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Counterfactual in Competition Cases

Its emergence in European and UK competition law

The term 'counterfactual' is surfacing with increasing regularity in decisions of the competition authorities and the courts. Here its use in 'behavioural' competition law investigations is examined based on a review of UK and EC competition guidelines, and several leading UK cases.

What is a Counterfactual?

A counterfactual is, literally speaking, the opposite of the factual. It is what will, or is likely to, happen in the absence of the some actual or likely occurrence. To be more specific, a 'conditional counterfactual' is an 'if-then' statement indicating what would be the case if its antecedent were true.

An early example of a counterfactual in European law was in 1966 when the ECJ stated in *Société Technique Minière:'The competition in question must be understood within the actual context in which it would occur in the absence of the agreement in dispute.'*

Today the use of a counterfactual is most evident under the Significantly Lessening Competition (SLC, and its EC equivalent SIEC) test in merger control. The UK Merger Guidelines (2010) - which mentions the word 52 times compared to only twice in the earlier 2003 version - describes the counterfactual (para 4.3.1) as *'a comparison of the prospects for competition with the merger against the competitive situation without the merger.'*

The use of counterfactual in behavioural competition law has been patchy or absent. In the UK, the Office of Fair Trading's (OFT) 2004 competition guidelines make no mention of the counterfactual. The recent Arts 101 and 102TFEU guidelines set out a counterfactual but only in passing, rarely using the word, and without explaining its use.

Nature of Counterfactual

From the use of the counterfactual to date several generalisations can be made:

- A counterfactual is an 'analytical framework' not a legal requirement with the possible exception of 'infringement by effect' under Art 101(1)TFEU.
- A counterfactual asks a question, it does not give an answer. It requires the parties to set out explicitly their theory of competition and harm which can be tested forensically and empirically. The decision maker is still required to select the most appropriate counterfactual and assess the evidence supporting it.
- On the other hand, a counterfactual may simply reframe competing theories/propositions of the parties with little value added or contributing to good decision-making.
- There is a tension between the counterfactual approach and the European Commission's decisional practice, case-law and recent effects based guidelines which determine infringements using benchmarks, checklists, and direct price and cost tests. These can be seen as part of a counterfactual test or alternative more direct approaches to the determination of an abuse or anticompetitive effect.
- There are cases where the counterfactual may not be helpful, such as refusal to supply in network industries.

Art 101/Chapter I prohibition

The strengths and weaknesses of recasting a case in terms of counterfactuals can be illustrated by three UK appeals in Art 101/Chapter I prohibition cases/decisions. In *Racecourse Assoc. v OFT* (collective agreement to set-up a new interactive horseracing betting TV service) in the CAT, and *BAGS v AMRAC* (collective agreement to set-up a second horseracing TV channel supplied to bookmakers) in the High Court and Court of Appeal the pleaded counterfactual was bilateral or small group negotiations instead of the impugned collective arrangements. This counterfactual was rejected in both cases. In *RAC* the CAT (para [170]) famously said that the OFT's counterfactual of separate bilateral negotiations by the '37 *course owners either could have been done, might have been done, or was ever even contemplated as something which could or might have been done, appears to us to represent a triumph of theory over commercial reality and to ignore the evidence of the events leading up to the* [agreement]'.

The OFT's *MasterCard MIF* (2005) opinion was based on the counterfactual that interchange fees for credit cards would be negotiated bilaterally between the banks. However, before trial the OFT changed its counterfactual from this to the more radical (and as yet untested) one *'that the MasterCard banks could deal with each other "at par" (in effect a zero interchange fee)'*. Again the bilateral bargaining counterfactual was untenable, and this realisation was partly responsible for unraveling the OFT's six year investigation.

The common thread running through these three cases/decisions is the use of an atomistic model of competition where all transactions are bilateral exchanges between firms and customers. In the two horseracing cases the proposed counterfactual in effect assumed that

any collective arrangement was anti-competitive. The appellate bodies correctly rejected this approach using a dynamic model of competition which took into account the network effects inherent in sports rights and broadcasting markets, and what they regarded as the realistic commercial options facing the parties, and importantly the fact that additional competition was introduced. All three cases show that the use of a counterfactual did not advance the case, and once a flawed counterfactual was pleaded made failure more certain.

Art 102/Chapter II prohibition

Counterfactuals are rare in Art 102/Chapter II prohibition cases, with the one exception discussed below. The long delayed EC Commission's Art 102 guidance (2009) briefly sets out a counterfactual test but does not apply it. Indeed, the guidance consists predominantly of a checklist approach (para 20), and direct tests for specific anti-competitive abuses. The *Microsoft* (2004) decision, arguably the EC Commission's first effects-based decision, does not refer to a counterfactual, nor do the Commission's and EGC/ECJ margin squeeze decisions (*France Telecom*, *Deutsche Telekom*, *Telfonica)*.

There are several reasons for this. The first arises from the dominance standard and case law which holds that there is no need to establish a direct causal link between an abuse and harm given a dominant firm's 'special responsibility'. Another reason is that the counterfactual is difficult to set out in most recent refusal to supply cases which involve network industries, telecoms in particular. These allege that the core network is a monopoly and an 'essential' input for downstream competitors. Assuming this is correct, What is the correct counterfactual? Is it what a non-super dominant network operator would have done assuming all other market factors remain the same? This cannot be correct even in the abstract, as no competition is possible and the benefits from economics of scale and scope would not be generated by smaller operators even if they could enter. Is it what would happen in a model of 'effective competition'? This again can be ruled out as infeasible. Or, is it simply based on a benchmark model, not a counterfactual, that competitive network operators would not cross-subsidise services and would ensure that they supplied their downstream operations earning a reasonable margin. Clearly, in this case the abuse is relative to a model of access competition which the regulator wants to promote rather than the competition law objective of maintaining effective competition.

Ofgem's *National Grid* (2008) decision appears the first Art 102 case to expressly use counterfactual analysis. This involved the terms of National Grid's contract for the supply of gas meters (note another agreement case). The CAT and Court of Appeal (2010) affirmed Ofgem's approach, with the Court of Appeal stating (para 57):

> *'The use of counterfactuals as a tool of appraisal is plainly permissible and of potential value. What is appropriate by way of counterfactual, however, is a matter of judgment for the decision-maker. There is no rule of law that the counterfactual has to take a particular form. The [European] Commission's guidance document refers to a range from "the simple absence of the conduct in question" to "another realistic alternative scenario, having regard to established business practices". It does not say that the alternative scenario must be based on alternative arrangements that the parties to the contracts in issue would or might realistically have made instead, and there is no principle requiring the adoption of such a restrictive approach. The purpose of the counterfactual is simply to cast light on the effect of the conduct in issue. It is for the decision-maker to determine whether a counterfactual is sufficiently realistic to be useful, and to decide how much weight to place on it. This is an area of appreciation, not of legal rules.'*

There are two features of the High Court/Court of Appeal judgments that warrant comment. First, the grounds for appeal set out by National Grid mirrored the discussion above, namely that the decisional practice of the European Commission uses 'benchmarks', not counterfactuals. Secondly, the counterfactual used by Ofgem (and approved by the courts) was not a contract that existed in the market at the time. National Grid argued that Ofgem had 'cherry picked' terms from existing contracts from non-dominant entities to create a synthetic 'hybrid contract', thus running contrary to the apparent requirement in other cases that the counterfactual be 'realistic'.

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