



# CONDITIONAL PRICING AND THE AEC TEST: A HAPPY MARRIAGE OR AN AWKWARD COUPLE?

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## *Post Danmark I and Intel (1)*

- Two key judgments (2012 and 2017) of ECJ sitting in Grand Chamber: decisive step for coherent effects-based approach under Art. 102:
- First key element: goal of EU competition law is to protect consumers
- Second key element: legal presumption against exclusivity rebates and arguably exclusive dealing, is rebuttable presumption: i.e. ‘by effect’ and not ‘by object’ conduct

## *Post Danmark I and Intel (2)*

- Third key element: by object conduct/naked restrictions category limited to conduct without credible efficiency rationale
- Fourth key element: efficiency defence with conditions aligned on Art. 101(3)
- Fifth key element: demystification of special responsibility of dominant firms: competition on the merits is conduct that does not harm consumers

## *Post Danmark I and Intel (3)*

- Sixth key element: pressure on competitors breeds competition and excellence - aim not to protect inefficient competitors – summarised as the AEC-principle
- Seventh key element: as regards pricing conduct, only pricing which is objectively too low can foreclose and harm competition. Generally not possible to foreclose efficient rivals by charging a price above cost, no matter whether it concerns a uniform low price for all customers, a low price only for some customers or only for part of customers' demand

## *Post Danmark I* and *Intel*: unresolved issues

- Rebuttable presumption: how high is the threshold for dominant firm to shift the burden to the authority?
- Relevance of *Post Danmark II* after *Intel*: can above cost pricing be abusive?
- What is the usefulness of the AEC test for assessing rebates?

# When is applying AEC test not sensible

- Exploitative conduct: rebate can be used to exploit by being an instrument for first or second degree price discrimination. Concerns high instead of low pricing: AEC test does not make sense
- Collusive or competition dampening conduct: retroactive rebates can be used to share markets. If consumer harm comes from collusion, price does not need to be below cost and applying the AEC test does not make sense

# When is applying AEC test sensible

- Exclusionary conduct: rebate can be used to foreclose competitors. In that case AEC test in principle useful to distinguish between intervention to protect competition and consumers and intervention to protect (less efficient) competitors
- This reasoning – that only too low pricing can harm competition and consumers – is found in *Post Danmark I* and *Intel*
- Rebates can help dominant firm to target its low pricing and make exclusionary strategy less costly, but foreclosure still the result of low pricing for marginal sales

## Applying AEC test *in principle* sensible (1)

- So when – in case of exclusionary conduct – is applying the AEC test not useful?
- 1) When rebate is not a real rebate but exclusive purchasing obligation: if buyer in practice not allowed to buy less at a higher price
- 2) When rival is not yet established on the market and not yet able to make a credible offer to the customers: problem of coordination between buyers may make that all purchase exclusively from dominant firm, even if rebate is minimal

## Applying AEC test *in principle* sensible (2)

- 3) When there are important economies of scale and the rebate is preventing rival(s) from reaching the minimum efficient scale: as a result of the rebate the rivals' costs are increased and the dominant firm may foreclose rivals that are in principle as efficient by pricing above cost

*Post Danmark II*: legal monopoly over part of the market prevented rivals to become as efficient?

## Applying AEC test *in principle* sensible (3)

- In other situations where rebates are used, applying the AEC test is in principle useful to distinguish between intervention to protect competition and consumers and intervention to protect (less efficient) competitors
- Not because exclusion of less efficient competitors can never harm consumers, at least in the short run, but because intervention above cost would create legal uncertainty (how much pressure can the dominant firm exert on its rivals?) and would also undermine the basic mechanism of competition - that pressure on rivals creates the incentive to compete and innovate

# Which cost benchmark to apply?

- The benchmark to be used should result from the objective of applying the AEC test
- The objective is to protect as efficient competitors, i.e. those competitors that are (most) useful for customers in terms of the price and choice they bring to the market
- For as efficient rivals to be able to compete in the long run, they should be able to cover all (variable and fixed) costs including a competitive profit margin to attract sufficient capital.
- The benchmark to be used is therefore the average total cost (ATC) benchmark

# No need for a profit sacrifice test

- Being able to show that the dominant firm's pricing conduct only makes commercial sense because of the foreclosure, i.e. that it is sacrificing profits in order to foreclose, is helpful to make a convincing case
- However, arguing that its conduct is profit maximising also without the foreclosure cannot justify anticompetitive foreclosure of as efficient rivals: the consumer harm requires that the conduct is prohibited

# Practical problems applying the AEC test

- Price cost tests are cumbersome and costly and reliable data are necessary to obtain reliable results. Implication: the reliability of the data should be taken into account when drawing conclusions
- It also implies that such tests should be used as part of a more elaborate effects-based analysis, as already required by the case law
- This also holds in case of predation and margin squeeze, where case law requires application of a price cost test, so what are the specific problems in applying the AEC test to rebates/conditional pricing?

# Conditional pricing and the AEC test (1)

- Conditional pricing can be used to foreclose if competition does not take place for the whole customer: competitors of the dominant firm are only able to compete for part of the demand of customers
- In that case dominant firm can use non-contestable part of demand as leverage to reduce the price for contestable part
- In case dominant firm is not an unavoidable trading partner for part of demand and rivals can compete for whole customer, there is no leveraging and competition takes place on overall prices and we are back to a predation test

## Conditional pricing and the AEC test (2)

- In case the dominant firm can use the non-contestable part of demand as leverage to reduce the price for the contestable part, it will be necessary to calculate the effective price that competitors must match in order to make customers switch part of their demand
- Because switching part of demand leads to a loss of rebates, this effective price is normally lower than the overall price the dominant firm is charging (all the rebate is allocated to the contestable part or relevant range of competition)
- Specific problem: it may be difficult to assess what the contestable part/the relevant range is

## Calculating the effective price in case of incremental rebates

- Incremental rebate: threshold at beginning of contestable part of demand, rebate only on units purchased above the threshold
- In that case no problem to calculate the effective price: is simply the rebated price customers get above the threshold
- Not different for individualised and standardised incremental rebate schemes

# Calculating the effective price in case of retroactive rebates

- Retroactive rebate: threshold in/at end of contestable part of demand, rebate on all units purchased once the threshold is attained
- In that case calculation of effective price requires assessment of contestable part of demand: effective price is price as if rebate is allocated only to the contestable units
- Difficulty different for individualised one-step and standardised multi-step retroactive rebate schemes

## Calculating the effective price in case of standardised retroactive rebate

- Defining the relevant range is no problem in case of a multi-step retroactive rebate scheme, i.e. what is usually a standardised retroactive rebate scheme
- Reason: in case the relevant range is smaller than a step, no rebate may be lost because of switching, so rebated price is effective price. In case relevant range is bigger than a step, the step provides the range and calculation of effective price is not problematic

# Standardised retroactive rebate of PD II

Number of letters	Rebate %	Average price	Effective price
30,000 – 74,999	6	94	94
75,000 – 149,999	7	93	92.3
150,000 - 299,999	8	92	91
300,000 – 499,999	9	91	90
500,000 – 749,999	10	90	88.5
750,000 – 999,999	11	89	87
1,000,000 – 1,499,999	12	88	85
1,500,000 – 1,999,999	14	86	82
2,000,000 or more	16	84	78

## Calculating the effective price in case of individualised retroactive rebates (1)

- Defining the relevant range may be difficult in case of one-step, i.e. usually individualised, retroactive rebate schemes
- However, defining the relevant range is in the interest of dominant firm itself: in order to grant the rebate efficiently it should find out over which part of demand it has to take competition into account (at what price customers may switch and, if so, which part of demand)

## Calculating the effective price in case of individualised retroactive rebates (2)

- For authority: internal studies of company, customer surveys and actual size and sales of competitors may give an indication of the relevant range
- Authority should retain discretion, taking into account facts and circumstances of each case, which tools to use to show anti-competitive foreclosure

# Conclusion

- Conditional pricing and the AEC test are a happy couple if the theory of harm is about exclusion, not if the theory of harm is about exploitation or collusion
- Nonetheless, in case of exclusion the AEC test may not be appropriate if the rebate scheme is preventing competitors to achieve important economies of scale and/or if the competitors do not yet have a credible market presence
- Practical problems to apply the AEC test are potentially relevant for individualised retroactive rebates, but not for standardised retroactive rebates and for incremental rebates

**Questions?**

**THANK YOU FOR YOUR ATTENTION**