E.CA Economics

Rebates:
To Hell with Consumers (Economists?)!

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On the relevance of the as efficient competitor test

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Assessment of exclusionary conduct

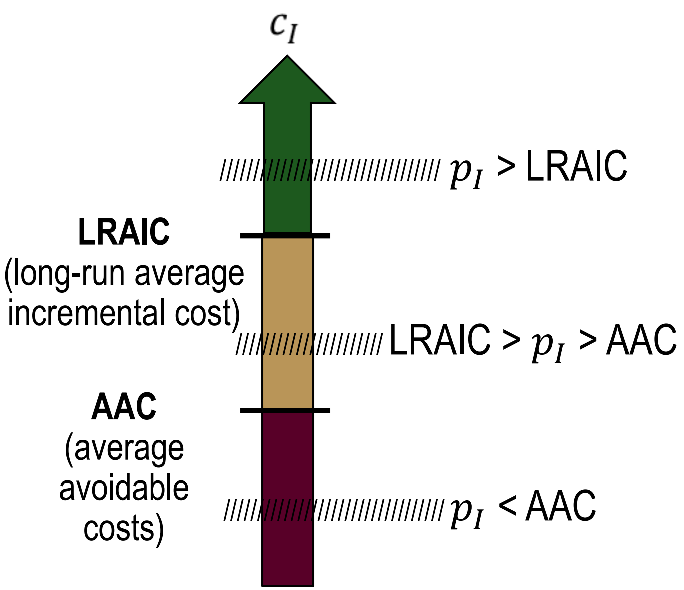
- EU Commission's **Guidance Paper** on exclusionary conduct stipulates that the identification of likely consumer harm can rely on **qualitative** and, where possible and appropriate, **quantitative evidence**
- Factors to be generally relevant to such an assessment are
  - the position of the **dominant undertaking**, its **competitors** as well as **customers** or **input suppliers** in the **relevant market**
  - the **extent** of the allegedly abusive conduct; evidence of **actual foreclosure**
  - **direct evidence** of any exclusionary strategy
- For price-based exclusionary conduct, the **as efficient competitor** test is carried out
  - Test indicates unambiguously no competition problems → Commission unlikely to intervene

    If the data clearly suggests that an equally efficient competitor can compete effectively … the Commission … will therefore be unlikely to intervene, para 27
  - Test result is ambiguous or problematic → Commission runs full fledged assessment

    …the Commission will integrate this in the general assessment of anti-competitive foreclosure…, para 27

The as efficient competitor (AEC) test as a quantitive tool

- Applied when assessing whether a **pricing practice** has an **exclusionary effect on an as efficient competitor**
- This requires that the incumbent has engaged in **below-cost pricing:**



The Commission will, in principle, infer that the pricing is **not likely abusive**

Pricing **could be abusive** if part of a plan for eliminating a competitor; other relevant quantitative and/or qualitative evidence, e.g. **objective justifications or realistic and effective counterstrategies**, are taken into account

Prices will, in principle, be regarded as **abusive**

- Where available, the Commission will use information on the **costs of the incumbent** itself

The AEC test and efficiencies

- **The AEC test integrates efficiency considerations**
  - The cost benchmarks are derived from the actual costs of the incumbent
  - High (low) efficiency translates into a less (more) restrictive legal standard

- **The AEC test integrates the evaluation of procompetitive motives**
  - Often the legal view is taken that if a conduct was based on legitimate grounds or efficiencies, it would not be abusive

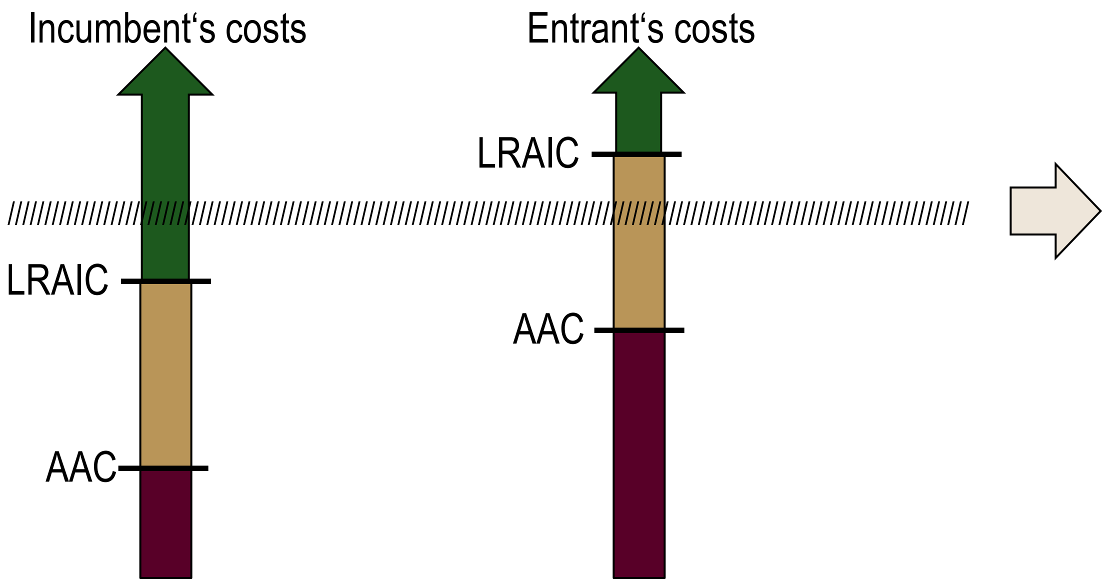
- **The AEC test does not include a balancing of pro- and anticompetitive effects**
  - The AEC test is an integrated part in the general assessment of anti-competitive foreclosure
  - Other relevant quantitative and/or qualitative evidence is taken into account besides the AEC test results
  - *Post Danmark*, 2015, para. 61:

> *The as-efficient-competitor test must thus be regarded as* ***one tool amongst others*** *for the purposes of assessing whether there is an abuse of a dominant position in the context of a rebate scheme.*

⇨ **The tension is mostly on whether the AEC test can/should serve as a (strict) safe harbour screen or not**

The AEC test and small (new) competitors (1)

- What to do if small (new) competitors have different (higher) costs?



Prices of the incumbent may lie above its own LRAIC but below the entrants‘ LRAIC

The AEC test and small (new) competitors (2)

- **Dominant undertakings may enjoy certain advantages** vis-à-vis new competitors, e.g.:
  - economies of scale and scope,
  - privileged access to essential inputs or natural resources,
  - important technologies (*Hilti,*1991, para. 19),
  - an established distribution and sales network (*Hoffmann-La Roche,* 1979, para. 48)

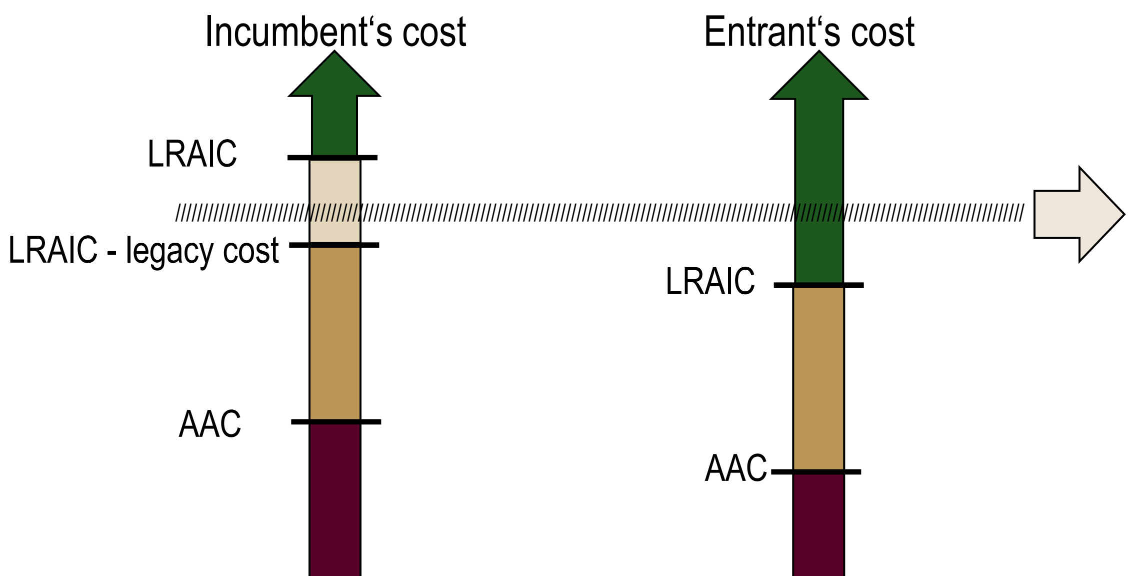
- In *Deutsche Bahn,* 2013, para. 55 ff., the EC considers (in the context of an already problematic outcome of the AEC test) that the AEC test is **not strict enough** in case of a former state-owned monopolists

- In *Post Danmark*, 2015, para. 59, the ECJ considers the AEC test to be even of "no relevance" under specific circumstances:

  > *On the other hand, **in a situation** such as that in the main proceedings, characterised by the holding by the dominant undertaking **of a very large market share** and by **structural advantages** conferred, inter alia, by that undertaking's statutory monopoly, which applied to 70% of mail on the relevant market, applying the as-efficient-competitor test is of **no relevance** inasmuch as the structure of the market makes the emergence of an as-efficient competitor practically impossible.*

The AEC test and small (new) competitors (3)

- Dominant undertakings may as well suffer from certain **disadvantages** vis-à-vis new competitors, e.g. **legacy costs**
  - In *EDF,* 2005, and *OTE,* 2008, the Commission rendered financial aid to compensate for stranded costs as legal; this suggests that under a price-cost comparison legacy costs are deductible, e.g. when calculating LRAIC
- The incumbent may have structural disadvantage due to providing **services in the public interest**
  - e.g. distribution of letters, weighing up to 50 grams, as in case of *Post Danmark*
  - e.g. **airports** in remote locations, generating only moderate passenger traffic, insufficient to cover their **fixed costs**
- Entrants may do **cherry picking**, entering in the most profitable market segment(s) only (e.g. direct advertising mail or packages delivery only)



- Prices of the incumbent may lie below its own LRAIC but above the entrants‘ LRAIC
- Once e.g. legacy costs are deducted from the incumbent’s LRAIC, this may no longer be the case

The AEC test and small (new) competitors (4)

- **Different service quality offerings may result in different price-cost-structures**
  - When the entrant makes high quality offerings only while the incumbent makes also low quality offerings, prices of the incumbent may lie above its own LRAIC but below the entrant's LRAIC
  - Monetary quantification of service quality (BKartA, B9-144/01, Lufthansa/Germania (2002), Section B.3.b)

⇨ **Differences in costs due to differences in service quality and other structural (dis-)advantages of the entrant need to be disentangled and monetarized**

AEC test and new business models (1)
Yield management

- Price discrimination leads to **optimal capacity utilization** and **profit maximization**
- As a consequence **single prices may lie below LRAIC** but above AAC
- If AAC are **almost zero**, e.g. for an otherwise empty seat on a plane, single prices may lie well below LRAIC
- Such low single prices may make the **impression of a predatory pricing strategy** even though average prices may still lie above LRAIC
- Yield management is important in many industries such as **hotel, telecommunication, transportation, car rental, insurance**
- It is widely acknowledged in the economic literature that yield management is **efficient independent of any strategic aspects** – also from the point of customers
  - Revenue management in aviation typically achieves a 3-9% revenue gain with as much as 11% at some leading airlines (*Airline Planning and Schedule Development*; T. L. Jacobs et al., page 82)
  - A survey result indicates that by implementing best practices in revenue management and proven techniques more than 25% incremental revenue is delivered to hotels (*What is the Importance of Revenue Management in Hotels?*; Xotel Blog)
- It also has to be noted that yield management requires **substantial investment**

AEC test and new business models (2)
Online world

- E-commerce and digital distribution enables companies to **collect price and other consumer specific data**
- **This offers potential for customer specific prices and offers**
- Effects on end consumer welfare seem to be positive, but still need to be fully understood
  - Targeted product offers vs. price discrimination
  - First order welfare effects of price discrimination positive but negative distributional effects
  - Increased price transparency for some products vs. increased search costs and hidden cost components for others
  - "Competition is just one click away" vs. lock-in and tipping effects
- Traditionally the AEC test was applied in **B2B markets, not in B2C markets.** In B2C markets **novel, loyalty inducing (?), pricing practices emerge**
  - **Two-sided market pricing**: One side may be charged a very low (zero or even negative) price
  - **Flat rates** (e.g. Spotify, Netflix) are common, but contestable market share presumably still often high
  - **Congestion pricing models** like Uber: predatory pricing in times of low demand?

Final statement

The AEC test is an economically meaningful tool to assess actual or potential effects of pricing abuses; it helps to understand & compare different pricing practices

Legal certainty would be improved by building a sound case law applying the test in different industries and market environments

Thank you!

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