricing
- NCA (2004), CAT (2005) and Danish Eastern High Court (2007): Post Danmark abused dominant position by taking over competitor's large customers to lower prices – hereamong lower prices than ATC, but higher than AIC
- European Court of Justice (ECJ) Post Danmark I rec. 38: "*Indeed, to the extent that a dominant undertaking sets its prices at a level covering the great bulk of the costs attributable to the supply of the goods or services in question, it will, as a general rule, be possible for a competitor as efficient as that undertaking to compete with those prices without suffering losses that are unsustainable in the long term.*"
- Supreme Court (our translation): "*It follows from paragraph 38, that if a dominant undertaking sets its prices at a level which covers the 'essential costs' attributable to the marketing of the product or the provision of the service in question, a competitor which is as efficient as that undertaking will in principle be able to compete on those prices without suffering unsustainable losses in the long term*."





ECJ 2015 Post Danmark II: Background

- Relevant market: Direct mail market in Denmark
- Post Danmark had a legal monopoly for direct mail up to 50 grams
- Rebate scheme
  - Reference period: 1 year
  - Rebate span 6-16 % - progressive
  - Retroactive
  - Covered all direct mail distributed by Post Danmark
  - Binding
  - No exclusivity
- Bring Citymail (Posten Norge) began distributing direct mail in the Copenhagen area in 2007; covering 40 % of all households in Denmark
- Post Danmark market share was approx. 95 %
- Bring Citymail suffered a loss of approx. 700 mio. DKK during 2007-2009 and ceased operations hereafter

ECJ 2015 Post Danmark II: Case history

- NCA 2009 and CAT 2010:
  Post Danmark rebate scheme on direct mail was abusive
- Post Danmark appealed to the Maritime and Commercial High Court
- Post Danmark argued that the NCA should have applied an AEC test
- The court decided to forward questions to the European Court of Justice (ECJ)

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ECJ 2015 Post Danmark II: Questions

"*What guidelines should be used …*

In its answer the Court is requested to clarify what relevance it has to the assessment whether the rebate scheme's thresholds are set in such a way that the rebate scheme applies to the majority of customers on the market.

In its answer the Court is further requested to clarify what relevance, if any, the dominant undertaking's prices and costs have to the evaluation pursuant to Article 82 EC of such a rebate scheme (relevance of an "as-efficient-competitor" test)"

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ECJ 2015 Post Danmark II: Ruling

57. *It follows that,…, it is not possible to infer from Article 82 EC or the case-law of the Court that there is a legal obligation requiring a finding to the effect that a rebate scheme operated by a dominant undertaking is abusive to be based always on the as-efficient-competitor test.*

58. Nevertheless, that conclusion ought not to have the effect of excluding, on principle, recourse to the as-efficient-competitor test in cases involving a rebate scheme for the purposes of examining its compatibility with Article 82 EC.

59. On the other hand, in a situation such as that in the main proceedings, characterised by the holding by the dominant undertaking of a very large market share and by structural advantages conferred, inter alia, by that undertaking's statutory monopoly, which applied to 70% of mail on the relevant market, applying the as-efficient-competitor test is of no relevance inasmuch as the structure of the market makes the emergence of an as-efficient competitor practically impossible.

60. Furthermore, in a market such as that at issue in the main proceedings, access to which is protected by high barriers, the presence of a less efficient competitor might contribute to intensifying the competitive pressure on that market and, therefore, to exerting a constraint on the conduct of the dominant undertaking.

ECJ 2015 Post Danmark II: Comments

- The ECJ killed the AEC test in this case regarding conditional rebate abuse in a market protected by high barriers.
- The ECJ established that applying of the AEC test is not mandatory
- In particular, the AEC test not neccessary in a market where the emergence of an AEC is practically impossible

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Some reflections from an economist

Competition is good!

When investigating potential price-based exclusionary conduct one should balance between:

Tough competition, low prices/high discounts **today**	**vs.**	Risk of excluding competitors => lower competition and higher prices **tomorrow**

Over-enforcement can result in significant costs to consumers

Price-cost tests holds some promise of narrowing down when exclusion is a real risk.

As-efficient vs. less-efficient competitors

Three outcomes of a price-cost test:

Prices foreclose…

1) As-efficient competitors (AEC-test): Probably **sufficient** condition for prices being anti-competitive

2) Less-efficient competitors: Not sufficient condition for prices being anti-competitive. Indicative?

3) No competitors: Should be a clear indication of no anti-competitive effect

Unknown to domco (legal certainty?)

When competitors are ”less efficient”

Post Danmark II ECJ-ruling, rec. 60: ”[…] *the presence of a less efficient competitor might contribute to intensifying the competitive pressure […]*”

This should not mean that less efficient competitors must always be protected against low prices. Even when barriers are high.

The significance of returns to scale and natural monopolies

Hypothetical example 1: Bridge vs. ferry

Hypothetical example 2: Manufacturing

Removing inefficient companies from the marketplace is what competition (on the merits) does – and should do!

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Reflections…

Not mandatory to apply the AEC test in conditional rebate cases

Cases show that marginal prices > own average costs is not enough to approve a conditional rebate scheme

But marginal prices < own average costs is a clear indication that the rebate scheme is abusive

The AEC test in the draft guideline on exclusionary conduct: ”*[…] when a price-cost test is carried out and shows that the effective price charged by the dominant undertaking is below AAC, the rebate scheme is found to depart from competition on the merits. The finding that the effective price is below AAC can also be relevant for the assessment of the capability of the rebate scheme to produce exclusionary effects […]*”

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