

European competition policy Competition An insider's prospective

Damien Neven, Chief Economist*
DG COMP, European Commission

*The views expressed are those of the author and do not necessarily reflect those of DG COMP or the European Commission

Introduction



- Still 15 years ago, explicit economic analysis in enforcement decisions was quite rudimentary
- Since then, there has been a significant shift towards economic analysis
- By now, the annual turnover of economic consultancies makes up 15% of the fees earned in antitrust cases
- Objective of enforcement has become more focused
What are the effects on consumers ?
- Contribution of economic analysis to enforcement and policy

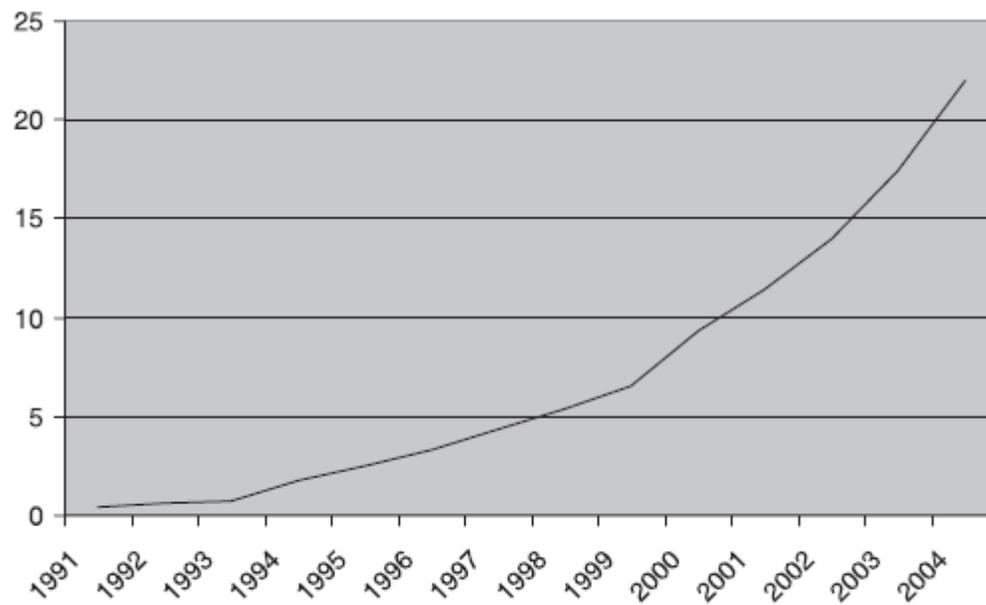


Figure 1. Turnover of economic consultancy firms (current £ million)

Outline



1. Legal concepts have been filled with economic insights
2. Economic evidence has been used in the design of rules
3. How to make the best use of economic analysis in individual cases
 - Adversarial vs inquisitorial systems
 - Standard of review
 - The Monti reforms
 - Transparency
4. Conclusion



Economic insights in legal concepts

Collective dominance

Collective dominance



- Absence of individual dominance
- Loose reference to a mechanism of coordination in Gencor/Lonrho and Nestlé/Perrier
- Airtours/First choice
 - Language suggestive of unilateral effects
 - [In the Airtours Decision]...*the Commission considers that it is sufficient to establish that the industry in which the merger is taking place is an oligopoly without actually showing that the merger creates or reinforces the collective dominant position (F. Jenny)*
- Court decision

Airtours decision



- "It is sufficient that the merger makes it rational for the oligopolists, in adapting themselves to market conditions, to act – individually – in ways which will substantially reduce competition between them, and as a result of which they may act, to an appreciable extent, independently of competitors, customers and consumers".
- "Nor does it regard a strict retaliation mechanism, such as that proposed by Airtours in its reply to the Statement of Objections, as a necessary condition for collective dominance in this case; where, as here, there are strong incentives to reduce competitive action, coercion may be unnecessary."

Court decision



- The Commission made an error of assessment when deciding the merger should be prohibited; it did not prove that the merger will impede competition
- Transparency is not high
- There are no sensible punishment mechanisms
- Cautious capacity setting is not an anti-competitive measure
- Collective dominance is now understood in the framework of coordination in repeated interactions
- Other examples : dominance and market power, distortion of competition under 81



Economic evidence

And the design of rules

Designing rules



- Per se rules or form-based approach:
 - Practices are per-se abusive or presumed abusive (e.g. tying, loyalty rebates, below cost-pricing)
 - A high market share is indicative of market power
 - Foreclosure = Abuse (to be abusive) “it is sufficient to show that (the conduct) tends to restrict competition (or) is capable of having that effect” (Michelin II, p. 239)
- Full rule of reason (unconstrained effects based approach)
 - Consider whether the practice has led or is likely to lead to consumer harm

Designing rules (ii)



- **Structured rule of reason (and simple rules)**
 - Particular findings trigger a different approach
 - California dentist association : agreement on prices are per se unlawful unless a justification can be found; its presence triggers a full rule of reason
 - Illustration : presumption that tying is not anticompetitive unless products are complements. If they are, a full rule of reason applies
 - The dominance screen is the expression of a structured rule of reason (practices are not anti-competitive in the absence of dominance – finding of dominance triggers an analysis of effects)

The problem with simple rules



- There are very few instances in which in which effects can be clearly associated with simple criteria
- Simple rules involves significant type I and type II errors
- And impose significant costs on companies
- Rebates :
 - Rebates schemes of dominant firms ought to be identical for all customers (Michelin II).
 - Retroactive rebates are not allowed (BA/Michelin)
 - Regional rebates are not allowed (Irish sugar)

Rebates



- But companies that are obliged to provide price list with volume discounts only are deprived from...
- Designing incentives for retailers to work harder in the interest of the consumer
- Rebalancing competition between large and small retailers (to the benefit of the latter)
- Lowering price selectively to increase sales
- Granting discounts to customers that negotiate hard
- Respond to entry...

Guidelines



- Non horizontal merger guidelines
- Guidance on the Commission priorities in the enforcement of Art 82.
- Outline the theories of harm – in terms of underlying economic theory and the the possible sources of efficiencies
- Indicate the evidence that is relevant to validate the theory
- Provide presumptions (when possible) based on available evidence

Resale price maintenance



- Per se unlawful in the US, until the *Leegin* judgment (2008)
- Court judgment reviews the existing economic theories and available evidence
- A hardcore restriction in the EU. A presumption that is unlawful. And the Commission does not have the burden of showing that it is anti-competitive
- In principle, companies could advocate a efficiency defence

Pro-competitive effects



- To motivate with higher margins more spending and investment by retailers to sell the manufacturer's product.
- To protect retailers from others' free-riding on their service provisions, in order to preserve retailers' incentives to perform.
- To permit the higher margins that motivate retailers to invest in their own reputations that can be transferred to the product.

Free-riding What Retailer Services?



Displays, advice, demonstrations, skilled sales force, effective showroom, demand-inspiring shopping experience, local advertising, post-sales servicing and parts availability, greater inventories, appropriate storage, longer selling hours, better retail location, more retail outlets, better shelf placements, ...

Why are these vulnerable?



- Without minimum RPM, price competition among outlets could drive margins too low to support the costs of these retail services, and to motivate their being incurred by the retailers.
- Without minimum RPM, retailers who charged high margins to support provision of services would be undercut by free-riding retail competitors who benefit from the services without paying for them. So retailers won't spend on the services without reward of diverted sales

Alternative mechanisms ?



- Not always, because contracts for the services incomplete, and costly to monitor.
- Retailers may know better what services to provide to build demand if motivated.
- Can't charge consumers, except through the good's price.
- Other incentive mechanisms even more limiting of dealer competition, like exclusives.

Collusion among producers:



- A cartel of manufacturers might use RPM to help monitor and enforce the cartel's agreement.
 - it is easier for manufacturers to observe the retail prices of their competitors' products than the prices those manufacturers charge retailers.
 - RPM agreements establish minimum retail prices for every manufacturer's products.
 - If these agreements are enforced, they take away the profitability of secret upstream discounts by manufacturers because retailers are not able to pass those discounts on to consumers in the form of lower retail prices.
 - The deviating manufacturer could still choose not to enforce its RPM policy so that its retail price would fall and sales would increase.
 - But this would be more easily detected than a secret upstream price cut by the other members of the cartel and could elicit an unfriendly response. Assumption: retail price cuts are more visible than upstream price cuts - plausible in some situations.
- Limited explanatory power:
 - cartels work best when manufacturers' products are homogeneous
 - RPM is used when products are differentiated.
 - Product differentiation creates all kinds of non-price competition among the cartel members that would be difficult for a cartel to control, especially in an environment where contracts cannot be enforced in a court of law.

Collusion among retailers



- Retailers conspire to get manufacturers to set resale prices at monopoly levels.
 - by inducing manufacturers to “impose” an RPM policy upon them, retailers in effect deter themselves from cheating on the agreement and discounting prices.
 - Retailers thereby delegate both the implementation and the enforcement of the cartel to the manufacturer.
- Retailers must possess monopsony power, either unilaterally or by means of a common agency (like a trade association), to induce the manufacturer go along
- Indeed, if retailers in one channel attempted a price increase using RPM, consumers might be easily diverted to other channels.

Collusion



- Note there is no evidence that retailer cartels held together by RPM are common
 - No account for how retailers could avoid their cartel being undermined by other forms of competition, such as non-price rivalry - precisely what RPM would tend to promote as argued above.
- Testable implication: the manufacturer would be worse off under the RPM agreement
 - However: the typical resale price maintenance case involves a manufacturer acting unilaterally
- Rey-Jullien (2007): RPM prevents adjustment to local conditions → trade-off between greater ability to detect cheating and less flexibility to choose profit-maximising prices. *Conclusion: RPM only reduces welfare when the goods are sufficiently differentiated.*
- Nocke-White (2006): vertical integration decreases incentives to cheat by “denying” the cheater access to some downstream channel(s).
- Evidence from Lafontaine and Slade (2008)

Rule of Reason



- Allegation of collusion facilitated by minimum RPM should be a required starting point for violation.
- Little inter-brand competition should be a necessary condition for proceeding with allegation of manufacturer collusion.
- Manufacturer coercion should be a necessary condition for proceeding with allegation of dealer collusion.
- Effects analysis should consider pro-competitive function of the RPM and how conducive is the market to collusion due to the RPM.

Guidance from *Leegin*



- the number of manufacturers that make use of the practice in a given industry can provide important instruction. When only a few manufacturers lacking market power adopt the practice, there is little likelihood it is facilitating a manufacturer cartel, for a cartel then can be undercut by rival manufacturers.”
 - “Likewise, a retailer cartel is unlikely when only a single manufacturer in a competitive market uses resale price maintenance.”
 - “Resale price maintenance should be subject to more careful scrutiny, by contrast, if many competing manufacturers adopt the practice.”
 - “The source of the restraint may also be an important consideration. If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer.”
 - “If, by contrast, a manufacturer adopted the policy independent of retailer pressure, the restraint is less likely to promote anticompetitive conduct.”
 - “A manufacturer also has an incentive to protest inefficient retailer-induced price restraints because they can harm its competitive position.”
 - “As a final matter, that a dominant manufacturer or retailer can abuse resale price maintenance for anticompetitive purposes may not be a serious concern unless the relevant entity has market power.”



How to make best use of economic Analysis in cases

Economic analysis in actual cases



- Capture by some unaccountable bunch of pseudo scientists ?
- Reversals in court: Airtours, GE/Honeywell, Tetra Laval/Sidel, Schneider/Legrand
- Sharp criticism by the court regarding the economic analysis and the treatment of the evidence (manifest errors of appreciation)
- Useful to understand possible sources of the difficulties

Inquisitorial vs adversarial



Inquisitorial :

- Self confirming bias ? Avoid cognitive dissonance
- Evidence from the US (FTC procedure)
- Career concerns (CS dislike the status quo)

Adversarial :

- Parties may provide misleading information

If evidence cannot be manipulated, the adversarial system dominates (DT, 1999) – the inquisitor may not look for evidence that may be conflicting

If evidence can be suppressed, inquisitorial procedures lead to extremism

Adversarial procedures may lead to either to inertia (a party does not reveal information conflicting evidence when the opposite party has positive evidence) or extremism (conflicting evidence is not reported when the other party has no evidence)

Standard of review



- The Court has made clear that it will not interfere with the complex economic analysis that is necessary to take correct decisions
- In the words of Advocate General Tizzano in *Tetra Laval*,

"The rules on the division of powers between the Commission and the Community judicature, which are fundamental to the Community institutional system, do not ... allow the judicature to go further, and ... enter into the merits of the Commission's complex economic assessments or to substitute its own point of view for that of the institution."

- And Microsoft..



"Although as a general rule the Community Courts undertake a comprehensive review of the question as to whether or not the conditions for the application of the competition rules are met, their review of complex economic appraisals made by the Commission is necessarily limited to checking whether the relevant rules on procedure and on stating reasons have been complied with, whether the facts have been accurately stated and whether there has been any manifest error of assessment or a misuse of powers."

"In so far as the Commission's decision is the result of complex technical appraisals, those appraisals are in principle subject to only limited review by the Court, which means that the Community Courts cannot substitute their own assessment of matters of fact for the Commission's."



- The Court understands that an assessment requires a story and a consistent set of facts (Impala judgment)
- "It follows that, in the context of the assessment of the existence of a collective dominant position, although the three conditions defined by the Court of First Instance in *Airtours v Commission*, paragraph 45 above, which were inferred from a theoretical analysis of the concept of a collective dominant position, are indeed also necessary, they may, however, in the appropriate circumstances, be established indirectly on the basis of what may be a very mixed series of indicia and items of evidence relating to the signs, manifestations and phenomena inherent in the presence of a collective dominant position".
(251)



- ECJ on series of indicators : “it is essential that such an investigation be carried out with care and, above all, that it should adopt an approach based on the analysis of such plausible coordination strategies as may exist in the circumstances”
- The CFI “did not carry out its analysis ...by having regard to a postulated monitoring mechanism forming part of a plausible theory of tacit coordination”.

Procedures : conclusion



- EU procedures can be described as inquisitorial with a prosecutorial bias (to compensate for the absence of plaintiffs in merger cases)
- But parties have a right to submit evidence at (almost) any time
- It is prone to particular forms of bureaucratic capture
- In addition, the merger regulation is symmetric (both authorization and prohibition with the same standard of proof)
- As a result, impossible to take some decisions if the standard is different from balance of probabilities (think of standard of 0.7 with evidence that the merger is anti-competitive with a probability equal to 0.6)
- The standard of review is limited in scope
- A spicy cocktail...

Procedural reforms



- Hearing officer, panel (fresh pair of eyes..), Chief economist office
- Establish an administrative law tribunal within DG Comp
- Make the CFI the first instance ? (the Commission becomes a prosecutor) – feasible under Treaty rule, at least for 81/82
- Move towards a more adversarial procedure ? Or at least enhance accountability during the procedure

Further transparency



- Adopt a code of conduct with regards to the development and submission of economic and econometric evidence
 - Research question
 - Data
 - Methodology
 - Results
 - Robustness
- Such code of conduct would apply to all parties involved, including the Commission.

Conclusion



- The EU is in a better position to take advantage of economic analysis than the US
- And abuse of it...
- Institutional response
- Strong demand for academic work
 - In theory
 - Econometric techniques
 - Accumulation of empirical evidence
- Interaction with judges and the legal profession
- Thinking that simple imprecise rules offer more legal security than sound principles would be an offence to the legal profession