frontier economics

European Commission's Consultation on the Draft Guidelines on the Application of Article 102 TFEU

Response of Frontier Economics

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Frontier Economics is an economic consultancy that regularly advises clients on antitrust issues relating to European and national competition law.

We welcome the European Commission's endeavour to update the guidance and issue guidelines on the Application of Article 102 TFEU. In this context, the purpose of this response is not to comment comprehensively on all aspects of the proposed Draft Guidelines, but rather to focus on a number of specific parts of the Draft Guidelines that we believe should be further clarified or improved.

1 The concept of competition on the merits

1 The concept of competition on the merits is at the heart of the framework proposed in the Draft Guidelines to determine whether conduct by dominant undertakings is liable to constitute an exclusionary abuse.[1] And it is defined as *"conduct within scope of normal competition on the basis of the performance of economic operators and which, in principle, relates to a competitive situation in which consumers benefit from lower prices, better quality and a wider choice of new or improved goods and services*".[2]

2 This concept is intended to capture both specific forms of conduct for which there is a defined legal test and, more importantly, articulate an 'umbrella' concept for all other potential forms of exclusionary abuses. Whilst the concept of competition on the merits has repeatedly been referred to by the Courts, the attempt by the Draft Guidelines to bring a practical definition to this concept is flawed.

3 First, conduct by dominant undertakings liable to constitute exclusionary abuse is defined by what it is *not* (situations that depart from competition on the merits) rather than what it *is*. This negative definition leaves the door open for a wide and unspecified array of conducts to fall under this definition.

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1 Draft Guidelines, paragraph 45.

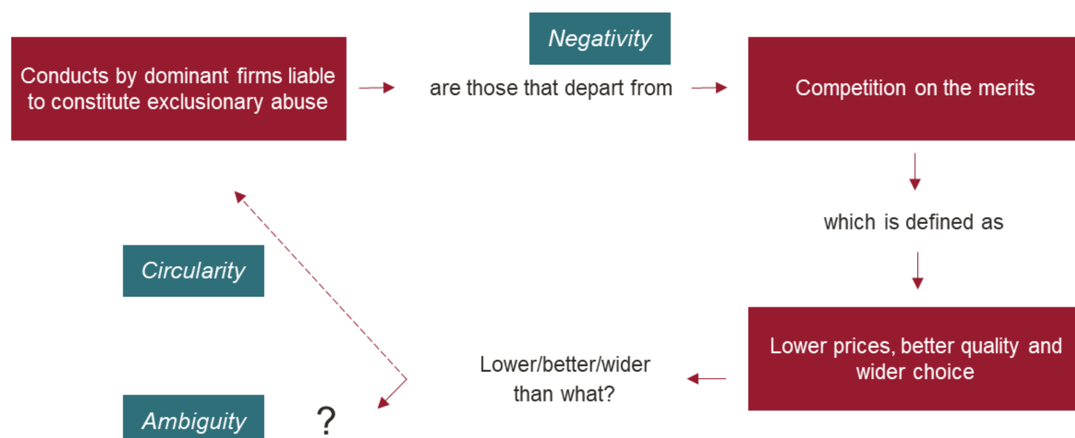
2 Draft Guidelines, paragraph 51.

4 The Draft Guidelines attempt to mitigate this issue by listing a few examples of specific conducts that do not fall under competition on the merits.[3] This is not enough, as the Guidelines do not explain why the named conducts do not qualify for it and therefore do not provide enough guidance to dominant undertakings aiming to conduct self-assessments.

5 All one needs do to satisfy this negative definition is to allege that a given conduct is not "normal competition". What is normal competition? The attempt to define "normal" by reference to certain desirable outcomes (lower price, better quality, wider choice, improved products) is entirely inadequate, and represents a backward step in economic thinking by the Commission.

6 Competition is a *process*, not an outcome. Yes, well-functioning competitive markets will generally produce desirable outcomes (and that is why competition policy seeks to protect the competitive process) but competitive processes can produce "abnormal" results, and it is poor policy making to second guess what the outcomes of any given competitive process might be. Yes, generally competitive markets tend to produce lower prices, but other times they do not (firms may exit, consumer preferences may change); sometimes competition produces more choice, but other times it may narrow the choices. The "normalness" of the outcomes of a competitive process are a yardstick that is unreliable at best, and potentially damaging at worst.

7 Moreover, competition on the merits is defined as a *relative* situation where prices are lower, quality is better and choice is wider. However, the Draft Guidelines do not provide any guidance as to what is the benchmark against which such relative terms would be assessed (creating ambiguity), and leaving the reader wondering whether the benchmark is the starting point: conducts liable to constitute exclusionary abuse (creating circularity).



3 Draft Guidelines, paragraph 53 to 54.

8 As a result, this negative, ambiguous and potentially circular definition obfuscates legal certainty and hinders the ability of firms to self-assess prospective conducts.

9 Ultimately, the Guidelines fail to provide an adequate definition of competition on the merits because they have deliberately moved away from the more concrete concept of *anticompetitive foreclosure*. Reinstating this concept would go a long way towards correcting the deficit in the Guidelines, since it would provide a means to give a positive definition to what it means to depart from competition on the merits. Rather than focus on the ambiguous (and impossible to define) concept of what "normal" competition by a dominant firm looks like, the focus of defining abuse would then rightly by shifted on to understanding the potential *impact* of conduct upon competitors' ability and incentive to compete on the market.

10 The importance of switching from a negative to a positive definition of departure from competition on the merits can be illustrated with a sporting analogy. Suppose one were to adopt the definition of "foul play" in sport along the lines proposed by the Commission: foul play would be match conduct that departed from "normal" play, where normal play were defined as games that demonstrated athletic prowess, entertaining match-play and nail-biting finishes. Now consider a dominant team who takes lead and then controls the ball, slows down the game, and plays nothing but defence until the final whistle. Foul play!

2 Replicability and the as efficient competitor principle as alternative proposals

11 As indicated in our submission to the EC call for evidence on the adoption of Guidelines on exclusionary abuses of dominance,[4] a more effective option would be to ground competition on the merits in the more tangible concept of replicability and the well-established as efficient competitor (AEC) principle. For instance, if a dominant undertaking's conduct is non-replicable by as-efficient, non-dominant rivals in the short or long-run, it is likely that it is capable of being abusive, especially if that conduct does not make economic sense over and beyond to exclude non-dominant, as-efficient rivals.

12 This principle is essential because it underlies the economic rationale for why acquiring dominance itself is not prohibited. The pursuit of market power (or more generally the pursuit of positive economic profits) plays a critical role in incentivising economic progress. If this incentive were removed from the economy, the result

[4] https://www.frontier-economics.com/uk/en/news-and-insights/news/news-article-i10258-response-to-the-ec-call-for-evidence-on-the-exclusionary-abuses-guidelines/

would be stagnation. Firms must create and innovate in how they identify and serve the needs of consumers before they can earn the reward of supra-competitive returns. Dominance (and the positive economic profits it generates) therefore sends a strong economic signal to the market for other firms to respond and also seek to compete to serve whatever economic need is being uniquely met by the dominant firm.

13 For the dynamics of a competitive market to function well over time, it is essential that rivals are not prevented from responding to the market signal that dominance creates. At the core of any exclusionary abuse is an attempt to interrupt this market mechanism, by preventing those who could and should respond to market signals from doing so.

14 But of course, not all challengers deserve success – hence the importance of the as-efficient competitor concept. This principle defines the conditions under which a rival should be expected to succeed against the dominant firm. If the dominant firm's conduct means that even an as-efficient competitor would be impeded from bringing effective competition, then that conduct stands in the way of the dynamic competitive process.

15 This is where the concept of non-replicable conduct is particularly useful, since it provides a way of identifying behaviour by a dominant firm which the as efficient competitor cannot access. If the competitive success of the dominant firm is predicated on the use of such conduct, then there are grounds to investigate whether this might be capable of anticompetitive foreclosure.

16 The application of the non-replicability test can be illustrated with (stylised) examples:

(a) **Rebates** – The dominant firm has a non-replicable offer such that customers need to purchase at least X% of their purchases from them. By employing a retroactive rebate scheme, whereby customers receive a discount across all purchases if they buy at least X% from the dominant firm, rivals find it extremely costly to expand beyond 1-X% of each customer's requirements, as to do so requires compensating customers for the full cost of the discount. *Non-replicable dimension: the minimum share of each customer's requirements that cannot be contested.*

(b) **Predation** – The dominant firm charges a price below average variable cost. Rivals can also charge a price at this level, and so it is not the pricing element that is non-replicable. Rather, the dominant firm is essentially focusing competition on its deep pockets – it can charge these prices because it can afford to make losses for a significant period of time, while the rival cannot. *Non-replicable dimension: the deep pockets of the dominant firm (within the context of a loss-making pricing strategy).*

(c) **Wholesale margin squeeze** – An infrastructure owner – typically one that is regulated, and hence has to provide access at a particular price – faces competition from a rival, who is gradually building a rival infrastructure network. Customers want full market coverage and do not want to "mix and match" from multiple providers, so to be credible the rival needs to purchase access from the incumbent. This provides the incumbent with the ability to influence or control (depending on the extent of regulation) the rival's costs and hence to influence or determine whether it will be able to survive. *Non-replicable dimension: the full market coverage of the existing network.*

(d) **Retail margin squeeze** – A monopoly infrastructure owner (wholesale level) also provides services over that network (retail level). It is required by regulation to provide wholesale access to all retailers. It sets wholesale prices at a level that means that rival retail offerings cannot make a profit, either through price discrimination, or through making a loss at the retail level. *Non-replicable dimension: the wholesale infrastructure (in either case, although in slightly different ways).*

(e) **Refusal to deal** – A monopoly upstream infrastructure provider refuses to provide access to a critical input for downstream competition. *Non-replicable dimension: the upstream infrastructure.*

(f) **Exclusivity dealing** – A dominant firm signs up key customers to "take it or leave it" long-term exclusive contracts. Rivals can offer similar contracts, but either cannot get access to the customers because they are not yet in the market, or cannot credibly supply the whole of a customer's requirements. *Non-replicable dimension: i) the fact that the dominant firm's market position gives it access to customers more quickly and/or ii) that only the dominant firm can serve the whole of a customer's requirements.*

17 There are other potential abuse of dominance strategies which are not covered in the non-exhaustive list above. However, hopefully these examples demonstrate that a credible abuse case needs to be rooted in a commercial strategy that utilises the non-replicable dimension of a dominant undertaking.

18 Whether or not the Commission agrees with Frontier's proposal of non-replicability and the AEC principle to ground the concept of competition on the merits in economic theory, the Commission, if it holds on to its two-part test, should consider presenting a more prescriptive definition of competition on the merits, or an explicit definition of conduct which departs from competition on the merits, in its final Guidelines. This would enhance legal certainty and facilitate self-assessment, one of the Draft Guidelines' objectives.[5]

[5] Draft Guidelines, paragraph 8.

3 Presumptions are not appropriate for all conducts

19 The Draft Guidelines maintain that certain conducts can be presumed to be either competition off the merits, or can be presumed as capable to exclude, as long as "*specific legal tests*" are met.

20 From an economic perspective, a presumption can be effective when established and practicable economic tests allow for identifying such conduct with reasonable certainty. Examples where this is the case are the conducts of **predatory pricing** below average cost and **margin squeeze** with negative margin.[6] The Draft Guidelines state that a presumption can be made once a price-cost-test is met, and we agree.

21 In addition, a general presumption on conducts that can be demonstrated to fulfil no economic purpose other than to exclude competitors ("**naked restrictions**") is equally justified.

22 However, for conducts where no established and practicable economic test exist to show that the conduct "*pursues no economic objective other than eliminating its competitors*"[7], presumptions are not effective and may even present a chilling effect on competition.

3.1 Tying and bundling

23 **Tying and bundling** are extremely widely adopted business strategies with established welfare enhancing potential (as recognised in the Draft Guidelines).[8] Any presumption, even if 'soft', may discourage such practices and, in turn, negate the consumer welfare enhancing effects that could arise from them.

24 On the contrary, the presumption maintained in the Draft Guidelines is far from being 'soft'. It states that exclusionary capability may be presumed where '*the inability of competitors to enter or expand their presence in the tied market is likely to directly result from the tying conduct due to the absence of clearly identifiable factors that could offset the exclusionary effects'.*[9] This presumption is poorly worded and hard to interpret. But it appears to be extremely wide-ranging and effectively imposes on dominant undertakings to assess every tying conduct for possible exclusionary capabilities and assess any offsetting factors a priori.

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6 Chiara Fumagalli and Massimo Motta, Economic principles for the enforcement of abuse of dominance provisions, CEPR, January 2024.

7 Draft Guidelines, paragraph 111a.

8 Draft Guidelines, paragraph 87.

9 Draft Guidelines, footnote 233.

25 Many innovative products combine hitherto separate products and may therefore initially qualify as tying conduct due to the market definition at the time of launching the product. An intuitive example of such innovation would be washing machines that include a drying functionality, or mobile phones that include high quality cameras. These products were originally separate, but have since become joint products loved by consumers. Again, presumptions on tying and bundling conducts risk discouraging such innovations and consumer welfare enhancing tying practices.

26 In addition, we note that the guidelines state that conduct may not qualify for a presumption (and warrant further investigation) where "(*i) the tied product is available for free and (ii) it is easy to obtain alternatives to the tied product"*.[10] We agree with the Draft Guidelines' suggestion that in cases where these two conditions are met, further investigation is warranted.

27 However, the absence of these two conditions is not in and off itself sufficient ground to warrant such a wide-ranging presumption of exclusionary effects. From an economic perspective a tying conduct where the tied product is *not free* and *does not have alternatives* could for example be the result of an innovative product that ties two functionalities that does not (yet) have alternatives and is not necessarily anti-competitive and exclusionary. It is therefore paramount that the EC does not fall back on presumptions for tying and bundling conducts and will have to continue to set out plausible mechanisms of exclusion in all cases.

28 Finally, the Draft Guidelines present the concept of *'coercion'* as a key condition for the tying conduct to be liable to be abusive. However, again, the definition of this concept is unduly wide-ranging and worryingly ignores consumer behaviour.[11]

29 For example, the current definition could allow a 'coercion finding' even in a situation where there is evidence that only a small proportion of users of the tying product actually use the tied product, and indeed many continue to use alternative offerings. Or where there is evidence that it is possible for users to opt out of any interaction and engagement with the tied product. In both those examples it is clear that coercion is not taking place, but the current Draft Guidelines fail to take this into account.

3.2 Refusal to supply

30 The Draft Guidelines now split **refusal to supply** and the softer constructive refusal to supply (or "*access restrictions*") into two different conducts, with no presumption of

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10 Draft Guidelines, paragraph 95.

11 Draft Guidelines, paragraph 92.

exclusionary capability applying to either but a presumption of departure from competition on the merits for refusal to supply only.

31 Specifically, the Bronner criterion of indispensability applies only to outright refusals to supply but not to constructive refusals. This lowers the hurdle for the EC to establish an abuse in the case of constructive refusals to supply compared to outright refusals to supply, as the EC does not have to prove that the upstream product is indispensable to be competitive downstream.

32 This does not make sense from an economic point of view, as the economic incentives and potential effects of the two types of behaviour are likely to be the same. Whether a dominant company refuses deliveries completely, or arbitrarily demands high prices or unreasonable conditions does not change the practical result of no delivery and thus also does not change the economic results in terms of higher prices and/or lower quality.

33 Moreover, this difference in treatment seems illogical because it lowers the barrier to intervention for less restrictive behaviour and creates the wrong incentives, as it is less risky for a company to refuse access than to provide it at a high price. The Guidelines should make an effort to align the evidentiary thresholds that need to be met for both conducts.

3.3 Exclusive dealing (including rebates)

34 **Exclusive dealing and exclusivity rebates** are among the practices economic research has identified as likely to constitute abusive exclusionary conduct, and hence a presumption could seem economically plausible.

35 However, such practices might not always be abusive and the Draft Guidelines outline several mitigating factors.[12] For example, they are less likely to be abusive if they only affect a small part of the downstream market, are applied over a short duration, or occur where the company's dominance is limited.

36 It is therefore clear that the potential for abuse depends on the specific circumstances rather than solely on the form of the conduct. A blanket presumption, as proposed by the Guidelines, does not seem proportionate.

37 Instead, if the presumption is to be maintained in the final Guidelines, the Commission should at least consider indicating thresholds for those specific circumstances that – if not met – free the conduct from a presumption of abuse.

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12 Draft Guidelines, paragraph 83.

4 The Commission's final Guidelines should allow for a realistic efficiencies defence

38 In our view the Draft Guidelines are a missed opportunity to further clarify and set out specific evidentiary thresholds that the Commission intends to apply to efficiency claims by dominant undertakings.

39 Instead, the Draft Guidelines remain essentially unchanged compared to the 2008 guidance paper, and while they now include minor clarifications evolving from the case law, other helpful examples and explanations have been dropped.

40 The explanations on the *Post Danmark I* criteria[13] now fail to link the benefits that need to arise from efficiencies to the consumer welfare standard (referring instead to "consumer interest"[14]). Helpful examples on what could constitute consumer benefits have been dropped. Explanations on the concept of indispensability[15] and the requirement that not all rivalry is eliminated have also been dropped with no replacement.

41 The draft holds the Post Danmark I criteria against a wholly undefined *'requisite standard of proof'*. It would be preferable if the Commission could provide further guidance on the standard of proof that is grounded in economic theory and can realistically be met by conduct that leads to clear and well-defined efficiencies that are highly likely to be passed on (akin to variable cost efficiencies in the merger guidelines).

5 The Draft Guidelines' departure from established rules of thumb hinders legal certainty and enforcement

42 In outlining certain exceptions to well-established rules of thumb in the enforcement of Article 102 TFEU, the Draft Guidelines fail to enhance legal certainty. For instance:

(a) it is established in the case law that it is seldom the case that an undertaking is considered dominant if its market share falls below 40%. In a move to the other extreme, the Draft Guidelines instead state that dominance can even be

13 Draft Guidelines, paragraph 169.

14 Draft Guidelines, paragraph 169a.

15 Draft Guidelines, paragraph 169c.

established "*in exceptional circumstances*" when an undertaking's market share is below 10%;[16] and

(b) according to the economic literature, pricing strategies above average total costs do not constitute an exclusionary abuse (e.g. predation). On the other hand, the Draft Guidelines present pricing above average total cost as an example of conduct that can "*in specific circumstances, be found to depart from competition on the merits*".[17]

43 Our understanding is that by outlining exceptions to the norm the Commission is attempting to future-proof the enforcement of Article 102 TFEU. However, by caveating well-established economic standards in the assessment of dominance and exclusionary conduct the Draft Guidelines instead fail to provide clear guidance which hinders the ability of (i) dominant undertakings to conduct self-assessments, and (ii) national competition authorities (NCAs) and courts in the EEA to consistently and predictably enforce Article 102 TFEU.

44 We invite the Commission to drop these statements or, at the very least, provide more clarity as to what conditions would need to be met for such exceptions to be considered in an enforcement investigation. Such a clarification will foster legal certainty as dominant undertakings, NCAs and the courts will be better equipped to understand how exceptional these exceptions really are.

16 Draft Guidelines, footnote 41.

17 Draft Guidelines, paragraph 57.