

Could a move to more presumption-based Legal Standards be justified, on cost of error minimizing grounds, for the big-tech digital platform markets?

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- **General Introductory Remarks**

Introduction - Objective

Two of the most important issues in the enforcement of Competition Law are those of (i) what is the right “criterion” and (ii) what is the right “approach” in assessing potentially anticompetitive conduct and reaching liability decisions under Competition Law.

There has been intense debate in recent years about what is the appropriate “criterion” and what is the appropriate “approach”, especially for the big-tech digital markets.

In this presentation I discuss the second issue.

Defining Standards & Terminology

- We call the **criterion** for reaching a decision about whether or not there is violation of competition law the Substantive (or Liability) Standard
- We call the **approach** (or Decision Rule) that describes *how* decisions are reached the Legal Standard. So: **how do we decide** that the criterion in a specific case is satisfied?
- Two main ways:
 - ❖ Through an *inference*, about the effect in the specific case, from a more general population of cases (in which we believe that the specific case belongs) the effect of which we believe that we know, or:
 - ❖ Through an *investigation* of the effect in the specific case.

What determines the standards that are applied?

- The substantive and legal standards applied in a jurisdiction are set by competition law and by the Courts interpreting the law (and the case-law), and are influenced by a multitude of factors:
 - Socio-political and cultural factors and ideology; legal tradition; historical / economic development; these define the objectives of competition policy.
 - Market conditions, such as market structure and degree of market contestability.
 - What economic theory suggests about the effects of different types of business conduct and what it suggests are the optimal legal standards if our objective is to minimize decision errors or to maximize social welfare.

Types of substantive standards

- Welfarist vs. non-welfarist Substantive Standards (SS):
 - *Welfarist SSs* assume that the criterion for reaching decisions is consumer surplus or economic efficiency; usually assumed in academic discussions by economists but probably rarely used in practice.
 - *Non-welfarist SSs*: these can be distinguished into:
 - (a) SSs that are just one of a *continuum of criteria* that need to be examined in order to form a judgement about the ultimate criterion of welfare - e.g. the criterion of monopoly power or the criterion of exclusionary effect / “disadvantaging rivals”; and
 - (b) non-welfarist SSs related to “*public interest concerns*” (e.g. concerns of equity, competitiveness promoted through industrial policy, employment etc; e.g. see articles: Baker & Salop (2016); Fox (2016); Gal (2004)).

Types of legal standards

- Literature usually distinguishes between two broadly defined types of legal standards:

- *Per Se (US), or object-based (EU)*: decision in a specific investigation of a given conduct is made on the basis of a **general presumption** about **the impact of a general class of conducts**, within which (class) we must establish that the conduct investigated falls.

With Per Se, beyond placing the conduct in the general class by virtue of its characteristics, no further investigation is undertaken (difference with object-based).

Effects-based (EB; EU), or rule-of-reason (US): decision made after pursuing a multi-stage investigation and assessment (as described below) of the *specific* case and establishing its impact, *in this specific case*, on whatever liability criterion is used.

- Standards vs. Rules: legal distinction – not used here.

Recent literature on **optimal** legal standards (1)

- Assumes welfarist SS.
- Adopts *welfare maximisation approach* (generalises traditional **decision-theoretic approach**) taking into account both decision errors and deterrence effects (and legal uncertainty).[References 5, 7, 8].
- Discussion below concentrates on traditional decision error-cost minimisation approach.

Recent literature on **optimal** legal standards (2)

- The presumption of illegality is extremely high for certain (hard-core) horizontal agreements – e.g. price fixing, market sharing, bid-rigging - and this is the reason for the essentially universal unanimity of using a **Strict Per Se Illegality** LS for these conducts.
- Important to understand that, for these conducts, this (Per Se) LS is indeed the LS that maximizes social welfare.
- But what about other conduct types?

Recent literature on **optimal** legal standards (3)

- Developments in economic theory (Industrial Organisation) and evidence suggest that **for a large number of other conducts in the categories of abuse of dominance and vertical constraints EB legal standards are more appropriate** (i.e. optimal, from the point of view of cost of decision error or social welfare maximisation).
- Note too: legal uncertainty and administrability issues may not reverse this conclusion (reference 5).
- These developments in economic theory have been an important factor responsible for a **move towards more EB legal standards (at least for vertical restraints) in North America in the last 25 years.**
- But this **move has not been universal** and also it has not been followed in Europe (at least until recent years) and other countries. We need to explain that.
- This may be related to the adoption of different liability standards, to the extent to which reputational concerns are important in the choice of LSs and to whether the jurisdiction is a mature or a developing one (as discussed below).

- **Back to the Question in Title of Presentation**

Introduction

- Given above clarifications, note that the move suggested by the Question on the title of this presentation can in principle be justified in two ways:
 1. **Legal standards** (LSs) can become more presumption-based by adopting a **non-welfarist substantive (liability) standard** (SS) e.g. by moving from the consumer welfare SS to a “disadvantaging rivals” or “distorting the competitive process” SS. [This has been examined in Katsoulacos Y (2019a) “On the Concepts of Legal Standards and Substantive Standards (and how the latter influences the choice of the former)”, *Journal of Antitrust Enforcement*. Do not examine this here]. Or:

Introduction (cont.)

- 2. Showing, while adopting a consumer welfare SS, that for a conduct type the presumption of illegality is high enough to justify presumption-based assessments, that do not rely on the examination of many effect-related screens, given the discriminating quality of additional screens, in order to decide that there is liability.**

I examine this here.

Introduction (cont.)

- Important also to note that our discussion below concerns whether there should be some *general* modification to the legal standards or screen tests applied in assessing ***conduct types*** recognised as potentially abusive, in dominance cases especially when these involve big tech digital platforms.
- That is, we fully agree with Cremer et.al (2019) that “competition law should *not* try to work with the error cost framework in a **case-by-case basis**”.

Introduction (cont.)

- Presentation / results are based on recent paper; Katsoulacos and Ulph (K&U, 2022):
 - “Choosing Assessment Procedures in Antitrust Enforcement in Different Markets and Countries: a Proposal for Extending the Decision-Theoretic Approach (with Applications to the Digital Platforms and Developing Countries)”, forthcoming in *Managerial and Decision Economics*, 2022.
 - Can find DP version in CREESE site (Publications 2022):

<https://www.cresse.info/wp-content/uploads/2022/06/Choosing-Assessment-Procedures-in-Antitrust-Enforcement-in-Different-Markets-and-Countries.pdf>

Introduction (cont.)

- Paper develops a new methodology for operationalizing the application of the cost of error approach to the choice of legal standards, for assessing different conduct types, in the enforcement of antitrust.
- Some of the ideas underlying this approach are based on Katsoulacos and Ulph (Journal of Industrial Economics, 2009). Important predecessors also include: Ehrilch and Posner (1974), Posner (1973), Easterbrook (1984), Breckner and Salop (1999), Hylton and Salinger (2001), Evans and Salop (2005).
- See also list of Background References at the end of the presentation.

Paper makes use of an old idea

Continuum of legal standards.

- Idea originated in writings of legal scholars and judges (Judge Stevens) some time ago.
- It was present in first *Antitrust Law* treatise by Arreeda and Hovenkamp (4th Edition, 2017).
- Idea's articulation closest to our approach is in Jones and Kovacic (2017). First formulation of our approach appeared in Katsoulacos, Avdasheva and Golovanova (2018).
- Other important predecessors: Gavil (2008 and 2012), Kovacic (2021), Italianer (2013).

Idea of continuum of LSs

- Italianer mentions that US Supreme Court has explicitly recognised that “the categories of analysis cannot pigeonholed into terms like “per se” or “rule of reason”. No categorical line can be drawn between them, instead, what is required is a situational analysis, moving along what the Court referred to as “a *sliding scale*””.
- Idea of continuum also clarifies relation between Legal and Substantive Standards.
- Further it is very useful for investigating empirically which LSs are adopted by different CAs – applications in number of papers involving Katsoulacos, Avdasheva, Golovanova and other authors.

Cont: our approach

- In K&U (2022) we define the *continuum* as:
 - *a sequence of steps or stages, in each of which additional screens are examined, using further blocks or components of economic analysis, generating additional information, building on the information already gathered in previous steps.*
 - *The question examined is: when is it best to add additional steps of economic analysis and hence move the LS from Per Se closer to full effects-based.*

Cont: our approach

- The objective of each step of the information gathering and analysis process is to examine whether certain *preconditions or screens* are satisfied that are considered necessary for demonstrating liability (welfare harm) – such as significant extant market power / lack of contestability, potential for exclusion, potential for consumer harm and potential for efficiencies. Then, **decision error costs** across steps or stages can be derived and compared in order to determine **the optimal number of stages, that defines the error-minimising LS**. Or, to use the term some authors prefer to use, defines the **error-minimising *standard of proof***.

Screens

0. Conduct characterisation screen.
1. Market contextualisation and SMP / contestability screen.
2. Potential for significant exclusionary impact or enhanced ability to exercise market power screen.
3. Potential consumer welfare loss, due to anticompetitive effects, screen.
4. Efficiencies assessment and balancing screen.

NOTE: we don't examine *exploitative* conduct.

Legal Standards

- Depending on the screens examined, $i = 0, 1, \dots, 4$, we can then distinguish the following legal standards (assuming a consumer welfare substantive standard).

(i) **Strict Per Se (SPS) LS**, is the LS: liability decision relies purely on the initial characterisation of the conduct (in stage 0) and the presumption that this generates about its welfare impact.

(ii) **Modified Per Se LS (MPS LS)**: liability decision relies just on the information from stages 0 and 1 and the presumption that this generates about its welfare impact.

Legal Standards

- (iii) **Truncated Effects Based I LS (TEB I LS)**: liability decision relies on the information from stages 0, 1 and 2 and the presumption that this generates about its welfare impact. US Quick Look LS can be considered as an intermediate LS between MPS and TEB I involving a “quick look” on the efficiency defense.
- (iv) **Truncated Effects Based II LS (TEB II LS)**: under this, a liability decision relies on the information from stages 0, 1, 2 and 3 and the presumption that this generates about its final welfare impact.
- (v) **Full Effects Based (or rule of reason) LS (FEB LS)**: under this, a liability decision relies on the information from all assessment stages 0 – 4 and a balancing between anticompetitive and efficiency effects to determine the net effect on consumer welfare

How to Determine the Error Minimising Choice

- The question is: how many screens to investigate to minimise costs of decision errors for any given conduct type?
- Intuition (first formalised by K&U, 2009): it depends on the **strength of the Presumption of Illegality (or Legality)** in a given stage, for a conduct type, relative to the ability to discriminate whether conduct in specific cases is harmful or benign, that depends on the **discriminating quality of information expected to be generated by the examination of the screen** in the next stage.

How to Determine the Error Minimising Choice (cont.)

- First thing to determine is whether the conduct type is **Presumptively Illegal** (on average harmful) or **Presumptively Legal (PL)** (on average benign). Also, important to examine whether there is a basis for the
- **Easterbrook (1984) Hypothesis**. Severely criticized recently by Shapiro (2021), Hovenkamp (2021), Hovenkamp and Fiona Scott Morton (2020), Stigler Committee Report (2019), Salop (2021). G Manne (2020) – for a dissenting view.
- Then, determine the **Legal Standard that minimises DECs**.
- Our approach to modelling the factors that determine **Decision Error Costs (DECs)** is exemplified by the **Decision Tree** in the Diagram below, which shows these factors and how the probabilities of **False Acquittals (FAs)** and **False Convictions (FCs)** can be derived.

Factors that affect choice of LS

- The factors that determine the size of FAs, of FCs, and hence of DECs (as shown in Diagram below), and how these are affected when decisions are based less on presumption-based assessments and more on effects-based assessments, are the probabilities γ , $\hat{\beta}$, p_H and p_B , \hat{p}_H and \hat{p}_B , in the Diagram, with parameters H and B where:

H = average harm of conducts that are genuinely harmful

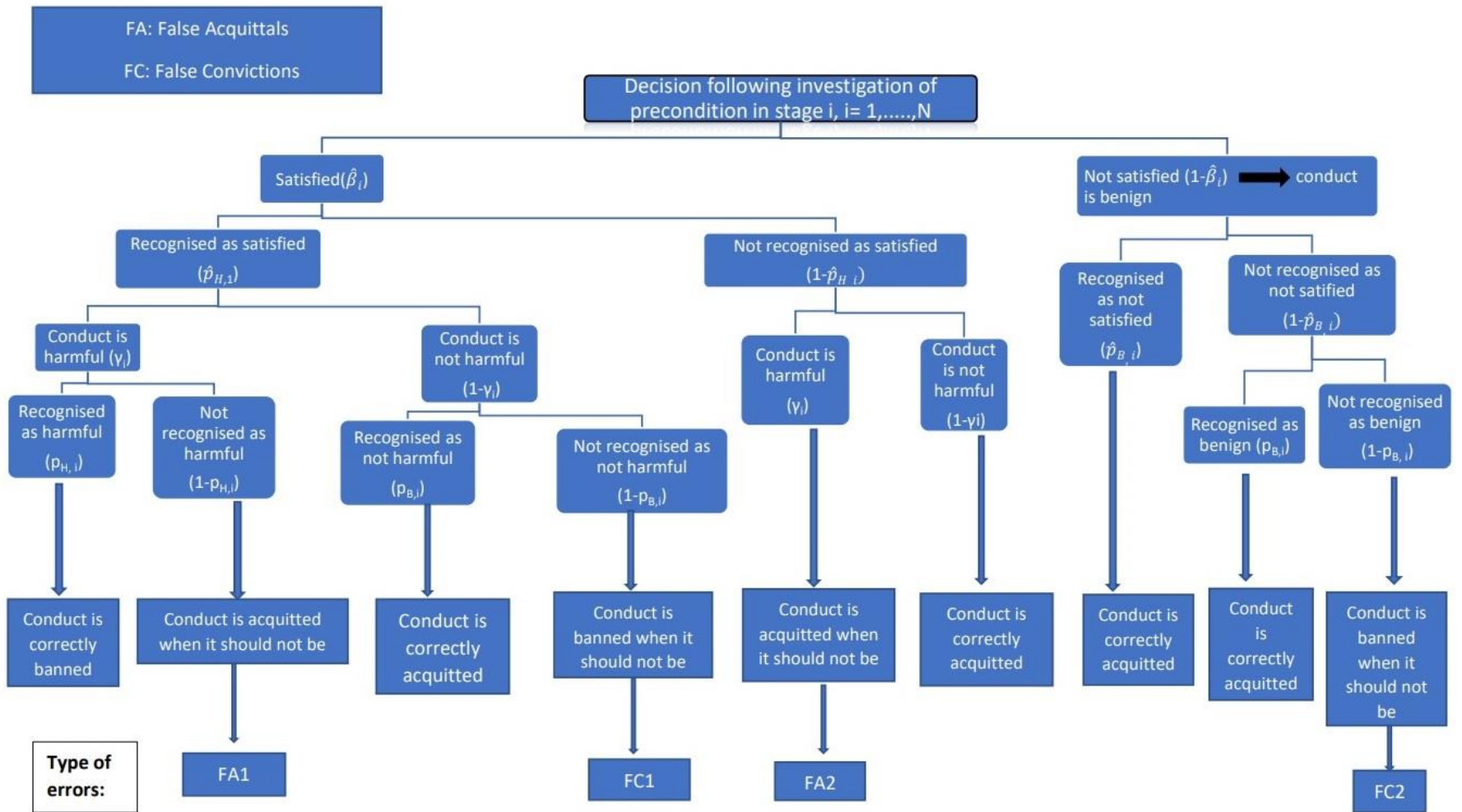
B = average benefit from conducts that are genuinely benign.

Factors that affect choice (cont.)

- γ_i is the likelihood that the specific conduct type investigated is genuinely harmful given information in stage i ;
- $\hat{\beta}_i$, is the prob. that precondition i is genuinely satisfied;
- $\hat{p}_{H,i}$ is the prob. that we can identify that precondition i holds when it does with a high degree of accuracy;
- $p_{H,i}$ is the prob. that we can identify when a harmful conduct is indeed harmful with a high degree of accuracy;
- $\hat{p}_{B,i}$, is the prob. that precondition i does not hold when it does not with a high degree of accuracy;
- $p_{B,i}$ is the prob. that we can identify when a benign conduct is indeed benign with a high degree of accuracy.

Factors that affect choice (cont.)

- Parameters H , B , γ and $\hat{\beta}$ influence the strength of the **Presumption of Illegality (or Legality) of the conduct type**.
- Parameters \hat{p}_H and \hat{p}_B , p_H and p_B , influence the ability to identify correctly whether the screen is satisfied or not and to discriminate whether conduct in specific cases is harmful or benign, that is, the **discriminating quality of the information expected to be generated by the examination of additional effects-related screens**.



Factors that affect choice (cont.)

- Example: the **Easterbrook Hypothesis**. In stage i :

$$DEC FA_i = \hat{\beta}_i \hat{p}_{H,i} \gamma_i (1 - p_{H,i}) H + \hat{\beta}_i (1 - \hat{p}_{H,i}) \gamma_i H$$

$$DEC FC_i = \hat{\beta}_i \hat{p}_{H,i} (1 - \gamma_i) (1 - p_{B,i}) B + (1 - \hat{\beta}_i) (1 - \hat{p}_{B,i}) (1 - p_{B,i}) B$$

According to this Hypothesis, which has led to what Hovenkamp (2021) calls an “anti-enforcement bias in antitrust”, we have:

$$DEC FC_i > DEC FA_i.$$

But we see that is likely to hold when:

The Easterbrook Hypothesis

- $\hat{\beta}_i$, is small (e.g. for stage 1, that the prob. that firm genuinely has SMP is small);
- $\hat{p}_{H,i}$ and $p_{H,i}$ are large, i.e. we can identify when harmful conduct is indeed harmful with a high degree of accuracy, while $\hat{p}_{B,i}$, $p_{B,i}$ are small, i.e. we cannot identify when benign conduct is indeed benign with a high degree of accuracy;
- γ_i is small, so the likelihood that the specific conduct type investigated is genuinely harmful (even by firms with SMP), is small;
- B is large relative to H. Many assumptions!!

The Easterbrook Hypothesis (cont.)

- The hypothesis has recently been the subject of severe criticism. According to Shapiro (2021) “...Easterbrook argued that antitrust courts should err on the side of defendants, because “judicial errors that tolerate baleful practices are self-correcting, while erroneous condemnations are not. Like Bork, Easterbrook achieved his desired result based not on economic theory or empirical evidence, but by making strong and unjustified assumptions”.
- Hovenkamp (2021), criticizes particularly the Easterbrook (1984) assumption that the average welfare cost B from a false conviction is likely to be larger than the average welfare cost H from a false acquittal, but we see from the above that **even if this were to be true** (which may well not be in many cases as noted by Hovenkamp (2021)), there is no obvious reason to expect that $DEC FC_i > DEC FA_i$.

Applications: The case of the big-tech platforms

- We have applied our approach to (a) the case of big-tech platforms and (b) developing countries.
- Big-tech platforms are generally characterised by extreme economies of scale and network externalities (creating very highly concentrated markets), the role of data (discriminatory access to data and lack of data portability), lack of interoperability, all of which act as a significant barrier to entry, often lack of multi-homing, and very significant economies of scope (that explain the emergence and growth of ecosystems and give incumbents a strong incumbency advantage). All of these may give dominant digital firms strong incentives to engage in anticompetitive behaviour.

Applications: The case of the big-tech platforms (cont.)

- Most commentators consider that the big-tech platforms do have SMP (or, $\hat{\beta}$ is large); the likelihood (γ) that the potentially abusive conduct types undertaken by them to be genuinely harmful is **not** small; and H could well be higher than B. THUS: these conducts are **presumptively illegal**.
- **Though this has been the presumption in EC/EU and other countries this has not been the case until very recently in US.**
- Also, the **Easterbrook Hypothesis is not likely to hold**. Given a strong presumption of illegality (measured by $\frac{\gamma_i H}{(1-\gamma_i)B} + \frac{\gamma_i H \hat{\beta}_i}{B(1-\hat{\beta}_i)}$), and also the relatively low discriminating probabilities, as a result of the complexity of identifying genuinely benign and genuinely harmful conducts in specific cases.
- However, this does NOT necessarily imply the use of a specific legal standard.

Applications: The case of the big-tech platforms (cont.)

- What is additionally proposed by many prominent commentators e.g. Cremer, Fiona Scott Morton, Shapiro, is that we **should abandon a full effects-based approach and rely on the presumption created by the exclusion screen, though making this presumption rebuttable and assigning to the defendants the burden of proof.**
- Is this justifiable? Is it justifiable not to undertake additional investigations beyond stage 2 (that involves identification of exclusion potential)?

Applications: The case of the big-tech platforms (cont.)

- K&U (2022) show that **the validity of the proposal for a more presumption-based LS cannot be established unambiguously.**
- It depends very much on what happens to our ability to identify correctly whether the precondition examined by **additional** screens holds relative to the increase in the presumption of illegality in stage 2 (i.e. when exclusion has been identified).
- One thing that has to be borne in mind is that many papers in IO literature have shown that “exclusion” does **not** necessarily imply consumer harm – so it is not clear whether the presumption of illegality in stage 2 is very high.
- Lina Khan, Tim Wu and other neo-Brandeisians follow a more direct approach in order to prescribe a presumption-based LS: that of adopting a **non-welfarist substantive (liability) standard.**

Applications: The case of developing jurisdictions

- On the other hand, in “Why should legal standards in antitrust enforcement be different in developing and mature jurisdictions?” Bageri and Katsoulacos (*BRICS Journal of Economics*, 2022), we show that **more presumption-based standards in AoD cases ARE more likely to be justifiable in developing jurisdictions on error-minimisation grounds.**

Background literature

1. “A Note on the Concepts of Legal Standards and Substantive Standards (and how the latter influences the choice of the former)”, 2019a. **Journal of Antitrust Enforcement**.
2. “On the Choice of Legal Standards: a Positive Theory for Comparative Analysis”, 2019b. **European Journal of Law and Economics**.
3. “A methodology for empirically measuring the extent of economic analysis & evidence and identifying the legal standards in Competition Law enforcement” (with S Avdasheva and S Golovanova), in Festschrift in Honour of Frederic Jenny, **Concurrences Review**, 2018.
4. “Legal Standards and the Role of Economics in Competition Law Enforcement” (with S Avdasheva and S Golovanova). **European Competition Journal**, 2017.
5. “Regulatory Decision Errors, Legal Uncertainty and Welfare: a General Treatment” (with D Ulph), **International Journal of Industrial Organization**, 2016.
6. “Optimal Substantive Standards for Competition Authorities” (with Eleni Metsiou and David Ulph), **Journal of Competition, Industry and Trade**, 2016.
7. “Legal Uncertainty, Competition Law Enforcement Procedures and Optimal Penalties” (with D. Ulph), **European Journal of Law and Economics**, 2016, 41(2).
8. “On Optimal Legal Standards for Competition Policy: A General Welfare-Based Analysis” (with D. Ulph), **Journal of Industrial Economics**, September 2009.

Note: details of many of the references to other authors mentioned in presentation can be found in the references section of papers 1 and 2 above.

Note:

we plan to publish a book (CRESSE Volume) on the issues discussed in this presentation – which will include chapters examining the approach to enforcement in big-tech digital markets in different countries.

- Thank you!
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