

A Too Efficient Competitor

An Alternative Interpretation of Post Danmark II

Dublin, 31.03.2019

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| Motivation

- The «as efficient competitor test» (AEC test) is one of the main ingredient of the «more economic» approach to exclusionary conduct
- However, until recently, the case law has been rather confusing:
 - Post Danmark I: application of AEC test, confirmed by CJEU
 - Intel (GC): AEC test is not necessary, largely form based approach
 - Post Danmark II (CJEU): AEC test not always necessary
 - Intel (CJEU): authorities need to establish the potential for foreclosure with the AEC test

→ **How can we explain this «zigzag course»?**

| Content

- The rationale for the AEC test
- A closer look at the relevant case law
- The wrong counterfactual
- The wrong cost
- The wrong incentives
- Post Danmark II
- The right cost?
- Conclusion

| The rationale for the AEC test

- Objective is to protect efficient competition, not individual firms
- Key economic rationale: a less efficient firm would leave the market as a result of the normal competitive process
- AEC test is well established for assessment of margin squeeze or predatory pricing
- For rebates, the economic theory is less clear cut since the AEC test is not capable of reliably proving anticompetitive conduct
- However, a price-cost test is necessary to assess the potential of foreclosure in order to support the theory of harm

→ **Without price-cost test, there is no point of reference**

| A closer look at the relevant case law

- The specific method to implement the AEC test was largely established with cases involving postal operators with an universal service obligation
- In Deutsche Post and Post Danmark I the authorities established the average incremental cost (AIC) as the relevant cost benchmark
- In Post Danmark I the following definition of AIC has been recognized:
 - Cost which disappear in the short or medium term (three to five years), if Post Denmark were to give up distributing unaddressed mail
 - The AIC include both variable and fixed costs specific to unaddressed mail and a share of the common (overhead) costs across all products
 - «Capacity cost» of fulfilling the universal service obligation was treated as common fixed cost and therefore was not included in the AIC

| The wrong counterfactual

- The costs of the « as efficient competitor» are usually taken from the dominant undertaking
- However, dominant postal operators are usually highly regulated, especially when they have a universal service obligation
 - A USP is by definition not efficient – otherwise there would be no universal service obligation
 - An efficient entrant to a postal market does not need to uphold reserve capacities and provide loss-making services

→ **To model an efficient market player based on an USP establishes the wrong counterfactual**

| The wrong cost

- AIC of a USP reflect a competitor which cannot efficiently reduce its capacity
- AIC of a USP may also include economies of scale and scope, which no other firm on the relevant market can achieve
- But in general, the AIC for the contestable part of the market of a USP are very low

→ **AIC of a USP carries no information about the cost of an efficient firm in a competitive postal market**

| The wrong incentives

- By modelling an efficient competitor on the AIC of a USP, the authorities assumed a too efficient competitor
 - The test assumes a competitor in the contestable part of the market, which does not have to bear the necessary capacity cost
 - No competitor will be able to offer services at this level
 - The more extensive the universal service obligation, the lower are AIC
- **To use AIC of a USP does not protect effective competition but rather the USP from competition in the contestable portion of the markets**

| A closer look at Post Danmark II

- Post Danmark II: strong evidence of a successful exclusionary strategy
 - Retroactive rebate scheme with strong loyalty effect
 - Bring Citymail suffered heavy losses and was finally prompted to withdraw from the market
 - The CJEU denied the necessity to conduct a AEC test because of the special market structure
 - Dominant undertaking with very large market share
 - Strong structural advantages
- **The emergence of an as efficient competitor is unlikely**
- **Also a less efficient competitor can exert competitive pressure**

| A too efficient competitor

- In Post Danmark II the authorities rightly concluded that according to the applied cost benchmark, the emergence of an as efficient competitors is impossible
 - Not because of economies of scale or scope or structural advantage
 - But because the cost for providing the universal service obligation were deducted from the AIC

→ **A competitor producing at AIC of a USP is too efficient**

| The right cost?

- Need to adjust the AIC for an efficient service provider without universal service obligation
- Calculate cost benchmark based on net cost of the universal service provision
- Bottom-up model of an efficient service provider
- ATC can serve as an upper boundary

| Conclusion

- Post Danmark II was as very special case: the CJEU dismissed the need for a AEC test because it realized no market entrant could produce at the presented cost
- Given the particular circumstances of postal markets, an AEC test «by the book» is not meaningful
- The use of AIC of a USP does not protect competition but the dominant firm from competition
- In abuse of dominance cases authorities need to adjust the relevant cost benchmark for postal operators
- Post Danmark II highlights the trade-off between the provision of universal services and the functioning of an efficient market

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