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Economic principles for the enforcement of abuse of dominance provisions

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1 INTRODUCTION

On 27 March 2023, the European Commission (EC) amended the Guidance on enforcement priorities,² which was issued in 2009,³ and announced it would write new guidelines on exclusionary abuses. It also published a Competition Policy Brief explaining these initiatives in light of the evolution of the case law and the EC's practice (European Commission, 2023).

In this Policy Insight, we offer our view on how to use economics to improve the enforcement of the abuse of dominance provisions of Article 102 TFEU. We shall do so by covering the points amended by the EC Guidance Paper and discussed in the related Policy Brief. In particular, Section 2 will discuss the definition and the objective of exclusionary abuse; Section 3 will focus on horizontal foreclosure, suggesting how to treat conduct such as predation, rebates, and exclusive dealing; and Section 4 will focus on foreclosure in adjacent markets, discussing how to treat, for instance, refusal to supply, margin squeeze, self-preferencing, and tying.

Before dealing more extensively with each of these issues, however, we spell out a few principles that in our view should guide an effects-based approach of exclusionary abuse, and summarise the main arguments we shall make in our paper.

1.1 General principles

We welcome the EC's intention to issue Guidelines on the enforcement of exclusionary abuse and to clarify how it intends to incorporate an effects-based approach (fully endorsed by the Union Courts in recent case law) in such enforcement. This will promote predictability and legal certainty.

Consistently with the objective of improving legal certainty, it is important to stress that an 'effects-based' and 'economically sound' approach does not mean a 'case-by-case' approach where each case is assessed in a completely different way, nor that

¹ This paper is based on two documents written for DG Competition of the European Commission. The information and views set out here are those of the authors and do not necessarily reflect the official opinion of the Commission. Without implicating them (on some of the issues, we 'agree to disagree'), we have greatly benefited from discussions with Giulio Federico, David Kovo, Thomas Buettner, Lluís Sauri, Hans Zenger, as well as members of DG Competition's Economic Advisory Group on Competition Policy (EAGCP), in particular Giacomo Calzolari, Patrick Rey and Emanuele Tarantino.

² Communication from the Commission. Amendments to the Commission Communication – Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conducts by dominant undertakings.

³ Communication from the Commission – 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, 24.2.2009, p. 7.

each and every case should necessarily involve sophisticated quantitative evidence or bespoke economic theory models. We also note that in some quarters the economic approach to abuse of dominance cases has been equated to the use of the (misleadingly named) ‘as efficient competitor test’. We strongly disagree: the now vast body of economic knowledge on exclusionary practices clearly indicates that price-cost tests are useful when dealing with certain practices, but irrelevant or misleading with others. Relatedly, certain practices, such as exclusive dealing and other practices that reference rivals, should simply be presumed to be anti-competitive. For other practices (e.g., predation, selective price cuts, quantity rebates), instead, the price-cost test is useful and its result should determine presumptions of harm or lawful behaviour.

We also stress that *formulating an explicit and coherent theory of harm is essential in all cases*, and all quantitative and qualitative evidence should be interpreted within its framework. Of course, this is even more relevant for cases which do not fall neatly within either of the two categories above, for instance, cases of rebates conditional on a market share which is appreciable but far from 100%, or cases where the price-cost test does not give unambiguous results.

1.2 Summary

General considerations on the concept of exclusionary abuse

Objective of enforcement. In line with EU competition law, *the objective of the enforcement of Article 102 should be consumer welfare*, a concept that (a) takes into account not only prices but also other factors such as quality, variety, innovation; (b) should be seen in a dynamic (or forward-looking) perspective, which takes into account (appropriately discounted) future effects; and (c) should be assessed by factoring in uncertainty through a ‘balance of harms’ approach where both the probability and the magnitude of harm are taken into account.

We also believe that the Guidelines should avoid reference to possible objectives (e.g., protection of the competitive structure of the market) which are sometimes mentioned in the EU case law but lack a clear economic counterpart, are not well-defined, and might give rise to ambiguity.

Definition of abuse. As a corollary of the previous point, *for an exclusionary abuse to be established, it is necessary to show that the conduct produces anti-competitive effects by harming consumers*.

Accordingly, we believe that the Guidelines should refrain from using ambiguous concepts such as “conduct not being competition on the merit” or tests which seem to identify an abuse with exclusionary effects on rivals rather than adverse effects on consumers.

Partial foreclosure. Importantly, and consistently with the above, a practice can be anti-competitive even if it has neither the intent nor the effect of fully excluding the rival. However, the conduct at issue should have *appreciable* anti-competitive effects.

Form versus effects of conduct. Although an effects-based approach is incompatible with the idea that a practice which takes a particular shape should automatically be considered abusive, as suggested above the economic literature shows that certain practices have a stronger anti-competitive potential than others. Therefore, we favour establishing rebuttable presumptions for these.

Horizontal foreclosure

Turning to practices which involve market rivals, and following on from the previous point, exclusive dealing and rebates conditioned on buyers purchasing a large part of their needs from the dominant firm – for brevity, henceforth we call them ‘**practices that reference rivals**’⁴ – do not necessarily require profit sacrifice on the side of the

⁴ Taken literally, even a discount conditional on 10% of the buyer’s need does ‘reference rivals’. Instead, we use the term to mean that it involves a significant proportion of needs of the buyers.

dominant firm and have a high anti-competitive potential. Accordingly, they should be treated as *presumptively abusive*, and the burden of proving otherwise should fall on the dominant firm. For this category of cases, a price-cost test does not shed light on the lawfulness of the practice. Accordingly, if the defendant showed that it is setting prices above costs, this should not be treated as discharging its burden of proof.

The role of the ‘as efficient competitor test’. Price-cost tests are crucial evidence for the practices which likely include profit sacrifice, such as predation, selective price cuts and quantity rebates⁵ (i.e., all forms of discounts which do not reference rivals). For such cases, we believe that – in line with case law – a price below the lower cost threshold (e.g., average avoidable costs) should be presumed unlawful, whereas a price above the higher cost threshold (e.g., average long-run incremental costs) should be presumed lawful. (A rule which could find above-cost pricing abusive, for instance, to protect less efficient competitors, would chill competition and harm consumers.) If prices fall between these cost thresholds, abuse should be established if the available evidence supports a clearly defined theory of harm. Such evidence includes documentary evidence showing intent and about the coverage and length of the discounts, as well as the *degree of dominance*. Indeed, we believe that a general principle when dealing with abusive conduct is that *the more entrenched a dominant position, the higher the potential for anti-competitive harm of any given conduct*.

More generally, since such tests necessarily involve some degree of judgement on the appropriate cost data and might entail complex calculations, their results might be uncertain and should be interpreted within the framework of a *theory of harm* and of all other qualitative and quantitative evidence available. (The same holds for cases where it is unclear if the practice has such coverage to trigger an anti-competitive presumption.) Indeed, *we regard the formulation of an explicit theory of harm as indispensable in any abuse case*: the EC should spell it out clearly and check the extent to which the facts of the case are consistent with such a theory.

It is also important to underline that price-cost tests should be carried out with measures of the dominant firm’s costs, not those of its rivals, whether as or less efficient. This is for at least two reasons: first, the price-cost test acts as a proxy for profit sacrifice by the dominant firm, and hence *the efficiency of the rivals is irrelevant*; second, given that cost information is typically private information, using a measure of cost that the defendant does not know would undermine legal certainty.

Foreclosure in adjacent markets

On indispensability in vertical foreclosure cases. When dealing with vertical foreclosure, one should be aware that a dominant firm might resort to different practices which, at least to some extent, can be substitutable to each other. An effects-based approach should not treat in a different way cases which differ in form but not in substance. For instance, there is no effective difference between a dominant firm which bluntly refuses to supply its input and another that offers it at such an arbitrarily high price that the buyer would obviously not buy, or accepts to give it but then delays access continuously, or degrades interoperability to a level that the input is of little use to the buyer. In this respect, we think that outright and constructive refusal to supply should *not* be subject to different standards, such as requiring to show the indispensability of the input in the former but not the latter cases in order to undertake antitrust action. We also note that constructive refusal to supply (which may include a range of degrees of unfairness in the terms of supply) has the same or less anti-competitive potential than an outright refusal to supply. Hence, if anything, it should be treated less strictly than outright refusal, contrary to the current case law.

⁵ Some quantity rebates may amount to practices that reference rivals. For instance, a dominant firm may offer individualised rebates which are conditional on a certain volume of orders, knowing (for instance, because of stable market conditions and absence of uncertainty) that that volume amounts to the totality or quasi-totality of the likely purchases of the buyer. In such a case, though, the EC should have the burden of showing why in the case at hand the quantity discount should be interpreted as a contract referencing rivals.

In any case, the literature on exclusionary practices shows that the indispensability of the input is not a necessary condition for a dominant firm to engage in vertical foreclosure (which includes outright or constructive refusal to supply, margin squeeze, tying of an important input, and self-preferencing) with anti-competitive effects. Therefore, (a) for a vertical foreclosure action, the input at issue should be a crucial asset but not necessarily an indispensable one (within the *Bronner* meaning); (b) all vertical foreclosure cases (including both outright and constructive refusal to supply cases), should be subject to this principle.

Yet, in order to preserve the incentives to invest and innovate, we would find it justified to limit vertical foreclosure actions only to dominant undertakings that (i) have not committed considerable resources, effort, creativity or acumen to develop the input; or (ii) have already abundantly gained from their input; (iii) or are already subject to regulatory obligations to share the input with rivals.

Self-preferencing. The term ‘self-preferencing’ refers to a number of situations where an integrated firm discriminates in favour of its (first-party) services or products to the detriment of those of a rival (third party). Since it is a relatively new concept, it is worth some additional considerations. Whatever the precise features it takes, it is a form of vertical foreclosure and can have the same anti-competitive effects. As such, the considerations we made about input essentiality also apply to practices which can be defined as self-preferencing. We also argue that *price-based self-preferencing* should generally be assessed under the usual margin squeeze approach.

Limiting principles. Practices which may be described as self-preferencing should be subject to limiting principles. First, as for other forms of vertical foreclosure, self-preferencing might have objective justifications, including safety or security concerns or reputational effects. Of course, the dominant firm should support such claims with unambiguous and objective evidence. Second, there might be situations where self-preferencing is unlikely to have appreciable effects. Third, in some cases, what might appear as self-preferencing is, in fact, an efficiency. For instance, a first-party app might guarantee a better and more seamless experience to users than a third-party app because its programming code is fully integrated into the software of the platform, while the third-party one is not. Therefore, for self-preferencing to constitute an exclusionary abuse, it should be shown that it leads to the (partial or full) exclusion of rivals to the detriment of consumers.

Tying and bundling. The current case law treats tying as abusive if certain conditions are satisfied. One such condition is that the tying at issue ‘restricts competition’. When assessing such cases, the Commission should be guided by the ultimate objective of consumer welfare, and interpret the concept of ‘restricting competition’ as ‘harming consumers’ rather than ‘harming rivals’. This, together with making explicit the theory of harm, that is, the mechanism whereby tying would allegedly be detrimental to consumers, is essential to avoid finding tying abusive even in instances where it is actually pro-competitive.

2 GENERAL CONSIDERATIONS ON THE CONCEPT OF EXCLUSIONARY ABUSE

2.1 Consumer welfare as the objective of Article 102 enforcement

From an economic perspective, the objective of competition policy should be economic welfare (i.e., total surplus). We understand, though, that under EC law, the objective is likely consumer welfare (or consumer surplus), and hence this should be the objective guiding the enforcement of Article 102. We take this objective as given and choose to avoid a discussion on the relative merits of economic welfare versus consumer welfare.

We would rather highlight three important features of the concept of consumer surplus. First, consumer surplus is a *broad objective* that takes into account not only prices but also other factors such as quality, variety, and innovation.

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