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Opening address: The interplay between law and economics

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Introduction

Ladies and Gentlemen,

I am delighted to be here today and to share my views with you on the relationship between law and economics in the application of our competition rules.

This year, the European Courts have ruled on a number of competition law cases where economic analysis has played a key role.

In particular, the Courts have strongly validated the Commission's increased focus on economic analysis in both mergers and unilateral conduct cases.

I will refer to these cases throughout my address of today.

I will start by highlighting the increased importance that economics has come to play in constructing our competition cases.

I will refer then to the current interplay between law and economics against the background of the standards of proof that the European Courts require.

1. Development of the use of economics in competition law enforcement

1.1 Increased economic analysis across instruments and sectors

Let me start with a few remarks on how economics became integrated into competition law enforcement over the last two decades.

It is widely known that the role of economics has grown significantly over this period. I will briefly mention a few highlights of this historical development that started in the merger field, and then spread to other instruments.

The introduction of the Merger Regulation in 1989 marked an increased use of economic analysis, and economics influenced the evolution of our substantive merger test in 2004. After a few years, we understood – largely as a result of economic analysis – that it was better to clarify the then prevailing test on

dominance in order to ensure that all potentially harmful mergers could be caught by the Merger Regulation.

This is why we moved to the "*significant impediment to effective competition*" test – the so-called SIEC test – in the 2004 Regulation.

By the time of these 2004 revisions, this more effects-based approach had already spread from mergers through to antitrust, with the revision of the horizontal and vertical guidelines in the late 1990s.

State aid followed shortly after, with the Action Plan of 2005. We have made substantial progress on the overall framework for a more economic approach to State aid, and on how to analyse certain areas such as R&D and environmental aid, but we still need to gather experience in other sectors.

In some policy areas this increased focus on economic effects was first driven by the Commission – notably on mergers. In other areas – such as Article 101 – we were first led by the Court. In both cases, the development of the law over time was based on the work of both institutions. I will give you detailed examples later on.

These developments in policy went side by side with changes to how DG Competition deals with economics on a day to day basis. The role of economics was boosted with the nomination of a chief Competition Economist and the creation of the Chief Economist Team in 2003. Damien Neven will also address you today. The Team which he has successfully led for four years has marked a "step-change" in the integration of economic thinking into our enforcement work, and Damien deserves all the credit for this.

The contribution of our in-house economists is not limited to quantitative econometric work. Our economists are now fully involved in the development of conceptual frameworks for our cases and our overall policy-making. Recent examples include guidance on non-horizontal mergers, Article 102 Enforcement Priorities or horizontal agreements in antitrust, and state aid policy.

Our economic work is also integrated into the overall sectoral approach on which the Commission focuses. In this respect, the work we are carrying-out to understand market dynamics and to remedy sectoral market malfunctions is very relevant.

I will mention only one example – the pharmaceutical sector inquiry completed last year. We conducted an extensive empirical study to assess the extent and timing of market entry of generic medicines and the effect of such penetration on average drug prices in European markets. This contributed to an informed understanding of potential competition problems within the pharmaceutical sector.

Because economics had become so embedded in competition policy, it was time for the Commission to explain how we dealt with economic evidence. This is why we drafted the Best Practices on the submission of economic evidence in early 2010.

1.2 The Best Practices on the submission of economic evidence

These Best Practices were provisionally adopted and implemented for both antitrust and merger proceedings.

The Best Practices crystallise the experience we have accumulated over the last years on receiving and processing economic evidence. Their aim is to explain how we deal with economic evidence and to set clear standards for its submission by parties and third parties.

The Best Practices aim to facilitate the assessment of the evidence and the replication of any empirical results by our teams or other parties. We also provide guidance on how to respond to our requests for quantitative data so as to ensure timely and relevant input for the investigation.

We have received a very positive response to this initiative.

I can tell you today that the Best Practices have already helped in a large number of cases to gather quantitative data and to limit the scope of data requests. As a consequence, we have received improved submissions over the last months in both merger and antitrust cases.

As I mentioned, the Best Practices were largely a codification of existing practice, perhaps best exemplified by the Commission's analysis in the *Ryanair* case, where we put forward extensive qualitative and quantitative evidence. I want now to say a few words about that case, and in particular the Court judgment.

1.3. *Ryanair*

In its judgment of July this year, the General Court upheld the Commission's decision to prohibit Ryanair's proposed acquisition of AerLingus.

In doing so, the Court did not shy away from a detailed review of the economic evidence put before it. It engaged in a detailed discussion of the extensive econometric evidence put forward by the Commission and by the parties in order to assess the impact of the transaction.

To take just a few textual examples, the judgement refers to "*panel and cross-section regressions*", "*fixed effects*" and "*two-stage regressions*".

The importance of the *Ryanair* judgement is far-reaching.

In addition to confirming that the Commission had been right on the substance, the *Ryanair* ruling also validated the process we had followed in terms of interacting with the parties to confront the econometric evidence.

And this is important feedback for us since it echoes the same approach taken in our Best Practices. There are already beneficial effects deriving from these Best Practices.

Most recently, the *Unilever / Sara Lee* merger was perhaps another good example. We had numerous interactions with the consultants to the parties at various stages of the data gathering, the development of the evidence and the cross examination of our (and their) evidence.

2. The interplay put to the test

I have given you examples that highlight where we have come to in terms of building economic analysis into our case practice.

However we must all bear in mind that we ultimately have to prove our cases before a court. And when we prove our cases we do not do it to an economic standard, but to a legal one.

The key point here is that we are in fact using economic analysis to support the construction of legally robust cases.

2.1 Merger cases

The feedback we receive from the Courts through the case law is that they are ready and able to conduct an effective review. We take that feedback and integrate it into our practice. Let me take a few merger-related examples to illustrate this point.

- In the *Impala* judgment of 2008 overturning the CFI decision on the Sony/BMG merger, the ECJ fully endorsed the economic model of tacit coordination between parties. The Court used this occasion to invite the Commission to go beyond a "checklist approach" in its cases and to develop a coherent narrative on how such coordination would operate.

- The Commission's *ABF/GBI* decision adopted shortly after is fully in line with the standard established by the Court in this respect. In *ABF/GBI* we assessed whether the transaction would likely lead to coordinated effects by making tacit or explicit collusion more likely, stable or effective. We went beyond a simple checklist approach and tried to understand how coordination would actually work in practice.

- This approach implied an in-depth understanding of the likely collusive mechanism. We had to understand what variables the colluding partners would agree upon and what mechanism they would use to retaliate against deviations from the collusive agreement. An analysis of the upstream and downstream dynamics of the industry was crucial to solving this case.

As well as showing the interplay between the Court and the Commission, these examples also confirm the intricate relationship between law and economics in putting together a case. They show that economics can help us to identify the parameters of a case - the factors relevant to showing harm.

Both quantitative and qualitative analysis can then contribute to assessing whether those factors are present in a particular case. Assessment of evidence requires both legal and economic input. The two are inseparable.

Ultimately, however, this is a question of being able to present a coherent story, a narrative of the operation of the market that fulfils the legal standard of proof.

And this is where we have come to today. It is the interplay of law and economics that allows us to put forward legally robust cases that can successfully go through the scrutiny of the European Courts.

I will turn now to what some see as a more difficult area – Article 102.

2. 2. Effects-based approach in abuse of dominance cases

There is relatively little debate about the use of economics in mergers and about the role of the Court in such cases. But this is perceived as a more delicate topic in cases involving Article 102.

In such cases, some portray the Commission as pushing for a more economic approach and argue that the Courts act as more of a barrier.

I think this is a somewhat misguided perception. It shows a certain lack of understanding of how law and economics inter-relate and of how jurisprudence develops:

- First, it may be economically appropriate to have clear-cut rules, even if that doesn't always lead to the perfect result in a particular case. There is an economic benefit to legal certainty, and to reducing compliance costs, which may outweigh the costs of false positives and false negatives.

- Second, a Court deciding on the interpretation of a legal rule is largely constrained by the arguments of the parties before it, and by the general knowledge existing at that point in time.

Assessment of these elements can change over time. And this assessment can be informed by economic thinking. New arguments and new understandings develop; the job of the Court is to reconcile these with the principles underlying the earlier rulings.

That is precisely how the law develops.

The Courts' antitrust case law is based on the identification of dominance (i.e. market power) and abuse (i.e. practices that could harm competition). This provides a valuable framework for our decision making; it is far from being a straightjacket as the underlying concern is always the identification of harm to competition.

Consequently, if the Commission carries out a detailed analysis of practices so as to determine whether or not they harm competition, the Court should understand and, I would hope, support such an approach.

2.3 *Intel, France Telecom* and *Deutsche Telekom*

This support was demonstrated in the *France Telecom* predation and *Deutsche Telekom* margin squeeze cases, and we are waiting to see how it will play a role in the Court's upcoming judgment in the *Intel* case.

- Almost two months ago, the ECJ also upheld the Commission's prohibition decision on Deutsche Telekom for abusing its dominant position through margin squeeze.

  This case is significant in that the Court endorsed the "as-efficient-competitor test" used by the Commission. The Court explicitly stressed in that case the need to determine whether the practice leads to anti-competitive effects, concluding that the practice of the company constituted an abuse to the extent that it had an exclusionary effect on competitors who are at least as efficient, to the detriment of consumers' interests.

  This is fully in line with our Guidance paper on exclusionary abuses.

- Last year the ECJ upheld the Commission's predation prohibition decision in *France Telecom*, confirming that recoupment was not a necessary part of a showing of predation. Leaving aside the question of recoupment of loss, I would note that the relevant question is one of demonstrating likely consumer harm as we seek to do in any abuse case, and there can be multiple ways of doing that. Indeed, the Court explicitly referred to our effects based analysis, opening the door to continued use of that analysis in the future.

- *Intel* is perhaps the leading example of our implementation of the thinking underlying our Enforcement Priorities guidance in Article 102 cases. In particular, the case examined whether the conduct at hand was capable of excluding a competitor as efficient as the dominant company.

2.4 Tomra and the principles of the Guidance paper on exclusionary abuse

Some have contrasted this effects-based approach with the General Court's ruling in *Prokent/ Tomra*. But again I do not think that such a contrast would be a fair reflection of the *Tomra* ruling.

I believe that on the facts of the case, the Court supported the Commission's analysis, which went beyond showing that effects were likely to occur, and showed that they had in fact materialised.

There are elements in the judgment that both support the earlier case law taking a view that certain types of conduct are in general illegal, and at the same time show that the Court is sensitive to an effects-based approach.

For example, the Court paid particular attention to the Commission's analysis of the structure and characteristics of the markets, the position held by Tomra and its competitors, the size of the customers, the development of demand, the coverage and duration of the contracts, and the "suction effect" of the rebate schemes.

Alongside the "as-efficient-competitor-test", such factors are identified in our Guidance as important for the assessment of conditional rebates. And these elements were clearly perceived by the Court as relevant and supportive of the solidity of the Commission decision.

Speaking in broader terms, I think that our Guidance Paper strikes a good balance in setting out our priorities for abuse of dominance cases.

The Guidance is based on the principle that all firms - including those that hold a dominant position - are entitled to compete on the merits. What these firms cannot do is use their position to cut out competition, prevent innovation and ultimately harm consumers.

There is no one test for determining the likelihood of harm, or which company is in a position to cause harm. It may be an electricity company that controls the price of your electricity at peak hours, or a quasi-monopolist software company that controls the operating system market at all hours. The long term harm to consumers of particular practices may be significant and justify intervention in both cases.

It is the likelihood of a negative impact on consumers – a concern clearly recognised by the Court, including in the Tomra judgment – that governs our enforcement policy.

This will continue to be the case in our enforcement going forward.

Conclusion

This is where we are at today. Competition cases are an intricate combination of legal arguments backed by solid economic analysis.

The interplay between law and economics has never been greater. And the Courts acknowledge this and welcome this interplay.

I see this trend going forward and developing across competition law instruments.

I hope to have set the scene for a fruitful discussion today.