Developments

Book Review: Alexander Morell's *(Behavioral) Law and Economics im europäischen Wettbewerbsrecht*

By Rupprecht Podszun[*]

Imagine your local supermarket invites you to get a 10% reduction on all food bills at the end of the year if you buy 90% of all food there throughout the year. Would you accept? If your supermarket is dominant in the sense of European competition law—and if it is located at the, say, Belgian-Dutch border—it may face an antitrust investigation. The rebate may turn into an exclusivity arrangement that hinders free competition for your money; welcome to the world of target rebates. The book under review[1] deals with the handling of target rebates in European competition law.[2] Above all, however, it is a study of the possible information to be drawn from economics and behavioral studies for the law.

The author, Alexander Morell, picked a particularly difficult topic. When I, your reviewer, was a junior case handler at the German Competition Office, the Bundeskartellamt, I got a case in my inbox dealing with rebates: A dominant distributor of pharmaceutical products had written to hospitals and promised year-end-rebates if they sourced their products exclusively from him. I thought this was abusive under Art. 102 Treaty on the Functioning of the European Union (TFEU) and I found case law supporting my argument. When I presented the case to my senior colleagues, though, they pulled it to pieces within minutes. The head of department said, consoling me with a sigh, "Don't worry. Rebates are so complicated." They are not, though, when Alexander Morell explains them to you. He has a concise and understandable way of writing, and that is particularly helpful for a book like this which deals with matters of law and economics alike. His research is a valuable contribution to the debate on the interplay between law and economics in competition law. The book was written as a Ph.D. thesis under the supervision of the ever-inspiring Christoph Engel, Director at the Max Planck Institute for Research on Collective Goods in Bonn, Germany.

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[1] ALEXANDER MORELL, (BEHAVIORAL) LAW AND ECONOMICS IM EUROPÄISCHEN WETTBEWERBSRECHT: MISSBRAUCHSAUFSICHT ÜBER ZIELRABATTE (2011).

[2] *See also* INES BODENSTEIN, KARTELLRECHTLICHE BEWERTUNG VON RABATTEN MARKTBEHERRSCHENDER UNTERNEHMEN (2013) (discussing the topic).

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In 2002, the Directorate General for Competition at the European Commission had its "annus horribilis," the terrible year, in the Court of First Instance. It saw three merger decisions overturned due to a lack of economic proof for restrictions of competition.[3] Then-Competition Commissioner Mario Monti, an economist by training, proved his skills as a reformer—also needed later in his role as Italian prime minister. He started a process to redesign competition law legislation and application to bring it in line with current economic thinking. The "more economic approach" was born and gained a lot of pace. In essence, this meant that the application of competition law became more consumer welfare-oriented and was based on econometric projections of future market developments. The theoretical framework was provided by the "post-Chicago School," a line of thinking that is influenced by the liberal approach of the 1980s Chicago School but questions general rules. The Commission, inspired by economists with a post–Chicago background, handles cases with a much closer look into the specific economic effects than submitting to precedent or traditional wisdoms of competition law—the per se rules. Economic expertise—i.e. lengthy opinions by economic advisory firms based on models—is introduced in proceedings. With the more economic approach, competition law became a front running field of law in adopting economics. Yet, the Court of Justice, the lower Court of which had triggered the whole approach, remained reluctant towards this new approach. In recent judgments, the Court did not exactly embrace a purely effects-based assessment of cases but resorted to a more traditional reading of the norms. Some scholars even discuss "the end of the more economic approach."[4]

Regarding the judicial skepticism (and ten years after the start of the redesign of competition policy), it is all the more deserving to analyze how economics can inform the law.[5] Alexander Morell sets out to take stock and to show that economics has something to say about rulemaking in competition law. He suggests using economics to formulate general rules instead of using economics to assess the effects on a case-by-case basis. Succeeding in this endeavor would combine the advantage of legal security with sound economic judgments. It requires a solid knowledge of the law (letters) and of the economics (formulae) alike and an idea how to speak to the readership about both areas. Morell excels in this regard. The structure of his argument is exemplary.

First, Morell defines the basics: Target rebates are rebates that are granted by the supplier under the condition that the buyer sources a certain quantity from the supplier during the period of reference. Such rebates may have a positive impact upon competition by solving

[3] Case T-342/99, Airtours v. Comm'n, 2002 E.C.R. II-2585; Case T-310/01 & 77/02, Schneider Elec. v. Comm'n, 2002 E.C.R. II-4071; Case T-5/02 & 80/02, Tetra Laval v. Comm'n, 2002 E.C.R. II-4381.

[4] Bien & Rummel, *Ende des More Economic Approach bei der Beurteilung von Rabattsystemen*?, EuZW (2012), at 737; Frenz, *Abschied vom more economic approach*, WRP (2013), at 428.

[5] *See also* Drexl et al., Competition Policy and the Economic Approach: Foundations and Limitations (2011) (undertaking this endeavor).

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hold up problems and passing efficiencies to customers. Yet, they may also amount to exclusivity arrangements that stifle competition by foreclosing markets. From the rulings of the Court of Justice of the European Union (CJEU), Morell identifies four criteria that may make a target rebate abusive under Art. 102 TFEU: The quantity is set close to the customer's full demand during the period of reference; the market share of the (dominant) supplier is relatively high; the period of reference is not short; and the rebate is granted for the full quantity, not just for the tipping bit.[6] The parties may prove though that granting rebates is efficient.

The Commission, as Morell points out, uses a new test, developed since the "more economic approach" gained pace.[7] Interestingly, the Commission watered down its more radical 2005 approach in a so–called Guidance Paper 2008/2009 after heavy criticism. Now, it suggests assessing in each individual constellation what share of the demand is subject to competition and whether this share is offered at average variable costs. This means that a competitor as efficient as the dominant company should be able to contest this share.

After this legal stock-taking exercise, Morell turns to the economic literature on rebates.[8] Surveying what economists have written on rebates and market access, he tries to extrapolate criteria for abuse. The notion of abuse is a black box. The famous definition of the Court from the *Hoffmann-LaRoche* case, repeated again and again in later judgments, goes like this:

> [A]buse is an objective concept relating to the behavior of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.[9]

Taking a closer look at this wording reveals that the charm of this famous definition is its openness: The first part basically repeats the definition of dominance. The third part requires a weakening of competition, not really a big surprise in a law dedicated to fight

[6] MORELL, *supra* note 1, at 33 f.

[7] *Id.* at 41ff.

[8] *Id.* at 61.

[9] Case 85/76, Hoffmann-La Roche v. Comm'n, 1979 E.C.R. 461, ¶ 91.

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the restriction of competition. The second part essentially tells the reader that abuse is a deviation from the methods of normal competition. This sends shivers down the spine of Hayekian competition advocates who see competition as a discovery procedure: Deviating from the norm, that is what the fight of rivals is all about.

Now, Morell tries to find out what economists make of this. As a working premise, he accepts the Commission's "as–efficient–competitor" test. The value of his book is the difference from the Commission's position: "The difference in the interpretation of Art. 102 TFEU here and in the Guidelines of the Commission is that the Commission plans to apply the as-efficient-competitor-test to each individual case while here abstract, general criteria are to be generated, based on the as-efficient-competitor-test."[10]

By careful analysis of studies, Morell tries to identify characteristics that justify a *presumption* of abuse so that firms know whether they are about to violate competition law or not. The review of economic studies concerning rebates or similar exclusivity arrangements is undertaken with diligence and with good explanations. It starts with Posner and Bork, the two Chicago School luminaries, who argued that a market foreclosure by rebates would be too expensive for the incumbent. Later, scholars such as Bolton, Aghion, Rasmusen, Motta, and others are presented as authors of model-based studies that deal with these questions. After an analysis of their results, Morell has an informed basis for designing a presumption of an abuse.[11] While the significance of the rebate and the length of the period of reference are common features, the models analyzed deliver detailed ideas about the market conditions: These need to be characterized by an asymmetry making it difficult for a competitor of the dominant undertaking to counter the target rebates. While the Court usually just looks at the relative market shares, Morell argues that a much closer look at the market situation needs to be taken, and he describes patterns of market conditions that induce abuses. He also shows convincingly that normally there is no justification by efficiency effects.[12]

One may object that the success of such an approach depends very much on the research undertaken so far—which may be random. Economic studies often concern very specific situations and are tough material for generalization. Morell is aware of such objections and handles the studies carefully. The trick he plays to address lawyers and economists alike is to leave out the nitty–gritty details of models and econometrics in the main part of the book. Still, in annexes to each passage, he explains in more detail—and with more formulae—how the case is argued in economics. This split is very helpful.

[10] MORELL, *supra* note 1, at 64 (translation by Rupprecht Podszun).

[11] *Id.* at 147 ff.

[12] *Id.* at 176.

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Starting from his theoretical analysis, Morell judges the tests applied by the ECJ and the Commission. While the ECJ test is "not completely misguided," yet too general,[13] Morell identifies "three serious concerns" with the Commission's test.[14] More sophistication would be necessary.

Other scholars would stop here, summarize their results—as done in Chapter 5 of the book—and maybe even apply the newly found wisdom to famous cases—a most commendable endeavor undertaken in Chapter 6—and have a decent conclusion—Chapter 7. In this book however, Morell introduces a critique from the view of behavioral economics—Chapter 4—and this is the sparkler of the whole study. In sixty pages, the author opens the curtain and lets the readers see the interesting spectacle of behavioral law, a discipline still in a fledgling stage in Germany.

Without a doubt, this part of the book is the most original and interesting part of it. In an attempt that is rare in literature, the author sets out to establish the applicability of behavioral insights to competition law theory.[15] Behavioral theories challenge the rational choice model that assumes that market participants act rationally like a homo oeconomicus and thus simply do profit–maximization. The as–efficient–competitor–test is based on this model.[16] Yet, do the customers, addressed by target rebates, really react in the way projected by the Commission? Experiments in labs often show that people do not necessarily act as profit-maximizers. Morell cites some of the exciting experiment stories. One of the most famous experiments is the dictator game, developed by Daniel Kahneman and others. The game shows that students in the lab do not necessarily act rationally: If they get 100 to share at will anonymously with another anonymous player, experiments show that most people give 10 or even 48 to the other person without benefit. A homo oeconomicus would have kept the 100.

Morell is not at all a radical apostle of the holy church of behaviorists. In contrary, he assesses very carefully whether the results from the experimentalists' labs can be transferred into competition law practice. In his view, lab experiments can show what may happen in practice rather than describe what happens. They are also a reminder of bounded rationality of market participants. This speaks in favor of using the results for qualitative statements, not quantitative.[17] Morell also lists a couple of criteria that need to

[13] *Id.* at 178.

[14] *Id.* at 185.

[15] *See* Niels et al., *Behavioural Economics and its Impact on Competition Policy: A Practical Assessment*, COMPETITION L.J. 374 (2013) (providing a recent overview).

[16] MORELL, *supra* note 1, at 191.

[17] *Id.* at 215.

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be met to adopt behavioral insights.[18] This critical acclaim of behavioral studies for law is concise and worth a read for everyone who wishes to draw from this field of study. The title of the book rightly references these pages.

So what exactly can we learn from behavioral studies for the test of target rebates? Using prospect theory and several experiments, one of which was undertaken by Morell himself with two colleagues,[19] he suggests to presume an abuse when the target is as high as the expected demand in the period of reference, when it is uncertain that the target will be met and when the customers are end consumers or agents dominated by individual decisions.[20]

This may look like a moderate output for practitioners, yet Morell analyzes famous cases with his results and comes to interesting conclusions. This chapter of the book, dealing with the cases *Michelin I*[21] *and II*,[22] *British Airways*,[23] *Tomra*,[24] and *Intel*[25] gives an interesting illustration of what the reader has learned over the first 250 pages. It is proof that a *Doktorarbeit* may enrich practice.

The book delivers great material for arguing cases of target rebates. What is more, the author delivers a timely answer how to shape the "more economic approach" after a decade of debates. Finally, this is an exemplary study for all those scholars who wish to write about law and economics in a way that makes sense to both disciplines.

[18] *Id.* at 215f.

[19] Morell et al., *Sticky Rebates: Rollback Rebates Induce Non-Rational Loyalty in Consumers – Experimental Evidence* (Max Planck Inst. for Research on Collective Goods, Working Paper No. 23, 2009), *available at* http://www.econstor.eu/handle/10419/32243.

[20] *Id.* at 246.

[21] Case 322/81, Michelin v. Comm'n, 1983 E.C.R.-3461.

[22] Case T-203/01, Michelin v. Comm'n, 2003 E.C.R. II-4071.

[23] Case C-95/04 P, British Airways v. Comm'n, 2007 E.C.R. I-2331.

[24] Case C-549/10 P, Tomra v. Comm'n, 2012 (not yet reported).

[25] Case COMP/37.990, Intel v. Comm'n, 2009 (pending at CFI, Case T-286/09).