GLOBAL COMPETITION REVIEW Antitrust Litigation Conference 2010

London, October

Counterfactuals – a shift in the burden/standard of proof?

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SUMMARY OF POINTS FOR PRESENTATION

Terminology and history

- The word “counterfactual” is nothing more than a technical term describing the thought process “what would happen if only...[something happened/did not happen]”.

- In competition law it has been prevalent – as a term and not just a concept - in merger control for some time. The accepted test is generally “what would happen in the absence of the merger”? (would prices be lower/higher than if there is a merger?)

- One might think - and certainly older cases show that - although not called a “counterfactual”, a similar test applied under 81/82EC (as was)

New developments

- What is changing? First of all, the language: “counterfactual” is now a term one is beginning to see not just in economic submissions, but in the language of competition authorities and courts under 101/102TFEU

- Sometimes, perhaps often, the “old assumption” will prevail and the simple “absence of behaviour in question” will be the correct test. Parties in litigation may use it as a shield (“you did not properly consider the counterfactual”) or a sword (“in the absence of your conduct we would have grown market share/not made a loss/made a profit”).

- However the Commission, in its Guidelines on enforcement priorities under Article 82 EC (now 102 TFEU) has explicitly recognised that there may be other counterfactuals, particularly where based on existing market practices:

> An appropriate counterfactual, such as the simple absence of the conduct in question or with another realistic alternative scenario, having regard to established business practices.

- This was fully tested in the UK case of National Grid v Ofgem (at CAT and Court of Appeal – the Supreme Court refused permission to further appeal in July 2010) which (i) involved more than one counterfactual and (ii) had a counterfactual based on a “hybrid contract” which was described in detail but found no precise analogue in the market.

Implications for litigation

- If you are attacking a competition authority’s decision, you may have to attack their decision on alternative fronts (if not counterfactual A, then counterfactual B, if not B, then C)

- If you seek to attack a competitor’s behaviour on the market, be it under 101 or 102 TFEU you may be well advised to consider alternative realistic counterfactuals for the same reason and posit them as proof of abuse either to the competition authority or in litigation (Counterfactual 1: you would not have included terms A,B,C in your contract; Counterfactual 2: you ought to have adopted the “standard” industry terms which include A and D but only a variant of C on occasion).

- Damages, and in particular causation and quantum may vary greatly depending on the counterfactual found by the court. There may be decreased certainty, leading to fewer settlements at the door of the court.
Introduction

The term ‘counterfactual’, despite technical connotations, simply describes the tendency to think about how things might turn out differently “if only”, and to imagine “what if?”. It finds voice in philosophy, psychology, history, economics and law.\(^2\)

In competition law specifically, the use of counterfactuals in merger control is virtually universal, and universally understood, across the competition law community worldwide.\(^3\) In most cases, it will involve comparing what is likely to happen post-merger, with the current position (the ‘counterfactual’ being the status quo ante – namely the absence of the merger). This already well-documented area, which essentially involves an ex ante analysis, is not treated in any detail. Recently, there have been a number of developments at EC and national (UK) level that implicitly or explicitly employ the concept of a “counterfactual” in the context of Article 101 EC and 102 EC and that is the focus of this article.

In short summary of what follows, it is submitted that recent case law and Commission guidance supports the view that a counterfactual may serve one of two primary purposes in identifying an infringement; in the ‘simple’ case the counterfactual is the position absent the anticompetitive behaviour, agreement or concerted practice and is aimed at determining actual or likely anticompetitive ‘effect’, using an economic approach, and to the requisite legal standard.

In another category of scenarios, it may be used to test not only anticompetitive effect, but also either the necessity or the proportionality of steps taken by the company alleged to have committed an infringement, where the company argues an Article 101(3) EC exemption, or in an abuse of dominance case, seeks to rely on arguments or defences as to ‘normal competition’, ‘competition on the merits’ or ‘objective justification’.

The particular issue faced by Ofgem, which it defended successfully before the Competition Appeal Tribunal and the Court of Appeal in the National Grid v Ofgem\(^5\) case largely fall into this latter category, and the inability of National Grid\(^6\) to exploit the ambiguities inherent in the concept of ‘normal competition’ or ‘competition on the merits’, as well as its failure to very strictly constrain the ability of a competition authority to adopt a plausible counterfactual as a key part of

\(^2\) As the reader’s professional interest is presumably in the latter field, and its use in merger control is already well known, an example in another area of law, albeit without the use of the term itself, can be found in the “but for” test in the common law principles of tort (causation) see Bonnington Castings Ltd v Wardlaw [1956] AC 613 at 620 for example, which can be found in all major common law jurisdictions. It is also presumably implicit in the Damnum Injuria Datum principle in civil law systems.

\(^3\) The Competition occasional paper published in April 2010 is an example: www.competition-commission.org.uk/our_role/analysis/10_05_20_Counterfactual_long_paper_v2_1.pdf

\(^4\) Failing or ‘flailing’ firm situations are notable exceptions.

\(^5\) National Grid v the Gas and Electricity Markets Authority (as this statutory body is commonly known by the name of its executive arm ‘Ofgem’, this case is referred to as National Grid v. Ofgem in this Article). In the Competition Appeal Tribunal [2009] CAT 14 Case Number: 1099/1/2/08, judgment of 29 April 2009, in the Court of Appeal [2010] EWCA Civ 114 Case No: C1/2009/1573, judgment of 23 February 2010. Permission to appeal to the Supreme Court was refused by Order of 28 July 2010.

\(^6\) Richards LJ commented in National Grid v Ofgem that “The complexities of Mr Turner’s submissions on this appeal are such that any summary of them do not run the risk of inadequacy, and the same must have been true of the proceedings before the Tribunal.” (paragraph 35) and the author recognises the sophistication of the arguments by leading counsel in the case, and the risk of over-simplification in attempting to still further distill the key legal principles from the case law in this article.
its case, carry lessons for practitioners and competition authorities alike. Equally, this case is unlikely to be the last word on an important area.

While the focus of this article is on the use of counterfactual analysis in the context of answering the primary question of whether there has been a breach of the competition rules, it should not be ignored that in the event of breach, a counterfactual analysis is also likely to be relevant to establishing the severity of any penalty imposed or the appropriate amount of damages; in the former case where (for example) the analysis demonstrates a high degree of foreclosure, and in the latter case in the context of applying the law on causation and proof of loss before national courts.

**Examples of a ‘simple’ failure by the European Commission to properly consider the counterfactual – using the counterfactual “shield” in litigation**

The European Courts (unlike the European Commission, certain national competition authorities such as Ofgem, or the Competition Appeal Tribunal in the UK) have not yet embraced the term ‘counterfactual’ outside merger control. However, a rose by any other name would smell as sweet, and it is only a matter of time before the European Courts do employ the term “counterfactual” under either or both of Article 101TFEU and 102TFEU, if only because the Commission decisions are more likely to do so in light of their own guidance on abuse of dominance.

For an example under former Article 81EC, the European Court of First Instance in Case T-328/03 O2 (Germany) v Commission [2006] ECR II-0000 (2 May 2006) upheld an appeal against a Commission decision because the Commission had failed to properly consider what would have happened in the absence of the agreement. Citing well established principles, the Court considered that the competition in question must be understood within the actual context in which it would occur in the absence of the agreement; the interference with competition may in particular be doubted if the agreement seems really necessary for the penetration of a new area by an undertaking. At paragraph 71 the Court stresses that:

> “the examination required in the light of Art 81(1) EC consists essentially in taking account of the impact of the agreement on existing and potential competition […] and the competition situation in the absence of the agreement, […] those two factors being intrinsically linked”.

As has pointed out, the “competition situation in the absence of the agreement” is what in economics literature is called the “counterfactual”.

By way of example under former Article 81(3), in GlaxoSmithKline v Commission Judgment of the court of first instance 27 September 2006 in case T-168/01 (subsequently upheld by the ECJ) the Court overturned a Commission decision on the basis that it had failed, in applying the Article 81(3) exemption, to properly consider various benefits (in particular as regards technological progress and other efficiencies) that would not have occurred under the counterfactual (ie in the absence of the contractual clauses at issue).

> “That approach may entail a prospective analysis, in which case it is appropriate to ascertain whether, in the light of the factual arguments and the evidence provided, it would be necessary to exclude any anticipated benefits”.

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7 Arkin [2003] EWHC 687, Courage [2003] EWHC 1510 in the English High Court and the still more recent case of Enron v EWS[2009] CAT 36 Case Number: 1106/5/7/08 in the Competition Appeal Tribunal and [2009] CA Civ 647 at the Court of Appeal (upholding the CAT’s decision) are examples of a failure to establish causation because in the ‘but-for’ world, or the counterfactual absent the anticompetitive contract or behaviour, the loss would nonetheless have occurred, or there was some intervening causation.

8 Emanuela Lecchi, in a Paper discussed at the IBA Singapore Conference in October 2007. In practice, the “but for” test has been manifest for some time – it is the simple counterfactual of “what if x clause was removed”?.
seems more likely either that the agreement in question must make it possible to obtain appreciable advantages or that it will not. “ (paragraph 249)

The court then referred to case law under Articles 81/82EC as well as referring “by analogy” to two leading merger decisions Tetra Laval v Commission, and General Electric v Commission, both of which involved overturning Commission decisions based on (in essence) a failure in counterfactual analysis. This is worthy of a brief comment: it is an example of the cross-fertilisation of concepts and of terminology between Articles 101/102 TFEU and merger control, and supports the author’s view that broader use of ‘counterfactual’ terminology and analysis outside merger control is now inevitable.

**Commission’s Guidance on the Commission’s enforcement priorities in applying Article 102EC of the EC Treaty to abusive exclusionary conduct by dominant undertakings – will the EC begin to use the counterfactual sword more frequently?**

After a considerable period of genesis, the Commission published in 2009 what its guidelines on “enforcement priorities” in respect of Article 102EC. This is the first time in any guidance (or decision) outside merger control that the Commission explicitly refers to the use of ‘counterfactuals’:

21. When pursuing a case the Commission will develop the analysis of the general factors mentioned in paragraph 20, together with the more specific factors described in the sections dealing with certain types of exclusionary conduct, and any other factors which it may consider to be appropriate. This assessment will usually be made by comparing the actual or likely future situation in the relevant market (with the dominant undertaking’s conduct in place) with an appropriate counterfactual, such as the simple absence of the conduct in question or with another realistic alternative scenario, having regard to established business practices.

(emphasis added)

This is critically important to the future development of antitrust law, in particular because it envisages both the ‘simple’ counterfactual (absence of conduct in question) but also alternative scenarios. Further, it is surely not limited to Article 102TFEU. Of perhaps greatest interest, is the reference to not only the ‘classic’ counterfactual of the simple absence of the conduct in question, but also reference to the possibility of deploying ‘another realistic scenario having regard to established business practices’. It is this latter issue that was particularly closely scrutinised in the National Grid case. Again, as a general proposition, the author would say:

- In the ‘simple’ case of testing for anticompetitive effect, asking ‘What would happen without the agreement/behaviour/relevant terms’ is an obvious – and generally used – approach; but

- Where the answer to that first question, whether under Article 101(1) TFEU or under Article 82EC suggests that the fabric of competition may well have suffered, and arguments are then raised either under Article 101(3) or analogues such as ‘Objective Justification’ under 102EC, a further counterfactual exercise

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9 Reference is made to the Article 81EC/101TFEU cases referred to above, and to the author’s review of the interplay and overlap between the two treaty articles in “Abuse of Dominance at a Crossroads – Potential Effect, Object and Appreciability under Article 82 EC” at [2004] 8 ECLR.
may be helpful by reference – for example – to other scenarios either actually observed in the market, or which are otherwise sufficiently plausible to provide a useful benchmark.

The parameters of that analysis under 101(3) EC are on their face clearer than under Article 102EC (not least as they are set out in the Treaty itself):

- First, the agreement concerned must contribute to improving the production or distribution of the goods in question, or to promoting technical or economic progress;
- Second, consumers must be allowed a fair share of the resulting benefit;
- Third, it must not impose on the participating undertakings any restrictions which are not indispensable; and,
- Fourth, it must not afford them the possibility of eliminating competition in respect of a substantial part of the products in question.

Without limiting the use of a counterfactual in considering any of the above, it is obvious that it is likely to be a particularly helpful tool in considering the third criterion under 101(3): it must not impose on the participating undertakings any restrictions which are not indispensable. It is useful because if a realistic counterfactual can be found that achieves the same positive effects (limbs one and two), but without one of the anticompetitive clauses, or with a clause which is less restrictive, then the Article 101(3) test fails under that third limb – it essentially fails on a ‘proportionality’ test. So, if some term protection is necessary, could it be of shorter duration without jeopardising the pro-competitive outcome (counterfactual: a different duration of exclusivity)? Rather than territorial protection, would a profit-share mechanism equally effectively protect the seller from the risk of arbitrage cannibalising their own sales elsewhere? Any particular counterfactual should certainly be considered if it is common industry practice, and perhaps even an uncommon, but nonetheless present, industry practice.

If this is accepted, it opens the door to certain obvious avenues of inquiry by companies and their lawyers in self-assessing compliance under 101(3): has the company group or any of its competitors (as far as this is ascertainable) entered into similar contracts without the restriction in question, and if so, can those be distinguished such that the indispensability requirement is met in the particular circumstances of the case? In practice, specialist competition practitioners already carry out this kind of analysis, without generally referring to the situation absent the restriction as the ‘counterfactual’. The risk for the company (assuming they fall outside any relevant block exemption) is that a competition authority, able to obtain copies of competitors’ contracts which have not been seen by them, may in future rely on a counterfactual grounded on those contracts; this is problematic in terms of competition policy at least if the company is not dominant (where utmost caution is advisable – ie a ‘special responsibility’ applies) and the restriction is borderline.

**National Grid v Ofgem and consideration of counterfactuals**

The decisions of the English courts (both the CAT and the Court of Appeal) might suggest that this was a very complex case indeed. In reality, although the contracts were complex, the points of actual legal dispute were relatively few and – importantly for present purposes – included significant focus on the use of a particular counterfactual and (at least implicitly) the leeway a
competition authority should have in constructing such a counterfactual when testing the legitimacy of the behaviour of a dominant undertaking.

While a full appreciation of the detail may be important to some readers, for present purposes, these are the key points:

- The behaviour in question concerned the entering into of long term rental contracts by a company which had over 90% of the relevant market at a time of liberalisation of the market;

- The two major new entrants supported the contention, with evidence, that they had been foreclosed within the meaning of the standard legal test;

- Against that prima facie foreclosure case (which might have been run under Article 101 and 102 though in the event proceeded on the latter alone), was an argument that was based on National Grid’s ‘sunk costs’ and the potential for legitimate means of recovering it through a series of charges imposed whenever a contractor exited the rental contracts above the ‘allowed’ rate;

- Although this was positioned by the Appellant throughout the investigation and subsequent litigation as a question of what must be permissible as ‘normal competition’, or ‘competition on the merits’ and the decisions generally reflect this terminology, the author would suggest that this might alternatively have been argued as an ‘objective justification’. The Court of Appeal in fact described the argument by National Grid as follows “The behaviour adopted was in itself the natural, efficient and only realistic way to achieve indisputably legitimate ends.” (paragraph 32), which is not dissimilar to arguing it is ‘objectively justified’.

- Importantly, and crucially for the conduct of other inquiries by competition authorities, the competition authority ultimately defeated this claim for objective justification using a counterfactual which pointed out a lack of proportionality – there was an alternative that National Grid might have adopted, which would have had less of a foreclosure effect (note here, the particular resonance with Article 101(3), third limb).

- Finally, the competition authority was not required, in establishing a counterfactual, to precisely mirror the terms in other contracts in the market. Rather, it was sufficient that the counterfactual, relying on elements found in the market, was “rooted in market reality”.

Turning to certain key elements of the judgment, certain more specific conclusions as to the use of a counterfactual can be drawn. For example, against the various criticisms raised against the case put by Ofgem, the CAT responded:

130. In our judgment this criticism is based on a misapprehension of the function of the counterfactual in the economic analysis required in a case such as this. The Authority does not have to establish that the parties would have preferred to enter into a contract along the lines posited in the age-related counterfactual. The [...]counterfactual is based on features of other contracts operating in the market [...] We regard that as a useful avenue of inquiry even if there would have been logistical or financial difficulties in setting up such a system”. As Ms Carss-Frisk QC argued in her closing submissions, the Authority is not setting out to prove that the counterfactual is

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10 It is a matter for speculation whether the case was framed by the Appellant so as to avoid the term of art ‘objective justification’ due to the reversal of the burden of proof that would arise.
11 Paragraph 137 of the CAT’s judgment.
12 This hardly suggests a high burden of proof.
what would or should have happened or that it would have been preferred by the parties. It is simply asking what would be the result if they had.

The Court of Appeal also stated that

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.¹³

Suggesting that its own level of scrutiny may be curtailed, perhaps at least so long as faced with a counterfactual “rooted in market reality” (e.g. evidencing clear similarities with agreements actually deployed in the industry) or which has otherwise been fully assessed by the relevant court of first instance.

**Concluding remarks**

Confirmation by both the Competition Appeal Tribunal (which, for those outside the jurisdiction, is a court with the same status as the High Court, and which sits with a panel including both an expert competition lawyer/judge and an expert economist, and which decides competition law appeals on the merits), and subsequently by the Court of Appeal, in the terms employed, is helpful in the context of both Articles 101 and 102 TFEU. This is particularly so as the Commission’s own guidance and certain recent case law of the European Courts, adopt a consistent approach, at least insofar as the terminology is concerned. At the time of writing it remains to be seen how consistently the particular approach of the English courts is adopted across the rest of Europe.

Does this case give carte-blanche to competition authorities to construct counterfactuals to suit their purposes? Far from it – indeed on one reading of the matter, and in particular at Court of Appeal level, it is only because of the anxious scrutiny to which Ofgem subjected the use of the counterfactual, combined with its attempt to align it with existing examples of industry practice, that the court found the exercise persuasive in the final analysis. If the purpose of the counterfactual had been, for example to establish effect or causation, it is a matter for conjecture whether the standard of proof may in practice be higher. That may legitimately be considered by the courts to be a different exercise to one in which a dominant company attempts to run an ‘objective justification’ argument where the core facts suggest abusive behaviour which requires explanation.

On that note, the author would reiterate that at heart this was a simple case on the law, enabling the Competition Appeal Tribunal to go so far as to say the competition authority’s main finding of abuse was “undoubtedly right” (paragraph 200).

It was against this that National Grid sought to run complex arguments under the terminology of ‘normal competition’ or ‘competition on the merits’. If it had (in the author’s view, arguably more satisfactorily as a matter of law) posited those arguments as ones going to ‘objective justification’, it would have both faced the burden of proof as a matter of law and would have been held to a standard of proportionality (incorporating the concept of necessity). On the author’s reading of the court decisions, National Grid was effectively held to these tests in any event, by reference to a counterfactual that demonstrated a failure to act proportionately in imposing restrictions in contracts. On this view, the case concerns no novelty in approach as regards either demonstrating actual or likely restrictive effect, in holding a dominant company to a ‘special responsibility’, or in considering whether its actions were ‘objectively justified’. The decisions do however progress our understanding of the scope for deploying counterfactuals in analysis under both Articles 101 and 102 TFEU.

¹³ This is, again, hardly demonstrative of a high burden of proof/degree of judicial scrutiny.