New challenges faced by competition law

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CURRENT TRENDS AND DEVELOPMENTS IN COMPETITION LAW

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Issues to be discussed

1) Cooperation: Have we reached the limit ?

2) Convergence: Unfinished business: Exploitative abuses of dominance

3) Competitive neutrality: A necessary complement largely ignored

4) Innovation and competition: As confusing as ever

5) Fairness and competition: What goal should we pursue ?

1) Cooperation

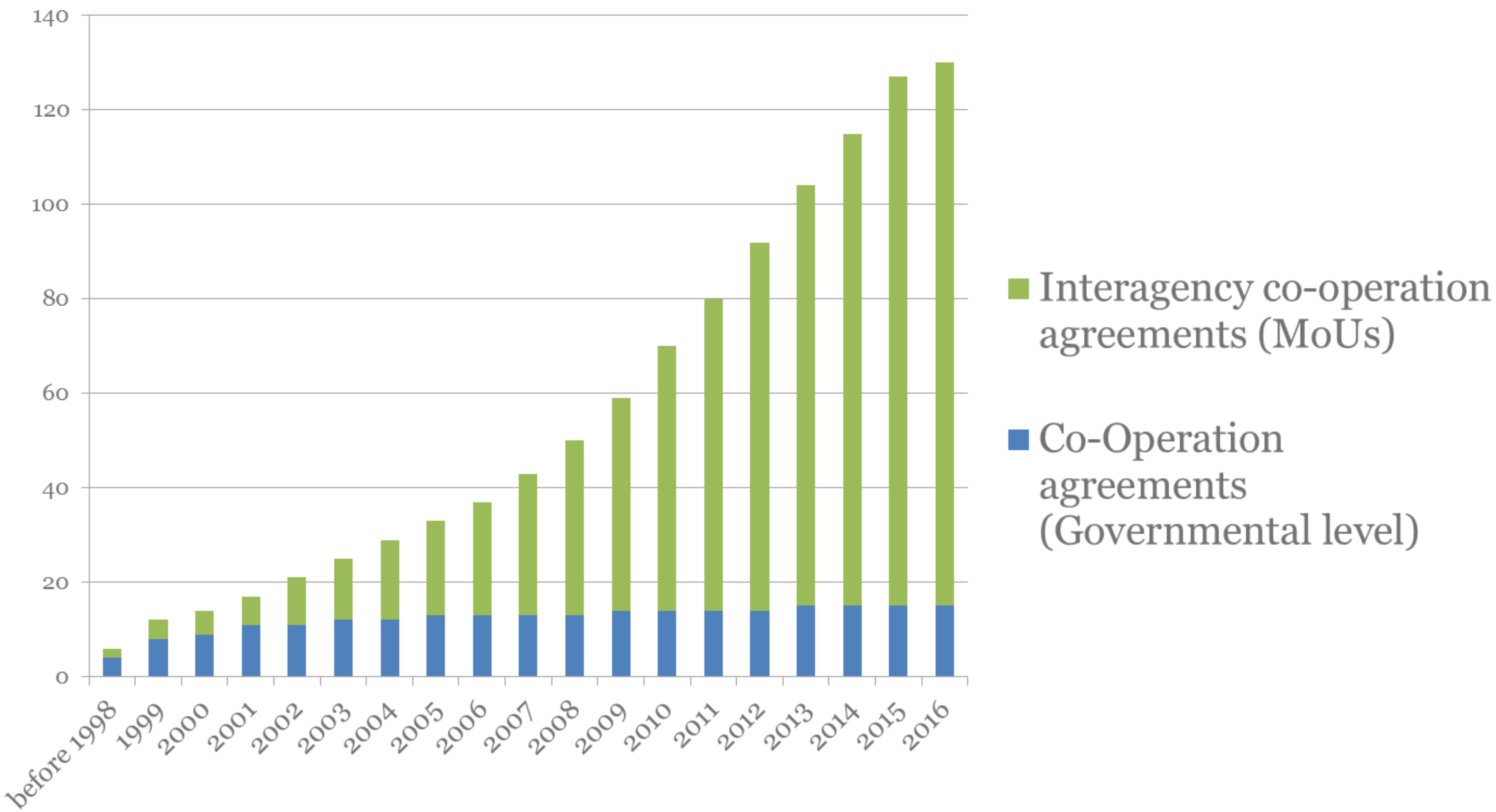
What can agencies co-operate on

- Locating and identifying persons
- Serving documents
- Taking evidence
- Executing requests for searches and seizures
- Providing publicly available evidence
- Exchanging information
- Providing documents and reports
- Discussing the theories of harm
- Enforcing administrative and judicial decisions, including the collection of fines

Instruments for co-operation

- Non-competition specific instruments
  - MLATs, Extradition treaties, Letter Rogatory
- Regional Trade Agreements
  - E.g. ASEAN
- Competition co-operation Agreements
- Provisions in national laws
- Confidentiality waivers provided by leniency applicants or merging parties
- Informal co-operation

Development of co-operation agreements *(2016 data)*



International co-operation is increasing

- The number of cases involving international co-operation has increased over time

	Increase in Cases Involving Co-operation (2007-2011)
Cartel	15%
Merger	35%
Abuse of Dominance	30%

- The frequency of international co-operation expected to continue increasing, due in part to more multi-jurisdictional cases

Report on the OECD/ICN Survey on International Enforcement Co-operation

Effective co-operation may be constrained

Ranking of Limitations and Constraints		
Rank	By “importance”	By “frequency”
1	Existence of legal limits	Existence of legal limits
2	Low willingness to co-operate	Lack of resources/time
3	Absence of waivers	Different legal standards
4	Lack of resources/time	Different stages in procedures
5	Different legal standards	Low willingness to co-operate

On-going challenges for international co-operation

- Increase the **number of countries** involved in international enforcement co-operation
- Improve **legal basis** for formal co-operation
- Facilitate the **exchange of confidential** information
- Envisage **new means of enhanced co-operation**?
  - Adopting multilateral instruments e.g. **one-stop shop for leniency markers**
  - Developing **international standards for comity**
  - **Mutual recognition** of other agencies’ decisions
  - Non-binding **deference to one ‘lead authority**’

2) Abusively high prices and economic logic

Monopoly price as an important element of the free market system

Similarly, in its **Trinko decision** (Verizon Communications, Inc v Law Offices of Curtis V. Trinko124 S. Ct. 872, 875, 879 (2004).), the Supreme Court stated :

“The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free market system. **The opportunity to charge monopoly prices—at least for a short period—is what attracts “business acumen” in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct.”**

Recent pricing issues in the EU

Margrethe Vestager , "Chillin' Competition Conference", Brussels, 21 November 2016

1) Gazprom:

"we're concerned that (…) restrictions on the free flow of gas may be against the competition rules and that they may have paved the way for charging excessive prices. And we're also concerned that **those prices themselves may be against the competition rules.**

2) Pharmaceuticals

"there can be times when prices get so high that they just can't be justified" (…) **there can be times when competition rules need to do their bit to deal with excessive prices.**

3) Standard-essential patents

" (…)some phone makers may need to accept whatever terms they're presented with. That could mean they end up paying unjustified royalties, and that their customers have to pay more than they should". Which is why the Commission ordered Motorola not to ask for injunctions against phone makers that were willing to pay a fair price for a licence, and accepted Samsung's commitments to stop doing the same thing.

The United Brands test

In its United Brands Judgement, the ECJ gave some indication of how the rule should be applied to excessive pricing by dominant firms. It stated that:

250. "**In this case charging a price which is excessive because <u>it has no reasonable relation to the economic value of the product would be an abuse</u>**".

The Court also proposed a test to establish a violation for excessive pricing:

251. "This **excess** could, inter alia, **be determined objectively** if it were possible for it to be calculated by making a **comparison between the selling price of the product in question and its costs of production, which would disclose the amount of the profit margin** (...)".

252. "The questions therefore to be determined are **whether the difference between the costs actually incurred and the price actually charged is <u>excessive</u>**, and, **if the answer to this question is on the affirmative, whether a price has been imposed which is either <u>unfair in itself or when compared to competing products</u>".**

The United Brands test revisited: fairness

The European Commission in subsequent cases, most notably in **its Scandline Port of Helsinbourg decision** (Case COMP/A.36.568/D3 – Scandlines Sverige AB v Port of Helsingborg), explained that the **assessment of the fairness of a price could not come from a simple comparison of the price–cost margin of two similar services on different markets.   Indeed the intensity of demand by consumers may influence the economic value of the product or the service and must be taken into consideration.**

As the Commission has stated in its decision: “227 **the demand-side is relevant mainly because customers are notably willing to pay more for something specific attached to the product/service that they consider valuable.**

This specific feature does not necessarily imply higher production costs for the provider. However, it is valuable for the customer and also for the provider, and thereby increases the economic value of the product/service”.

Test in the Helsinbourg case: Is it applicable to « free markets » ?

Nils Wahl "Exploitative high prices and European competition law – a personal reflection", Pro and cons of High Prices, 2007

However, the difficulties now sketched out would seem minor as compared to an assessment of whether a price is unfair in itself. **If one would – as the Commission in Scandlines – take into account also other non-cost related factors, it would seem less likely that monopoly pricing or any price less than that would be considered excessive**.

Assuming that the primary objective of the pricing strategy of any firm (on a free market) is to extract the maximum from its customers, it is respectfully submitted that I fail to see that any price would be excessive in itself.

Given what has been stated previously, it would seem as **the prohibition against excessively high exploitative prices has its primary scope of application in situations of legal monopolies or regulated markets**.

In free markets it may principally be used when the **pricing strategy focuses on something other than exploiting its customers on that particular product**, for example by trying to prevent parallel imports.

The Aspen case/ Unfairness

The ICA considered case specific elements to evaluate the **general unfairness of prices applied by Aspen.** These are:

- **Absence of any economic justifications for such an increase**:

- No increase in production or distribution costs documented by Aspen;

- No justification based on the innovative efforts and on R&D expenditure;

- Absence of any non-cost related factor leading to an improvement in quality or in the level of service to the NHS or patients;

- Nature of the drugs (antineoplastic) and absence of substitutes driving to inelastic demand: no possibility for patients to shift to alternative medical life-saving treatment (high-level willingness to pay);

1) Alessandra Tonazzi Italian Competition Authority (ICA), ICN Annual Conference , Porto, 10-12 May 2017

Comparison between the assessment of excessive prices and predatory prices

In predatory pricing cases, a misguided finding of violation (a type I error) will not have the same consequences as a misguided finding of an excessive price will.

A type I error in an excessive price case can discourage investment and R&D expenditures both by the dominant firm and by potential entrants and reduce dynamic competition.

A misguided finding by a competition authority that the price of a dominant firm is predatory will, if anything, improve the investment prospects of potential entrants (in the industry and because of the value of the decision as precedent in other markets as well) and lead to more dynamic competition on their part rather than less competition.

So the social cost of errors in the case of predatory cases is lower than the social cost of errors in excessive pricing cases.

Limits to excessive price cases suggested by economists

:

1) High non transitory barriers to entry

2) Near monopoly not resulting from innovation or investment

3) Exclusion of IP cases

4) No competent sectoral regulator

5) « Wide » difference between price and average cost

6) Consideration of pricing of elements of a portfolio

7) Non applicability to one side of a multi-sided markets

8) No fines or damage actions for abusively high prices

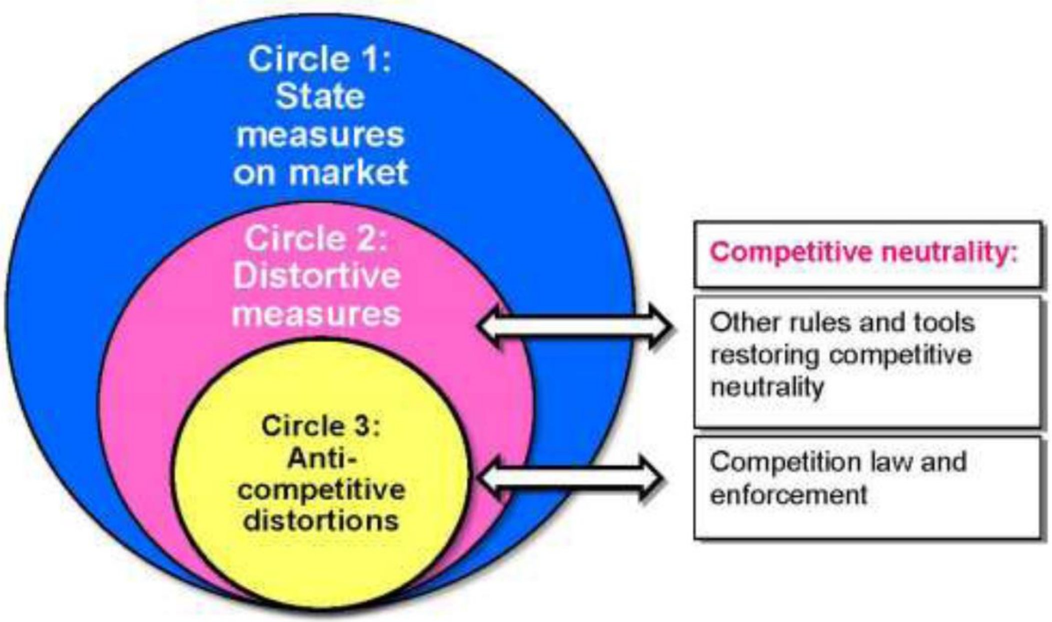
3) Competitive neutrality

State intervention in markets

The **state represents 40-50% of GDP in OECD countries**.

Questions to be asked:

(i) Is there a distortion?
(ii) Is the distortion avoidable?
If not(iii) Do the benefits of this policy outweigh the costs? This last is often a political rather than merely technical question, as it is for government to determine the relative importance attached to different outcomes.

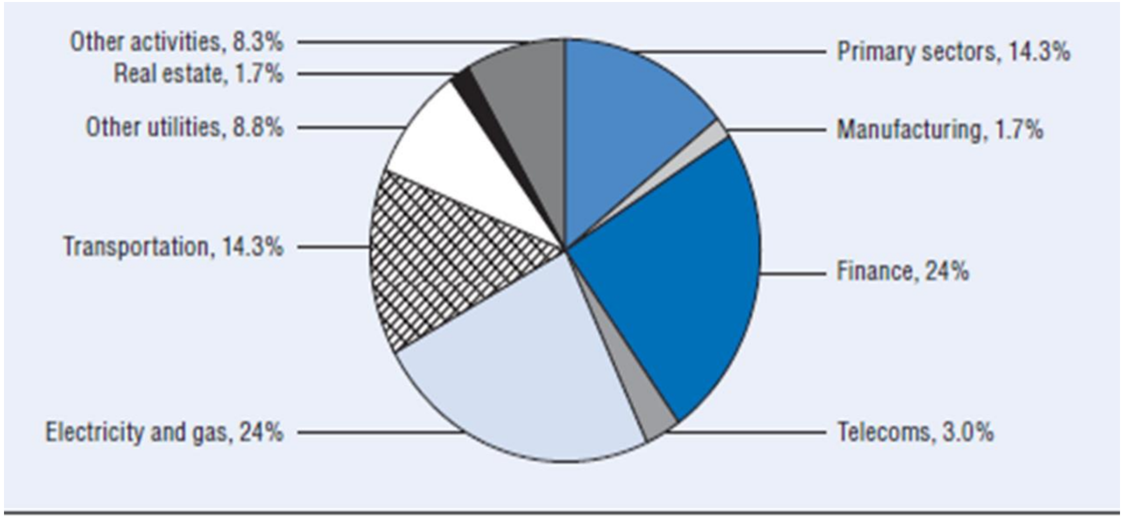


State interventions in markets

State ownership and control

Possible advantages : lower capital cost from government financing,
protection against hostile acquisitions and bankruptcy,
privileged access to information and infrastructure,
favouritism in public procurement (as a buyer or seller).

Possible disadvantages: restrictive labour practices and bureaucracy,
weak management due to lack of incentives,
requirements to carry out non-commercial functions.



OECD 2014
34 Jurisdicitions

State interventions in markets

Subsidies and public services

Regulation

Liberalisation is incomplete or de-regulation is uneven;

Regulator or incumbent wears various hats (e.g. infrastructure owner, operator and service provider), and structural separation or behavioural conditions are lacking to prevent bias and conflicts of interests

No domestic co-operation between the government or sector regulator and the competition authority;

No international co-operation and co-ordination among governments liberalising those sectors with an actual or potential cross-border dimension.

Special professions and licensing regimes

Industrial policy and state activism

Golden shares and shareholder's activism, investments by sovereign wealth funds, political involvement in strategic deals, joint technological or industrial initiatives, public-private partnerships for infrastructure, administrative hardship or ease on certain industries

Competitive neutrality framework

Overall competitive neutrality framework, or competition neutrality piece by piece

Australia overall framework : first OECD country to develop a comprehensive policy framework articulated by the Commonwealth Competitive Neutrality Policy statement which establishes that "**Competitive neutrality requires that government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership**"

EU piece by piece regime State Aid regime ; Altmark case law provide a useful framework to assess so-called services of general economic interest (SGEI) under state aid law, and to draw the line between warranted and distortive compensation schemes.

4) Competition law and innovation

Competition authorities and innovations

The Dow/Dupont EU Merger case

Dow DuPont merger decision: Justification for the unilateral effect theory of harm on incentives to innovate

(40) **A merger between two out of a limited number of innovators is likely to reduce competition in innovation, and thus limit the overall rate of innovation**. **This conclusion is supported by a number of articles - see for example Gilbert (2006b), Gilbert and Greene (2015), Shapiro (2010) , Shapiro (2012) and Whinston (2012).**

(41) **The intuition for this proposition relies on the standard logic of unilateral effects**. (…) when competing against other firms for the introduction of new products, **each firm imposes a "negative externality" on its competitors**. If it is successful in introducing a new product, the innovator will capture profitable sales from its rivals. A merger between two potential innovators internalises the negative innovation externality. In other words, **from the perspective of each innovator, the lost expected profits on the products of the other merging firm become an opportunity cost of innovating. Following a merger the opportunity cost—that was not present before—leads to lower incentives to innovate for each of the two firms (absent merger-specific efficiencies).**

Product innovation

Bruno Jullien, Yassine Lefouili, Horizontal Mergers and Innovation, March 2018

We pay special attention to the recent theoretical papers by Federico, Langus and Valletti (2017a, 2017b) as they formalize the arguments that the Commission used in the Dow/DuPont case.

With respect to product innovation we consider the **innovation diversion effect, the demand expansion effect, the margin expansion effect, the spillover effect**

In particular, we argue that these two papers provide only a partial picture of the impact of mergers on innovation and do not justify the authors "claim that "a merger between two out of a limited number of innovators is likely to lead to a reduction of innovation in a market characterized by limited knowledge spillovers and in the absence of other possible countervailing efficiencies" In contrast, Bourreau, Lefouili and Jullien (2018) show that **the overall impact of a merger may be positive even in the "worst-case" scenario in which the merger leads to monopoly and there are neither spillovers nor efficiencies.**

Disruptive innovations

The Facebook/ Instagram merger
OFT decision: 22 August 2012.

Potential competition in the supply of social network services.

29. In summary, **the evidence** before the OFT **does not show that Instagram would be particularly well placed to compete against Facebook in the short run**. In addition, there are other firms that appear to be presently able to compete against Facebook for brand advertising. For these reasons, the OFT believes that there is no realistic prospect that the merger may result in a substantial lessening of competition in the supply of display advertising.

5) Should competition authorities care about fairness?

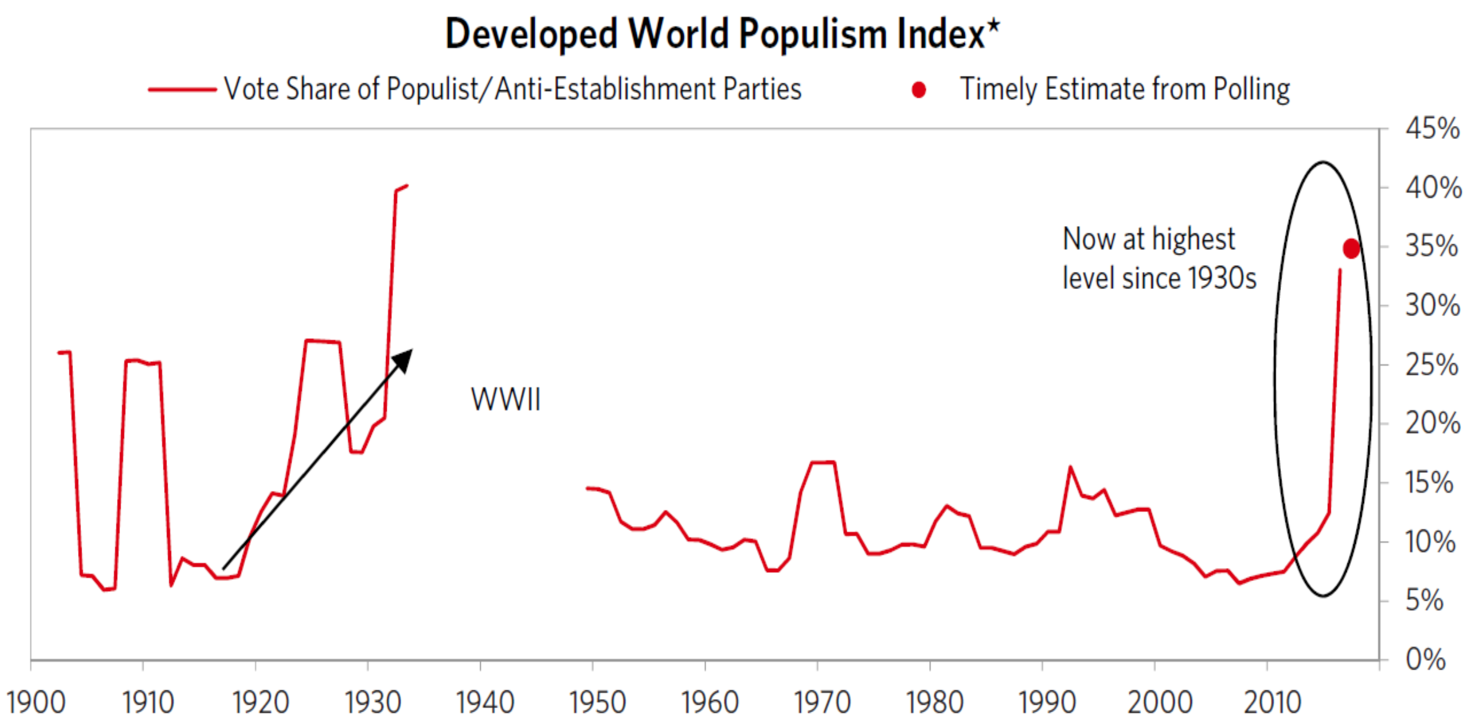
Drivers of economic resentment

Economic resentment: Drivers: Economic insecurity, inequality and stagnation

This resentment is driven by **the consequences of globalization on the distribution of jobs, wealth and income** and by the **disruptions that globalization implies in terms of increased competition.**

By claiming that economic liberalisation and globalisation benefit society, the elite and the media are considered to be « lying » and « pushing an agenda which works against the people ».

Resurgence of populism in the world



**The latest point includes cases like Trump, UKIP in the UK, AfD in Germany, National Front in France, Podemos in Spain, and Five Star Movement in Italy.*

1) **Bridgewater Associates, 2007, Ray Dalio Steven Kryger Jason Rogers Gardner Davis**

Inequality and the vote for Trump

Table 1: Regression estimate for the determinants of the share of Trump votes relative to the average of the Republican candidate votes in 2004, 2008 and 2012

	Model A	Model B	Model C	Model D
Gini coefficient	0.60**	0.64*	0.98**	0.80**
	(2.06)	(1.97)	(2.38)	(2.41)
Share of Hispanics	-0.19***		-0.21***	-0.22***
	(-3.39)		(-3.65)	(-3.62)
Share of foreign-born population		-0.25**		
		(-2.32)		
Share of population aged 18-44	-0.71**	-0.71**	-0.75***	-0.49
	(-2.62)	(-2.45)	(-2.76)	(-1.51)
Share of population with a high school diploma or less	0.24**	0.21	0.26**	0.30**
	(2.13)	(1.66)	(2.26)	(2.45)
Share of male population			1.24	
			(1.29)	
Share of African-American population				-0.090
				(-1.23)
Constant	-0.10	-0.11	-0.88	-0.28
	(-0.77)	(-0.74)	(-1.43)	(-1.43)
R-squared	0.49	0.43	0.51	0.51
Observations	51	51	51	51

Zsolt Darvas and Konstantinos Efstathiou, Bruegel : November 9, 2016

Inequality and the vote for Brexit

	Model A	Model B	Model C	Model D
Share of population aged 20-34	-0.49 [-4.0]	-0.95 [-6.6]		
Share of population aged 65 and over			0.45 [3.2]	0.69 [3.7]
Share of population with a degree	-0.97 [-11.9]		-1.05 [-13.5]	
Share of population without qualification		0.58 [4.9]		0.64 [5.0]
Disposable income per inhabitant	0.04 [1.9]	-0.08 [-3.2]	0.05 [2.0]	-0.09 [-3.3]
Gini coefficient of income inequality	0.77 [2.6]	0.89 [2.4]	0.93 [3.1]	1.24 [3.1]
Poverty rate	1.00 [3.0]	0.85 [1.9]	1.06 [3.1]	0.95 [2.0]
Unemployment rate	-0.14 [-0.7]	-0.06 [-0.2]	-0.34 [-1.7]	-0.48 [-1.6]
Share of non-UK born population	-0.02 [-0.3]	0.01 [0.1]	-0.05 [-0.6]	-0.12 [-1.2]
Scotland	-19.64 [-17.9]	-19.99 [-14.2]	-19.92 [-18]	-20.73 [-13.7]
Northern Ireland	-14.61 [-6.5]	-17.15 [-6.0]	-14.13 [-6.1]	-17.38 [-5.5]
Wales	-5.30 [-3.9]	-6.82 [-3.9]	-6.00 [-4.3]	-8.39 [-4.5]
London	-8.84 [-2.9]	-11.71 [-3.0]	-9.27 [-3.0]	-12.78 [-3.1]
R2	0.85	0.76	0.85	0.72

Zsolt Darvas Date, Brexit vote boosts case for inclusive growth, Bruegel, July 13, 2016

What do we learn from the trade debate ?

- Competition create winners and losers

- **Labor markets do not adjust as economic theory suggests they do** and exogeneous shocks lead to both higher unemployement and lower wages in competitio-exposed markets.

-The **losers of (international) competition are low-skilled wage earners**. Even when they find new jobs, the tend to earn les than they did before competition set in.

- **Capital is definitively on the winning side since it is very mobile**

- Attempts to help low-skilled labor reallocate do not work well

-(International) competition, even though it has global advantages is detrimental to the interests of some economic groups and is thus seen by them as unfair.

Economic globalization has been mismanaged

"I would say **the agenda for globalization has become very imbalanced**.

There are **specific groups that are benefiting handsomely, and there are groups that have lost out**. The challenge is not to reverse or oppose globalization.

I think the **challenge is to rebalance it in a way that will provide broad gains to many groups who feel they have been excluded**.

I do think we've mismanaged this process badly.

The forces that have gained, the right-wing populists, don't have a stake in either liberal democracy or the liberal world economy, and both are at stake right now. But I do think there is a way out.

It's going to require alternatives to the narrative of the right-wing populists, and I'm hoping that will come about."

1) Interview de Dani Rodrik, Professor of economics at the Kennedy School of Governement, Harard University, « The rise of populism shouldn't have surprised anyone", Washington Post, August 10 2017

Fairness is the problem, not inequality

"Inequality has been named as a culprit in the populist incursions of 2016 and 2017 (…)what is inequality, and what role does it play in inhibiting or encouraging growth, or in undermining democracy? Does inequality kill, say, by driving people to suicide or to "deaths of despair"? Or is inequality a necessary evil that we must tolerate at certain levels?

These are questions I am often asked. But, truth be told, none of them is particularly helpful, answerable, or even well posed.

Inequality is not so much a cause of economic, political, and social processes as a consequence. Some of these processes are good, some are bad, and some are very bad indeed. Only by sorting the good from the bad (and the very bad) can we understand inequality and what to do about it.

Moreover, **inequality is not the same thing as unfairness; and, to my mind, it is the latter that has incited so much political turmoil in the rich world today.** Some of the processes that generate inequality are widely seen as fair. But others are deeply and obviously unfair, and have become a legitimate source of anger and disaffection".

Angus Deaton

Unfairness and populism

Who can be surprised that white, blue-collar Americans turned out of once-secure employment now back Mr Trump? Nor is it strange that similar demographic groups supported Brexit — swayed by the toxic rhetoric that blames their misfortune on immigrants.

Look across continental Europe and the rise of extreme nationalism mirrors the erosion of the social market economy — a brand of capitalism that offered a stake to ordinary voters.

The strains have been intensified, of course, by digital technology and by the anti-competitive rent-seeking of a handful of tech behemoths. The cost of Google's aggressive tax avoidance falls on those least able to bear it**. The emotion that has done most to swell the ranks of the populists has been a sense of unfairness — the belief that elites are indifferent to their plight.**

Philip Stephens, "Populism is the true legacy of the global financial crisis", Financial Times , 31/08/2018

What is fairness ?

Implicit in the debate between critics and proponents of fairness, is however an **overly broad, undefined notion of fairness, which in our view fails to advance the debate**. In contrast, we highlight the need to **assess specific dimensions of fairness that are pertinent to the domestic competition policy domain**, which we evaluate in turn.

(…) we identify the following specific notions of fairness that are pertinent to domestic markets:

vertical fairness (between producers and consumers);

horizontal fairness on the demand side (between consumers);

horizontal fairness on the supply side (between producers);

procedural fairness (due process and private enforcement).

MICHAEL TREBILCOCK & FRANCESCO DUCCI, "THE MULTIFACETED NATURE OF FAIRNESS IN COMPETITION POLICY", Competition Policy International, 2017

Behavioural economics and vertical fairness

The approach of the present study is purely descriptive. Normative status is not claimed for the generalizations that are described as "rules of fairness," and the phrase "it is fair" is simply an abbreviation for "a substantial majority of the population studied thinks it fair."

The paper considers in turn **three determinants of fairness judgments:**

1) the **reference transaction**,

2) the **outcomes to the firm and to the transactors**, and

3) the **occasion for the action of the firm**

Daniel Kahneman, Jack L. Knetsch and Richard Thaler "Fairness as a Constraint on Profit Seeking: Entitlements in the Market, The American Economic Review, Vol. 76, No. 4 (Sep., 1986), pp. 728-741

Vertical fairness and reference transaction: principle of dual entitlement

Implications

An increase in price by a firm not justified by an increase in cost or by an increase in the price of a competitor is likely to be seen as unfair (even if it is not anticompetitive)

An increase in price following an increase in price by a competitor or an increase in cost is likely to be seen as fair (even if it may be anticompetitive)

Vertical fairness and outcomes to the firm and its transactors

Example

A shortage has developed for a popular model of automobile, and customers must now wait two months for delivery. A dealer has been selling these cars at list price. Now the dealer prices this model at $200 above list price.

(N = 130) **Acceptable 29%** **Unfair 71%**

Question B..... A dealer has been selling these cars at a discount of $200 below list price. Now the dealer sells this model only at list price.

(N = 123) **Acceptable 58%** **Unfair 42%**

Daniel Kahneman, Jack L. Knetsch and Richard Thaler "Fairness as a Constraint on Profit Seeking: Entitlements in the Market, The American Economic Review, Vol. 76, No. 4 (Sep., 1986), pp. 728-741

Vertical fairness and outcomes to the firm and its transactors

Implications

A cartel to **reduce discounts** is **less likely to be seen as unfair** than a cartel to increase prices.

A cartel to **slow down a decline in price** is **less likely to be seen as unfair** than a cartel to increase price.

A cartel **to pass on an increase in cost** is **less likely to be seen as unfair** than a cartel to increase profits (without cost increase)

A **cartel crisis** among firms losing money is **less likely to be seen as unfair** than a cartel among profit making firms to increase their profits

Daniel Kahneman, Jack L. Knetsch and Richard Thaler "Fairness as a Constraint on Profit Seeking: Entitlements in the Market, The American Economic Review, Vol. 76, No. 4 (Sep., 1986), pp. 728-741

Vertical fairness and exploitation of increased market power

Implications

- Monopoly pricing for consumer goods is likely to be seen as unfair.

- Abuse of economic dependency is likely to be seen as unfair

- Price discrimination for consumer goods is likely to be seen as unfair

- Auctions of consumer goods are likely to be seen as unfair

- Monopoly pricing for durable goods which can store value is likely to be seen as fair since consumers can resale the good at an equivalent or higher price

What do we learn about fairness from Kahneman and others ?

Fairness is an argument in the utility function of at least some consumers (a fact usually not taken into onsideration by competition authorities). However fairness is a complex concept and needs to be elaborated in any discussion of its impact on human behaviour

Depending on the circumstances profit maximization and pro-competitive behaviour may be perceived to be fair or unfair. Competition law enforcement is not necessarily seen as being fair to consumers and more competition is not necessarily perceived as leading to more vertical fairness.

The refusal of many competition authorities to deal with issues of abuse of dependency or excessive prices or to treat crisis cartels leniently or their use of auctions theory, their treatment of multi-sided markets (see for exemple the recent American Express US Supreme court decision) , as well as their reluctance to be lenient with respect to cartels passing on increases in costs , or their fondness for auctions may lead the general public to regard their activity as occasionally (vertically) unfair.

Competition authorities will just keep crashing if they never take their eyes off the rear view mirror

Thank you very much
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