

The Counterfactual Method in EU Competition Law

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What is the Counterfactual Method?

- Counterfactuals can be used to assess the effects of an event. They describes the world in the absence of (or “but for”) that event
- First trace of the counterfactual method can be found in *Société Technique Minière* (1966) in which the ECJ indicated that for an agreement between competitor to be caught under Article 101 it is:
 - “necessary to find that those factors are present which show that competition has in fact been prevented or restricted or distorted to an appreciable extent. The competition in question must be understood within the actual context in which it would occur in the absence of the agreement in dispute”.

Use of the Counterfactual Method

- Until recently, this method was essentially confined to the area merger control
- Under Articles 101 and 102 TFEU, the Commission and the EU Courts initially adopted a “form-based” approach
- Because the aim of the counterfactual technique is to analyse the *effects* of a given event it had little relevance under the form-based approach
- In recent years the Commission has transitioned towards an effects-based approach. The modernisation of EU antitrust enforcement caused a renewed interest in the counterfactual technique. Counterfactuals are discussed in various Article 101 guidelines and in the Article 102 Guidance Paper

Ex ante vs Ex post Counterfactuals

- In this presentation, I distinguish between:
 - *ex ante* counterfactuals (merger control and Article 101 self-assessment): These counterfactuals are relatively easy to establish because they are usually based on the *status quo ante*; and
 - *ex post* counterfactuals (investigations under Articles 101 and 102, damages litigation): These counterfactuals are more difficult to build because they are intrinsically speculative

Ex ante Counterfactuals: Alternative Future

- In our paper, my co-author and I focus on the use of the counterfactual method under EU merger control rules and in *ex ante* control and self-assessment under Article 101 TFEU
- We also demonstrate that while the *status quo ante* constitutes the default counterfactual in these procedures, the Commission is gradually adopting a more dynamic and forward-looking approach towards the counterfactual in merger control cases

Ex ante Counterfactual in EU Merger Control: The Static Approach

- The standard merger control counterfactual is the *status quo ante*, i.e. the situation that prevails at the time when the Commission reviews the merger
 - This approach is illustrated by the use of analytical tools such as the HHI, which is based on the parties' and competitors' market shares and allows the Commission to compare the level of market concentration before and after the transaction
 - The HHI reflects a static vision of the counterfactual: The Commission assumes that in the absence of the transaction, the market will remain unchanged

Ex ante Counterfactual in EU Merger Control: The Dynamic Approach

- The Commission has acknowledged that the *status quo ante* may not always constitute the relevant counterfactual. It is sometimes necessary to take into account certain future events that are likely to take place in the absence of the transaction
- Article 9 of the EMCR:

“In most cases the competitive conditions existing at the time of the merger constitute the relevant comparison for evaluating the effects of a merger. However, in some circumstances, the Commission may take into account future changes to the market that can reasonably be predicted. It may, in particular, take account of the likely entry or exit of firms if the merger did not take place when considering what constitutes the relevant comparison”

Dynamic counterfactual: Illustrations

- **Failing firm defence:** The counterfactual is no longer the *status quo ante*: Rather, it is an alternative future in which the target disappears from the relevant market for reasons unrelated to the merger
- Other example:
 - In *Lufthansa/Austrian Airlines*, the Commission concluded that in the absence of the transaction, the target would have probably been acquired by Air France-KLM. The Commission therefore compared the effects of the notified transaction with those of a hypothetical acquisition of Austrian Airlines by Air France

Ex ante Counterfactual under Article 101 TFEU

- Guidelines on Horizontal Agreements suggest a three-step analysis:
 - Parties need to determine whether the agreement restricts competition by its object
 - If the agreement's object is not anti-competitive, it is necessary to examine its effects on competition
 - The parties should use the counterfactual method and compare the agreement's potential effects with the situation that would arise in the absence of the agreement
 - If the parties conclude that their agreement falls under Article 101(1), they should consider whether it can be exempted pursuant to Article 101(3) because it generates efficiency gains
 - This examination also involves a counterfactual analysis as the parties need to consider whether similar efficiencies can be achieved in the absence of the agreement

Counterfactual under Article 101 TFEU : Static v. Dynamic Approach

- The default counterfactual under Article 101(1) is the *status quo ante*, i.e., the situation that prevails at the time when the parties are planning to enter into an agreement
- The counterfactual should also incorporate the events that are likely to happen in the near future in the absence of the agreement, for instance whether the parties would compete with each other in the absence of the agreement
- But EU Courts will not allow mere speculation. See *European Night Services* where the GC ruled that the Commission's counterfactual (which contemplated operators competing with ENS) was based on “a hypothesis unsupported by any evidence or any analysis of the structures of the relevant market from which it might be concluded that it represented a real, concrete possibility”.

Ex post Counterfactual: Alternative Past

- In *ex post* investigations, the Commission needs to adopt the opposite perspective and consider an alternative past: It needs to imagine what would have happened in the absence of the alleged infringement
- This exercise is intrinsically speculative as it is based on a hypothetical and has to consider one or several scenarios that have never occurred

Ex post Counterfactual Methods: Analytical Methods

- The most important analytical methods that can be used to develop an *ex post* counterfactual rely either on comparators or on economic modelling:
 - First, the Commission can use comparator-based methods taking the data (prices, volumes, etc.) in the unaffected period or on the unaffected markets as an indication of the “but for” scenario
 - Second, the Commission can build economic models simulating the likely market outcome that would have occurred without the infringement

Ex Post Counterfactual in Article 101 TFEU Cases (1)

- The counterfactual method is rarely used in *ex post* investigations under Article 101 for the following reasons:
 - The counterfactual method is only relevant to restrictions by *effect* since restrictions by *object* are essentially *per se* illegal. In recent years, the vast majority of Article 101 investigations initiated by the Commission have related to infringements by object, such as hard core cartels
 - Since the adoption of Regulation 1/2003, the parties are required to perform an *ex ante* self-assessment of horizontal and vertical agreements that may potentially fall under Article 101. The Commission will initiate an *ex post* investigation only if it considers that the self-assessment has not been correctly performed

Ex Post Counterfactual in Article 101 Cases (2)

- In order to engage in counterfactual analysis, the Commission can use a variety of techniques:
 - Demonstrate the anticompetitive effects of a given agreement by comparing prices that prevail on the relevant market with prices on a comparable product/geographic market that is not affected by the agreement. But regression analysis may be needed to control for exogenous factors
 - Simulate counterfactual market outcomes on the basis of models. Models range from monopoly to perfect competition with intermediate models (such as Cournot and Bertrand models)
 - Finally, the Commission can also use the cost-based method, which estimates the level of prices that would have emerged absent the infringement by calculating the relevant firm's production costs per unit and adding a mark-up representing a "reasonable" profit in the non-infringement scenario

Counterfactual in Article 102 Cases: From form- to effects-based approach

- The Commission and the EU Courts have traditionally adopted a “form-based” approach to abuses of dominance and, as a result, paid little attention to the effects of alleged abuses. As long as the form-based approach prevailed, the counterfactual technique had little relevance under Article 102
- However, in recent years the Commission began to gradually shift towards an “effects-based” approach notably with the adoption of the Guidance Paper

The Counterfactual in the Article 102 Guidance Paper

- Paragraph 21 of the Guidance Paper states that:

“This assessment will usually be made by comparing the actual or likely future situation in the relevant market (with the dominant undertaking’s conduct in place) with an appropriate counterfactual, such as the simple absence of the conduct in question or with another realistic alternative scenario, having regard to established business practices”

Not every effects-based analysis is based on a proper counterfactual

- In the *Telekomunikacja Polska* refusal to supply case, the Commission's analysis of the conduct's effects is based on a series of comparators:
 - *Anti-competitive effects*: Evidence of foreclosure is largely based on statements from competitors and on the analysis of failed negotiations
 - *Consumer harm*: The Commission used a comparator-based approach to demonstrate that broadband penetration in Poland was low, retail broadband prices were high, etc.
- The *Telekomunikacja Polska* case shows that while the Commission is eager to include some effects-based analysis in its Article 102 decisions, it is generally unwilling to go beyond a fairly simplistic comparator-based approach and consider more elaborate counterfactuals

The Counterfactual Used as a Defence by Dominant Firms

- Dominant firm can use the counterfactual in Article 102 investigations:
 - First, the dominant firm can use the counterfactual to demonstrate that the theory of harm developed by the Commission and/or complainants does not hold. Exs: *Qualcomm*, *Microsoft Internet Explorer*
 - Second, counterfactuals can be used to demonstrate the lack of anti-competitive effects of a given dominant firm's conduct
 - Finally, counterfactuals can also be used to demonstrate the lack of consumer harm

Use of Counterfactuals in Quantification of Harm in Actions for Damages (1)

- In *Courage v. Crehan*, the ECJ held that the full effectiveness of Article 101 “*would be put at risk if it were not open to any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition*”
- In June 2011, the Commission published a draft Guidance Paper on quantifying harm in actions for damages based on breaches of Articles 101 or 102. The purpose of the Damages Guidance Paper is “*to place at the disposal of courts and parties to damages actions economic and practical insights that may be of use when national rules and practices are applied*”

Use of Counterfactuals in Quantification of Harm in Actions for Damages (2)

- The difference between the use of counterfactual to determine whether Articles 101 and/or 102 TFEU have been breached and the use of counterfactual for the assessment of damages is that in the former case there is no need for the relevant authority to determine the exact *level* of the damages caused by the infringement
- The methods used for counterfactual analysis are, however, similar to those that can be used to assess whether a breach of Articles 101 and/or 102 TFEU has been committed

Economic variables to be considered

- The type of harm for which the injured person seeks compensation determines which kind of economic variables need to be considered
 - In a cartel leading to higher prices for customers, a non-infringement price (or “but for” price) will need to be estimated to have a reference point for comparing it with the price actually paid by these customers
 - In an abuse of dominance case in which the dominant firm’s rivals were foreclosed from competition, the profits lost by these competitors may be measured by comparing their actual turnover and profit margins with the turnover and profit margins they would have likely generated but for the infringement

Measurement difficulties

- Measurements can be difficult as one can never be certain just what would have happened in the “but for” world
- The typical method is to pick some contemporaneous or past baseline where or when markets or firms were not affected by the anticompetitive conduct and assume that any difference between the baseline and reality was caused by the anticompetitive conduct. Contemporaneous or past baselines may be inaccurate because of different costs or demand, because they were also affected by the same anticompetitive conduct, or because firms differ in their efficiency or other features. These differences can, however, be controlled for by econometric analysis
- As a result claimants must often base their cases on expert projections about what prices or profits would have been but for the anticompetitive conduct in a way that accounts for differences between the “but for” world and the posited baseline

Conclusions

- Counterfactual analysis is a very useful analytical method in competition cases
- It seeks to analyse the effects of a given transaction, agreement or conduct
- Ex ante counterfactuals require the development of an alternative future, whereas ex post counterfactuals require the development of an alternative past
- Economists have developed a variety of tools to assist lawyers in counterfactual analysis
- Not every effects-based analysis rely on a proper counterfactual
- The use of proper counterfactuals in Articles and 102 cases is still relatively rare