

EC workshop of economic experts on the quantification of anti-trust harm (26th January 2010)

Some observations on damages to competitors arising from unlawful exclusionary practices (Zoltan Biro, Frontier Economics)

The issue in hand is how a national court might be expected to determine what levels of sales and margins an actual or potential competitor would have achieved but for the presence of a form of exclusionary practice which has been found to constitute a competition law breach. This memo explains that an infringement decision under Article 101 or 102 TFEU will itself typically constitute insufficient evidence to support a follow-on damages claim, and that a claimant will usually need in a national court to adduce additional factual (and perhaps expert) evidence in order establish the causation and the quantum of loss arising from an unlawful practice. Some observations are then offered on the types of evidence and analysis that will likely be of relevance to such proceedings, and the associated challenges. Finally, a summary of a recent case in the UK Competition Appeal Tribunal is presented, which (like most cases) turned on the particular facts of the case, but which nevertheless illustrates some points of broader interest.

1) Infringement decision unlikely to constitute sufficient evidence of harm

Under European law, where a breach of the EU competition rules has been found in a decision by the European Commission, a claimant can rely on this decision as binding proof of the infringement in civil proceedings for damages. Moreover, in some Member States (such as Germany and the UK), a competition law infringement decision by a national competition authority (NCA) will also be binding on a national court hearing a private action for damages. In these circumstances, a national court will not be concerned with the correctness of the finding of infringement, but only with whether it has been made and the determination of any loss which results.

An infringement decision may therefore define the extent of a follow-on claim for damages, e.g. a claimant may rely on the infringement finding to determine the unlawful conduct, the period and the products to which the claim relates.¹ However, a claimant will generally have to prove in a national court that the infringement caused it loss and to establish the quantum of that loss; the burden of proving that the defendant's unlawful conduct caused a claimed loss will usually rest on the claimant.

The European Commission's Article 82 EC (now Article 102 TFEU) Guidance states that "The Commission will normally intervene under Article 82 where, on the basis of cogent and convincing evidence, the allegedly abusive conduct is likely to lead to anticompetitive foreclosure." In particular, the Commission will intervene:

- where the conduct is capable of hindering competitors and so competition, as well as where the conduct has already hampered competitors and competition; and

¹ In the absence of a binding European Commission or NCA decision that makes a relevant finding of infringement, a claimant will need to prove its case on the facts. In *Crehan v Inntrepreneur* (which concerned the legality of a 'beer tie', under which Mr Crehan had been obliged as a term of his pub lease to purchase most of his beer from a single supplier) the issue arose whether the England & Wales High Court should have followed the assessment in the Commission's previous *Whitbread* decision and, therefore, have concluded that Mr Crehan's agreement with Inntrepreneur also infringed Article 81(1) of the EC Treaty. The House of Lords ruled that, as a matter of European law, the judge in the High Court was not bound to adopt the Commission's market assessment in *Whitbread* because that decision related to a different subject matter and different parties and, therefore, there was no prospect of a conflict between the Commission's decision and an eventual judgment of the High Court. Inntrepreneur had not had an opportunity to challenge the *Whitbread* decision because it was neither an addressee nor directly and individually concerned by it; it could not, therefore, have brought an appeal as a third party before the European Court of First Instance and ultimately the ECJ. The House of Lords accordingly held that Inntrepreneur would be denied the right to a fair trial if the economic and legal assessment in its case were determined by a Commission decision over which it had no influence and in respect of which it had no right of appeal.

- on the basis of the as-efficient competitor test (e.g. the prices and costs of the dominant firm), without necessarily establishing whether an as-efficient competitor in fact exists.

It follows that a finding of infringement of Article 102 TFEU will not imply that a competitor was actually damaged by the abusive conduct. Moreover, an Article 102 TFEU infringement decision will not necessarily contain an assessment of whether, and to what extent, a competitor was damaged.²

These general points can be illustrated by reference to specific types of conduct that could give rise to foreclosure findings contrary to Article 102 TFEU, for example:

- Conditional rebates: an infringement decision may determine the 'required share' of competitors, and to state that this exceeds the 'contestable portion of sales', i.e. the total sales that were potentially available to the dominant firm's competitors.
 - However, an infringement decision is unlikely to establish how the 'contestable portion of sales' would naturally be apportioned across the dominant firm and its competitors under normal competitive conditions. As such, it may provide an upper bound to the level of but-for sales, but is unlikely to contain an assessment of the level of sales that competitors would actually have achieved but for the abuse.
 - Moreover, it cannot be assumed that any additional sales that competitors would have achieved but for the abuse would necessarily have been made at the same prices as the actual sales that they did secure from those customers, e.g. the dominant firm might be expected in the but-for world to have applied an alternative (non-abusive) form of discounts to the contestable portion sales that was targeted by its unlawful rebate scheme.
- Predatory pricing: an infringement decision would be expected to determine which sales were made by the dominant firm at below its costs of supply.
 - However, an infringement decision is unlikely to contain an assessment of the level of sales that the dominant firm would otherwise have achieved and/or the prices that it would otherwise have set.

² Similar considerations apply in relation to the application by the European Commission or a NCA of Article 101 TFEU, as an agreement will be considered to restrict competition if it is capable of creating (or contributing to) foreclosure effects.

- Moreover, it cannot be assumed that all of the dominant firm's below-cost sales would necessarily have been won by competitors in the but-for world, e.g. if the dominant firm had instead priced in line with its costs, then it might be expected to have won a portion of these sales.
- Nor can it be assumed that any (non-abusive) prices that the dominant firm set to other customers or customer segments would in the but-for world also have been applied to those sales which were the subject of the abuse, e.g. the competitive conditions across these sets of customers might be expected to have differed if the predatory prices were targeted in a selective manner.
- Refusal to supply: an infringement decision may determine the nature and the prices of the inputs that would have been made available to competitors by the dominant firm in the but for world, but not the consequent sales and margins that competitors would then have achieved.

Thus, a competition law infringement decision will often contain findings of fact by the European Commission or a NCA, which may be of relevance to the questions of the causation and the quantum of loss in a follow-on damages case. However, it is unlikely that an infringement decision under Article 101 or 102 TFEU will itself constitute sufficient evidence to support a follow-on claim for damages, and a claimant will usually need in a national court independently to prove harm and to show that any losses claimed were caused by the breach of competition law.

2) Evidence and measurement of harm

The European Commission's Article 82 EC Guidance states that "The aim of the Commission's enforcement activity in relation to exclusionary conduct is to ensure that dominant undertakings do not impair effective competition by foreclosing their competitors in an anticompetitive way, thus having an adverse impact on consumer welfare, whether in the form of higher price levels than would have otherwise prevailed or in some other form such as limiting quality or reducing consumer choice ... the term 'anticompetitive foreclosure' is used to describe a situation where effective access of actual or potential competitors to supplies or markets is hampered or eliminated as a result of the conduct of the dominant undertaking whereby the dominant undertaking is likely to be in a position to profitably increase prices."

This statement by the European Commission emphasises two components to 'anticompetitive foreclosure' within the meaning of Article 102 TFEU:

- the implementation by the dominant firm of a form of conduct (e.g. conditional rebates, predatory pricing or refusal to supply) which is capable of causing a direct reduction in the level of sales and/or margins that competitors are able to achieve during the period that this practice is exercised; and
- a consequent impairment of the ability of rivals to compete with the dominant firm, e.g. as a result of reduced investments in productive assets, an inferior reputation with customers, or lost learning-by-doing effects.

In principle, therefore, there could be two limbs to a claim for damages following on from an exclusionary conduct infringement decision in relation to (i) an immediate loss of profits (i.e. reduced sales and/or margins) during the infringement period arising directly from the dominant firm's unlawful conduct and (ii) a further, longer-term loss of profits arising from a consequent worsening of the claimant's competitive capabilities.

In practice, a claimant may often be expected to focus on the first of these effects. This is because any immediate, direct loss of profits resulting from the dominant firm's exclusionary conduct will likely be easier to evidence than any longer-term, indirect harm due to foregone investment opportunities (and because the lost margins associated with pre-existing, sunk investments could be relatively large compared with the lost margins associated with foregone, additional investments).

In order to show any longer-term, indirect harm arising from a competition law breach, the claimant would face the evidentiary burden of needing to establish:

- what actions and timeframe would naturally have been required in order for it to have grown its business in competition with the dominant firm, and that these were negatively affected by the dominant firm's abusive conduct, e.g. that a reduction in its sales and/or margins during the infringement period deterred it from making investments in its businesses that it would otherwise have made, and how these investments would have enhanced its competitive capability and so its sales; and
- that it would be expected to have earned incremental revenues in excess of its incremental costs, including the cost of capital, from the investments in growing its business that it would have made but for the unlawful conduct.

Although evidencing such longer-term, indirect losses would likely be challenging for a claimant, it is possible that they could represent the major source of any loss in some cases. One can readily envisage scenarios in which an entrant had entered a market and, in the face of abusive conduct by a dominant firm, decided to cease to invest in developing its business further. If an entrant chose to mitigate in this way, then the lost profits associated with the investments that it had actually made could be relatively small compared with the lost profits associated with the additional investment opportunities which it was denied.

This issue would appear to be most relevant in those cases where the unlawful exclusionary conduct persisted for a prolonged period and where, as a result, a claimant would have had the time to develop its business substantially but for the abuse. However, in these circumstances, a claimant would need a reason why it might be expected to have earned more than its cost of capital on the investment opportunities which it was denied, e.g. a pre-existing asset or capability that it had already established and which it could profitably have exploited further by means of additional investments in its business but for the abuse.

As with damages claims following on from cartel findings, the most likely source of evidence in respect of the harm that may have resulted from an unlawful exclusionary practice will often be some form of comparator analysis (although there will of course be exceptions, such as the *ECSL v EWS* example summarised below). This involves establishing how the sales and the margins achieved by the claimant in relation to the relevant time period, geography, product and customer base compared with the same

firm's (or a similar firm's) performance in relation to a different time period, geography, product and/or customer base that was not subject to the unlawful conduct.

The most informative and reliable type of comparator will clearly depend on the particular facts of the case, but, in the case of exclusionary conduct, temporal comparators may be of more limited use than in the case of cartel damages. This is because:

- there may be no relevant 'before' period when considering exclusionary conduct - this conduct often being used to halt entry and expansion by smaller rivals rather than to oust established competitors; and
- in relation to the 'after' period, one needs to be mindful that the effects of exclusionary conduct could persist long after the infringement period, potentially limiting the relevance of post-infringement comparisons - whilst cartel overhang effects can also arise, the likelihood of effects persisting post-infringement will often be greater when dealing with exclusionary abuses.

As with any comparator analysis, there will clearly be a need to ensure that a potential comparator is in fact comparable, and to control for any differences, in order to isolate any effects of the unlawful conduct. The issues associated with determining what constitutes a reasonable comparator or set of comparators are essentially the same as those that one would face in relation to a cartel damages claim:

- to identify whether the underlying economic factors determining the comparator levels of sales and margins are similar to those that would have prevailed in relation to the relevant time period, geography, product and customer base but for the unlawful conduct; and
- where there are material differences, to adjust the results of the comparator analysis to reflect the likely effect of these differences on sales performance.

In so doing, it will be necessary to understand whether the reason that a potential comparator was not subject to the unlawful conduct itself undermines its comparability, for example because the underlying conditions of competition were not the same. One would need to consider whether a potential comparator may not have been subject to the exclusionary conduct because the dominant firm was either in a stronger position (i.e. it did not need to rely on the exclusionary conduct) or in a weaker position (i.e. the exclusionary conduct would not have been effective).

By way of example, one can consider the application of an unlawful exclusionary rebate scheme to retailers by a dominant firm. Suppose that this practice was applied market-wide, but that a subset of retailers decided to forgo the dominant firm's rebates and to stock the product of a competitor instead. It could be tempting for this competitor, if bringing a follow-on action for damages, to use the share of sales that it achieved with this subset of retailers as an estimate of the share of sales that it would have achieved in the market more widely but for the presence of the dominant firm's unlawful rebate scheme. However, it should be borne in mind that those retailers that stocked the product of the claimant demonstrated themselves as having a relatively strong preference for stocking the claimant's product through their willingness to forgo the dominant firm's rebates. One might therefore expect that, all else equal, the share of sales that the claimant achieved with this subset of retailers was higher than the share of sales that it would naturally have achieved elsewhere but for the abuse.

3) An example: ECSL v EWS, UK Competition Appeal Tribunal, 2009

In 2006, the UK Office of Rail regulation (ORR) found that English Welsh and Scottish Railway (EWS) had engaged in unlawful discrimination between its customers contrary to the UK Competition Act 1998 and Article 82 of the EC Treaty. EWS was found to have set an existing customer, Enron Coal Services (ECSL), selectively higher prices in May 2000 for the provision of coal haulage services by rail than it subsequently charged another customer, Edison Mission Energy (EME), in October 2000 for the same flows. According to the ORR's infringement decision, this behaviour was a manifestation of EWS's wider strategy to exclude or limit competitive opportunities for potential new entrants, such as Freightliner Heavy Haul (FHH), to the market for coal haulage in Great Britain. EWS was concerned that ECSL could facilitate such entry into this market by developing an intermediary role, including through the negotiation of end-to-end (E2E) coal supply contracts with new owners of power stations such as EME. The ORR found that EWS had sought to constrain this competitive threat by ensuring that it, and not ECSL, secured direct contracts for coal haulage with the power stations.

In 2008, the liquidator of Enron brought a follow-on claim for damages against EWS in the UK Competition Appeal Tribunal (CAT). Enron alleged that EWS's unlawful discriminatory behaviour had caused ECSL to lose a tender for the haulage of coal by rail to power stations operated by EME, and also a real or substantial chance of winning a four-year E2E contract to supply coal to one of those power stations, Ferrybridge. This was the first follow-on claim for damages to reach trial in the CAT, and the issue of causation was at the centre of the litigation.

Infringement decision unlikely to constitute sufficient evidence of harm

The central question in the case was whether EME would have awarded a four-year E2E coal supply contract to ECSL in the hypothetical 'but for' world in which it should be assumed that EWS had not abused its dominant position. The ORR concluded that EWS's discriminatory treatment of ECSL had placed it at a competitive disadvantage in tender negotiations between June and October 2000 in relation to the provision of coal haulage services to EME. However, the infringement decision stated that it was not possible for the ORR to conclude that ECSL was thereby displaced from supplying coal haulage services to EME. Nor did the ORR's decision consider whether ECSL would

have had the opportunity to secure a four-year coal supply contract to Ferrybridge power station but for the abuse.

Enron argued that, given the ORR's finding of competitive disadvantage, ECSL must have suffered loss.³ It was submitted that it is hard to see how a party can suffer such a disadvantage if its chances of success were zero - if ECSL was materially hindered in efforts to secure business from EME, then necessarily it followed that a real chance to win that business had been lost. In these circumstances, contended Enron, there was no need for the CAT to consider further evidence.

The CAT disagreed. According to the CAT, "a finding of discrimination that results in competitive disadvantage is not the same as a finding that loss was caused thereby to a trading partner of an undertaking in a dominant position. The finding of competitive disadvantage (which EWS accepts, as it must) means that EWS hindered the competitive position of ECSL in relation to the EME tender. This is certainly relevant to, but not determinative of, the question of causation. It is relevant because it means that ECSL was impeded in its ability to offer EME competitive rates for coal haulage and supply. It is not determinative because the Decision does not establish that ECSL was well-placed to win a coal supply contract with EME absent the abuse."

Evidence of harm and the role of economic experts

In evaluating ECSL's loss of chance, the CAT held that two main questions had to be decided:

- Whether ECSL would have sought to negotiate with EME for a four-year E2E contract to supply coal to Ferrybridge power station in the but-for world. The CAT considered that this question depended only on the actions of the claimant itself, and so the claimant had to show on the balance of probabilities what it would have done but for the infringement. It concluded that ECSL had not proven this to be the case.
- Whether negotiations between EME and ECSL would have led to the award of a four-year E2E contract to supply coal to Ferrybridge power station but for the

³ ECSL also argued that the CAT is bound by all of the findings of fact made by the ORR in its infringement decision. The CAT did not agree. It relied on a previous UK Court of Appeal judgment which confirmed that 'decisions' of a NCA are binding in follow-on proceedings, but implied that findings of fact are not to be treated in the same way as findings of infringement. Although the CAT carefully considered all findings of fact made by the ORR, it did not regard itself as formally bound by those findings where the parties adduced evidence that contradicted a statement by the ORR.

infringement. The CAT considered that this question depended on the actions of a third party (EME), and so the claimant had to show on the balance of probabilities that there was a real or substantial (i.e. not negligible) chance that the third party would have acted in the way that the claimant alleged. It concluded that this was not the case, and that this was instead a speculative prospect.

The key issues considered by the CAT in evaluating these questions were as follows:

- The nature of the commercial arrangement that would have been agreed between ECSL and EWS in the but-for world - the coal haulage prices and performance terms that EWS would have offered to ECSL but for the abuse, and whether these would have differed from those that EWS offered to EME.
- Whether ECSL would have decided to contract with EWS for the provision of coal haulage services to EME in the but-for world - or whether ECSL would still have chosen to contract with FHH, as it did in the real world.
- The nature of ECSL's bid to EME in the but-for world - whether the but-for coal haulage prices and performance terms would have differed from those that ECSL actually offered to EME (on the basis of coal haulage services provided by FHH), and to what extent.
- Whether, in these circumstances, EME would have preferred ECSL's bid to provide coal haulage services in place of EWS's bid - the reasons why EME rejected ECSL's bid in the real world, and whether those factors would also have prevailed in the but-for world.
- Whether there was an opportunity for an E2E arrangement associated with EME's tender for coal haulage - and so whether ECSL would have had a real or substantial chance of being awarded a four-year coal supply contract to Ferrybridge power station if it had been awarded the EME coal haulage contract.

The CAT was provided with documentary evidence and statements from witnesses of fact by current or former employees of ECSL, EWS and EME in relation to many of these issues. Of particular importance in this case was a witness statement by the person who had been responsible for negotiating and managing EME's coal supply and haulage contracts. This statement described the way that EME assessed the bids that it received in response to its tender for coal haulage to its power stations, the reasons why EME rejected ECSL's bid and chose EWS's bid, and EME's coal purchasing strategy in

relation to Ferrybridge power station. According to this statement, a previous breakdown of the relationship between EME and ECSL would have deterred EME from awarding the coal haulage tender to ECSL in the but-for world; moreover, for various reasons, EME would not have wished to negotiate or enter into a long term E2E arrangement of the type that ECSL was claiming.

The CAT was also provided with evidence from three experts in competition economics and accountancy. The contribution of the experts was as follows:

- An expert economist on behalf of Enron gave evidence on causation, and argued as follows:
 - The CAT should consider what a rational economic decision-maker in EME's position would have done in the but-for world.
 - Based on EWS's discriminatory May 2000 offer to ECSL, ECSL was prepared to accept significant negative margins in its actual bid to EME for the provision of coal haulage services, presumably in anticipation of making profitable follow-on coal sales to EME. In the but-for world, ECSL would similarly have been prepared to accept significant negative margins in supplying EME with coal haulage services, but on the basis of lower costs comparable to the non-discriminatory prices that EWS offered to EME. Hence, ECSL would have undercut EWS's coal haulage prices by a significant amount.
 - The historical relations between ECSL and EME were not relevant to the outcome of the EME tender in the but-for world, as a rational economic decision-maker would look for best value and not allow an incident in its previous commercial dealings to cloud its judgment. Moreover, the statement of the person responsible for negotiating and managing EME's coal supply and haulage contracts about EME's likely decisions in the but-for world should be disregarded, since this individual was not sufficiently removed from what actually happened in the real world and his views had been tainted by EWS's abuse.
 - As a consequence, and since coal supply on an E2E basis would objectively have produced economic advantages for power generators compared with coal supply on a DIY basis, EWS caused ECSL to suffer

anticompetitive injury in the form of a significant diminution in its chance to win a four-year E2E coal supply contract to EME's Ferrybridge power station.

- An expert accountant on behalf of Enron gave evidence on the quantum of loss that ECSL suffered as a result of failing to secure a four-year E2E coal supply agreement to EME's Ferrybridge power station – estimated on the basis of the volumes of coal to be supplied to EME under the rail haulage tender and the average margins earned by ECSL's coal supply business.
- An expert economist on behalf of EWS stated that he did not agree with the characterisation of the relevant facts by Enron's expert economist, and that he therefore disagreed with his conclusions regarding ECSL's loss of chance. He also argued that the estimate of loss by Enron's expert accountant was inconsistent with the economic logic of Enron's expert economist, which would imply that the size of the competitive disadvantage which ECSL faced as a result of EWS's discrimination should place an upper bound on any losses suffered by ECSL.

Enron placed heavy reliance on the opinion of its economic expert that it is necessary to consider how EME, as a rational economic decision-maker, would have acted in the but-for world. At the hearing, EWS challenged the admissibility of the evidence of Enron's economic expert on the basis that there was direct evidence of fact (from a former employee of EME) indicating what EME would have done absent EWS's abuse. In these circumstances, it was argued by counsel to EWS, inferences about what EME might have done (as a rational economic decision-making) in the but-for world were irrelevant. The CAT ruled that the evidence of Enron's economic expert was admissible, but that limited weight should be placed on it as its focus was on the decisions that would have been made by an hypothetical, rational economic decision-maker in EME's position rather than by the actual third party decision-maker in this case.