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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE****Summary of Discussion of the Roundtable on Competition Issues in Aftermarkets  
Annex to the Summary Record of the 127th meeting of the Competition Committee****21-23 June 2017**

This document prepared by the OECD Secretariat is a detailed summary of the discussion held during the 127th meeting of the Competition Committee on 21 June 2017.

More information related to this discussion can be found at

[www.oecd.org/daf/competition/aftermarkets-competition-issues.htm](http://www.oecd.org/daf/competition/aftermarkets-competition-issues.htm)

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## *Summary of Discussion of the Roundtable on Competition Issues in Aftermarkets*

The **Chair**, Professor Frédéric Jenny, opened the Roundtable on Competition Issues in Aftermarkets, a topic addressed for the first time in the Committee although very common across modern economies. He noted that there are still divided views in this area, which will make for an interesting discussion.

Before opening the floor for discussion, the Chair introduced three expert panellists: Lorenzo Coppi, Executive Vice President at Compass Lexecon and Visiting Professor at the College of Europe, Thomas Graf, partner at Cleary Gottlieb Steen & Hamilton LLP, and Luis Cabral, Professor at Stern School of Business, New York University.

The Chair suggested that the discussion should be structured around four main issues:

1. The economics of aftermarket monopolisation and its influence on competition law enforcement;
2. Market definition and market power in aftermarket cases;
3. The legal treatment of aftermarket monopolisation; and
4. Non-competition enforcement remedies and other regulatory remedies to aftermarket concerns.

To set the background for the roundtable, the Chair asked the **Secretariat** to give a brief presentation on the key findings of the background note, which touched upon the Chicago and Post-Chicago debate on aftermarket monopolisation, the enforcement of competition law in aftermarkets and some key questions, such as: how can competition authorities define an aftermarket separate from primary market and establish market power of supplier, when can a competition authority find competition law infringement considering various justifications such as IP rights and efficiencies, which remedy is better placed for aftermarket monopolisation and to what extent should competition authorities be concerned about aftermarket monopolisation.

### **1. The economics of aftermarket and its influence on competition law enforcement**

The Chair thanked the Secretariat for the introduction and then asked Professor Cabral to give a general overview of the interplay between aftermarket power and foremarket competition in a dynamic context.

**Professor Cabral** began by clarifying that the focus of his presentation would be the recent theoretical developments which involve not only how to address aftermarkets but go to the essence of what an aftermarket really is. After a short reference to the conventional wisdom on the topic, Professor Cabral pointed out a first important element for the discussion, underlining how from the point of view of the economic theory the issue of foremarket and aftermarket is much broader than just the choice of the purchase in a primary market (e.g. buying a printer).

According to Prof Cabral, attracting a customer in the foremarket is now more than ever about increasing the installed base more than only about the promise of a profit in the

aftermarket. This is because we are living in an era of winner-takes-all races, with many industries characterised by increasing returns to scale. Consequently, the appropriate context in which to look at aftermarket power is the one of markets characterised by hyper-competition. As a matter of fact, under these circumstances prices in the foremarket can decrease by more than 100% with respect to the increase in aftermarkets, and this is a first important feature of these markets. The second one is increasing dominance, i.e. the idea that a firm leader in the market has more to gain from capturing a new customer than an entrant or small firm has. These two characteristics are two fundamental points in the dynamics of aftermarkets.

Professor Cabral addressed the issue of aftermarket power, highlighting how both the hyper-competition and the increasing dominance effects are magnified by the existence of market power. Overall this dynamic effect is the big elephant in the room, especially with regard to high-tech industries and the digital economy. To conclude, he stressed that it does not make sense to examine aftermarkets in isolation and that with increasing returns to scale, which are a feature of many modern industries, it is important to move from static analysis to dynamic models.

The **Chair** thanked Professor Cabral for his presentation and for setting the scene for discussion among competition authorities. He then asked the delegation from United States to explain their narrow interpretation of when it is justified to intervene in aftermarket cases, following the well-known Kodak case in the US.

The **United Stated** described how in the US vertical restraints imposed by original equipment manufacturers in aftermarkets are normally reviewed under a rule of reason analysis which takes into account potential benefits for competition. For this reason, after the 1992 Kodak case only few plaintiffs have prevailed on an aftermarket claim. As a matter of fact, when a customer enters a contract containing obligations on aftermarket sales, US courts are unlikely to find antitrust liability if the manufacturer lacks market power in the foremarket and consumers have alternative choices at the time of the initial sale. US courts are also unlikely to intervene when any changes in aftermarket policies are predictable and aftermarket costs are clear to customers at the time of their initial purchase, allowing them to engage in a rational life-cycle pricing analysis. The US delegation briefly presented two cases where the US Department of Justice intervened in relation to aftermarket issues, the General Electric/Alstom merger and a 1998 consent decree involving General Electric.

The Chair then turned back to Professor Cabral for a clarification and asked how he would have applied his previous reasoning to the Kodak case.

**Professor Cabral** explained that in his view the principles mentioned earlier would apply in the context of Kodak. To the extent that the foremarket was relatively competitive, i.e. that there were alternatives to Kodak and Kodak's incentives to invest into quality improvement were preserved, the market would be characterised by hyper-competition and increased market power would come with a significant benefit to consumers.

The Chair thanked Professor Cabral and asked Japan if there is scope for economic analysis when the JFTC assesses anticompetitive effects of aftermarket practices.

**Japan** described its approach to aftermarkets with an example related to the elevator maintenance case. The JFTC found that the market for maintenance services was independent from the market for the supply of elevators. This was based on information on both demand and supply sides, on market structure and companies' behaviour in the market. Moreover, for the future the JFTC expects to be able to employ more sophisticated analyses in aftermarkets cases.

## 2. Market definition and market power in aftermarket cases

The Chair introduced the second part of the discussion, on market definition and market power in aftermarket cases. He invited Lorenzo Coppi to address the practical aspects of the implementation of economic analysis in competition law, starting from the definition of the relevant markets and market power.

**Lorenzo Coppi** outlined the three necessary steps for the analysis of competitive effects in aftermarket. The first one is to ask oneself whether the manufacturer would have the ability to monopolise the aftermarket. The second would be whether it would have the incentives to do so and the third one whether any anticompetitive effect would arise from the practice. The second part of the analysis, focused on incentives, entails a trade-off between exploiting locked in customers and the possibility of losing customers to competitors. This debate is a crucial point of the economic literature.

Market definition is a key step when determining if it is possible to raise the price and it can be quite complex exercise in aftermarkets, due to the need to consider links between the two markets, the fore and the aftermarket. Lorenzo Coppi discussed a potential methodology which includes different steps. First of all, a SSNIP test is applied to the brand-specific aftermarkets to determine if there is an overall market for secondary products or not. If not, then it needs to be assessed if consumers can switch the primary product. If they can, the market could be a market for systems, as consumers can just choose another foremarket product as a result of a price increase in the secondary market.

However putting in the same market products that are not substitutable but complementary in use could make such a market definition controversial. In any case, an analysis of market power should follow, and sometimes going directly to the dominance analysis in the secondary market is a possibility. To conclude Lorenzo Coppi mentioned some factors which are key to understand the degree of completeness of waterbed effects and therefore whether a player would have the incentive to monopolise the aftermarket to increase profits and potentially harm consumers. These elements include the degree of primary market competition and the degree to which consumers engage in the lifecycle assessment of prices. Economic literature finds that the waterbed effect can be complete, incomplete or even over-complete, reflecting the degree to which high secondary market profits can be offset by low foremarket pricing. Therefore, a case-by-case analysis is suggested.

**Professor Cabral** agreed with Lorenzo Coppi. **Thomas Graf** asked if the analysis of the system competition should take place at the market definition stage or at the dominance stage, since in jurisdictions like the EU this is normally done at the dominance stage. He also asked if customer myopia should be an important criterion from the point of view of economists or not. **Lorenzo Coppi** replied that conceptually it should not matter when system competition is looked at, unless one thinks that the thresholds for a dominance analysis and a market definition analysis are different. On the second point, he agreed with Professor Cabral that myopia in general is an important question; however even customers are myopic, foremarket competition may still take care to some extent of consumers that are locked in.

The Chair turned to Turkey and asked to explain its approach to market definition in aftermarket cases and discuss the impact of such approach to its enforcement practices.

**Turkey** reported that competitive concerns may arise when brand-specific aftermarkets are defined as relevant markets. In case of brand-specific markets the main questions are in relation to compatibility and switching costs. As for dominance, brand-specific market

definition does not guarantee a finding of dominance in the Turkish Competition Authority's (TCA) cases, where the authority considers the link between primary and secondary markets and decides accordingly. Turkey then discussed its 2009 decision on medical devices, where the TCA defined a brand-specific aftermarket for technical services and found each manufacturer dominant in its own aftermarket.

The Chair asked to Chile to expand on their automobile industry and car repairs case, where it defined multiple relevant markets, and to explain the reasons for this approach.

**Chile** explained that in this case, due to significant switching costs, absence of sophisticated buyers and uncertainty about the possibility of having to purchase spare parts during the life-cycle of the car, the authority decided to define two separate markets. The case was closed because the FNE considered that the company did not have incentives to charge high prices in the aftermarket, however it recommended making public the cost of aftermarket's products in order to reduce the information asymmetry detected in the investigation and consequently to improve the quality of the purchasers' decision-making process.

The Chair asked Spain if their decision to narrowly define markets was a way to justify more easily the existence of market power.

**Spain** replied that there were economic justifications for such market definitions. When there is a specific and differentiated demand for just aftermarket services, the CNMC has opted to define narrow secondary markets. In particular, the supply of original spare parts of a manufacturer or even the supply of specific technical information and support services of each manufacturer products can become a differentiated relevant product market. These narrow product markets definitions were very relevant in the analysis of the anticompetitive effects of the investigated practices.

The Chair turned to Latvia, for its references to aftermarkets in public procurement tenders.

**Latvia** reported that in public procurement unnecessary lock-in effects emerge in some situations. More could be done to promote competition in these markets. Indeed, for what concerns the definition of primary and secondary markets, usually in public tenders the demand side influences the way in which the relevant market is defined. In cases where the tender requires to submit a proposal also for aftermarket services, a market for systems should be defined. Only in those cases when public procurement is organized separately for secondary market services (for example, maintenance of IT software) a separate aftermarket may be defined.

The Chair asked the EU to present the EFIM and the EU approach to dominance in aftermarket cases.

The **European Union** opened its intervention by agreeing with what was said previously by the speakers and clarified that the Commission deals with aftermarket cases on a case-by-case basis. As for dominance in aftermarket cases, the Commission applies the criteria stated in the EFIM case. In order to conclude that there is no aftermarket dominance four conditions have to be met, which correspond to the following questions: Can customers make an informed choice, including lifecycle-pricing, between the various manufacturers in the primary market? Are they likely to make such choice accordingly? If prices were raised significantly in the aftermarket, would a sufficient number of customers adapt their purchasing behaviour at the level of the primary market? Within a reasonable time? If the answer to any of the questions is negative, this does not automatically imply dominance, but it merely means that the Commission must do a careful analysis of the competitive

conditions and take into account the degree of interdependence between primary and secondary markets.

**Professor Cabral** intervened to suggest that there are three important questions to take into consideration in relation to the interdependence between primary and secondary markets: does aftermarket power lead to changes to what happens in the foremarket? Would consumers change their behaviour in the primary market? Would suppliers, sellers, change their behaviour in the primary market? **Lorenzo Coppi** asked where is interdependency between markets considered, because if it is considered both at the market definition stage and at the dominance stage it could be difficult logically to reconcile a narrow market and no dominance by the brand in that narrow market. The **European Union** clarified that the way the Commission deals with this is by considering interdependence in the dominance analysis.

### 3. The legal treatment of aftermarket monopolisation

The Chair moved to the third part of the roundtable discussion and gave the floor to Thomas Graf for his presentation on the legal treatment of aftermarkets.

**Thomas Graf** noted that these aftermarket questions have great practical importance, firstly because the same issues arise in a broad range of circumstances (for example in digital platforms), secondly because they relate to core commercial business issues of companies, their business models and their ecosystems. From a business perspective predictability and legal certainty are quite valuable, and there is a question if market definition and dominance analysis give sufficient predictability and legal certainty, since it is often a case-by-case analysis with a significant degree of agency's discretion. In his view it is very important to apply rigorous principles when looking at firms' conduct.

One key point is to distinguish between practices that prevent or restrict independent competition by rivals versus cases where the issue is a duty to supply a valuable asset. Although in practice this distinction is not easy, it is very important because the legal test is quite different under EU law, as for duty to supply cases there is a higher legal threshold (i.e. it is necessary to show that the asset is indispensable and that the refusal would eliminate all competition). This threshold is easily reached in aftermarket cases with a brand-specific market, and that is why one needs to be careful with defining brand-specific markets. Finally Mr Graf underlined that the concept of objective justification is an important criterion for the conduct analysis.

The Chair turned to Sweden for a summary of the criteria used to prioritise aftermarket cases.

**Sweden** reported that the process of selecting cases is set out in the prioritisation policy and several factors are taken into account. First, whether the conduct harms competition and consumers. Second, whether it is important to set a guiding precedent. Third, whether the competition authority is the best-placed agency to intervene. And fourth, whether it is possible to effectively investigate and remedy the competition concern at stake. An aftermarket conduct, which is capable of leading to exclusionary effects would have a high likelihood of being prioritised.

The Chair asked Korea to summarise the Hyundai Mobis case and to explain how in this particular case the KFTC adopted a quasi-regulatory solution.

According to **Korea** in the Hyundai Mobis case the KFTC concluded that prohibiting car dealers from selling generic parts to third parties amounted to an abuse of market dominance and issued an order to discontinue the practice. The KFTC set an important social agenda in the automobile industry in the process of reviewing the case and the government accredited certification agencies (rather than the car manufacturers) to verify the quality of competing spare parts.

The Chair turned to Israel and asked how they looked at aftermarket issues and especially at the interdependency between primary and secondary markets in the elevators case, and what regulatory steps were suggested.

**Israel** replied that their analysis of the case took into account both the question of consumer behaviour and of the effects on producer behaviour. In this specific case, given the gap existing between the primary market and the secondary market (due to the elevator being chosen and paid for by the contractor that builds the building, while the service costs are borne by the residents who will then purchase an apartment), any assumption of a waterbed effect needs to take into account the degree of competition in the foremarket and whether the savings can be assumed to be rolled over to consumers. The issues that emerged are primarily sectoral in nature, i.e. they have to do with the nature of the elevators, thus the suggestion that the solution should be worked with sectoral regulators like the regulator responsible for safety inspections and safety of elevators, the housing authority and with the consumer protection authority. Currently the steps that are considered relate to access to spare parts, provision of technical information, and actions to reduce the gap between contractors and residents.

**Professor Cabral** noted that if both small and large operators have a certain degree of exploitative market power in the aftermarket, to him that should be a sufficient condition for the foremarket to take care of it.

The Chair asked France to discuss the case of the Autorité on coffee machines and its aftermarkets.

**France** briefly summarised the Nespresso case highlighting that the main questions related to innovation. At the time of the case, Nespresso's property rights on machines and capsules were expiring and new competitors were entering the market with different kinds of capsules. Forcing competition on the market for capsules could lead to Nespresso decreasing its efforts to innovate in the market for coffee machines, but at the same time more competition in the coffee machines market could lead Nespresso to increase its efforts to innovate in the market for capsules. However, the agency concluded that Nespresso's innovation was related exclusively to the introduction of modifications that would create obstacles for competitors in the aftermarket for capsules.

The Chair turned to BIAC to expand on their view that investigations of aftermarket abuses should not be undertaken lightly.

Since aftermarket cases are fact-intensive and difficult, **BIAC** suggested that they should be pursued only when there is a clear impact on competition and consumers. BIAC listed the indicators that in its view should be applied by an authority before considering undertaking an aftermarket case. First of all, there should be limited competition in the primary market; secondly one should observe lock-in or high switching costs or barriers to switching. The third element is the presence of a substantial consumer effect. If these screening mechanisms are met, it is still important to consider and evaluate all the case specific factors, such as the ones of the EU EFIM test.

#### 4. Non-competition enforcement remedies and other regulatory remedies to aftermarket concerns

The Chair moved to the last part of the discussion and gave the floor to Italy to talk about possible measures to alleviate some of the aftermarket problems in public procurement cases.

**Italy** reported that they looked at the interplay between aftermarkets in public procurement while reviewing draft guidelines proposed by the Italian anticorruption authority, and issued a formal opinion about this. The authority found that public procurement is often carried out without open tenders. One of the main reasons for this is the lack of substitutable products and services which is often due to lock-in effects deriving from past procurement decisions. The guidelines look at both primary and secondary markets in order to alleviate problems that might arise due to lock-in effects, and a first suggestion is that situations of lock-in should be avoided from the outset by an accurate design of the tender for the procurement of the primary product or service. In the presence of a lock-in situation, public procurement should in any case take a forward looking perspective and try to understand whether indeed negotiating the contract in those conditions is better than perhaps purchasing a new primary product altogether.

The **Chair** referred to a few important points from other country contributions, such as Romania's HP case, Croatia's PRIMALAB case, India's case in the automobile industry, Kazakhstan's cases that deal with the interface between IP rights and aftermarkets, Chinese Taipei's discussion on justifications as factor to look at in aftermarkets analysis, Singapore's cases that highlight the usefulness of commitments and Russian Federation's use of code of conducts.

Finally, the Chair turned to the experts for final comments and thoughts.

**Professor Cabral** stressed that the critical concept in aftermarkets is interdependence of the primary and secondary markets, and that in his view if there is sufficient competition in a primary market ex-post switching costs should not be a problem. It is indeed not obvious that reducing ex-post switching costs increases the overall competitiveness of the market.

**Thomas Graf** noted that the variety of cases was very rich, the discussion was very interesting, and that an important issue for agencies to consider in the discussion of aftermarket cases is remedies.

**Lorenzo Coppi** agreed that the discussion was very interesting and concluded that, although aftermarket cases are often complex, this does not necessarily mean that there should be limited enforcement. A possible way would be to prioritise a certain number of cases where the issues are important, the volume of commerce is large and there are no clear efficiency justifications.

The **Chair** thanked the experts and the delegates and closed the session.