

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Competition Issues in Aftermarkets - Note from Italy

21-23 June 2017

This document reproduces a written contribution from Latvia submitted for Item 4 of the 127th OECD Competition committee on 21-23 June 2017.

*More documents related to this discussion can be found at
www.oecd.org/daf/competition/aftermarkets-competition-issues.htm*

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1. Introduction

1. As emphasized in the Background note by the Secretariat, aftermarket are widespread in the economy and might raise competition concerns, but antitrust cases involving aftermarket are somewhat rare. As a matter of fact, the Italian Competition Authority (hereafter also “the ICA”) has dealt with very few cases involving aftermarket in the course of its activity.

2. This contribution summarizes three main investigations carried out by the ICA in this field. Noteworthy, only the most recent decision addressed an abuse of dominant position. The other two cases tackled anti-competitive agreements between the main competitors active in the primary market. Therefore, a number of aspects of the economic analysis typically concerning anti-competitive conducts in aftermarket have not been entirely addressed. Nevertheless, the ICA’s decisions touched upon some of the topics under discussion and might contribute to the on-going debate.

3. Furthermore, in an opinion issued in 2016, the ICA dealt with the interplay between aftermarket and competition from a different perspective: public procurement. An opinion to the Anti-Corruption Authority in 2016 concerning *Guidelines for negotiated procedures without tender for procurement of non-substitutable products or services* gave the ICA the opportunity to set out some key principles to ensure competition in public tenders involving aftermarket.

2. Cases involving competition issues in aftermarket

4. Following two decisions concerning aftermarket adopted in 1999 and 2003, the ICA did not intervene in this area for several years. Nevertheless, in 2017 the Authority concluded an investigation regarding a conduct that can be interpreted as an attempt to maximize profits in the less competitive aftermarket, in light of fierce competition in the foremarket.

2.1. Wall-mounted Gas Boilers (1999)

5. In April 1999 the Italian Competition Authority fined four major manufacturers, which held over 50% of the Italian market for wall-mounted boilers¹. The companies participated in a trade association, subsequently transformed into a consortium. Following the introduction of a law that imposed periodic check and maintenance of boilers, the manufacturers agreed to grant regional exclusivity to Technical Assistance Centres (TACs) for the provision of check and maintenance services for their boilers. Thereafter, they refused to supply spare parts to independent service providers. The agreement also obliged TACs to solely purchase original spare parts from the manufacturers and banned TACs from operating in the sale of boilers.

6. The ICA held that the agreement had produced a double set of anti-competitive effects, affecting both the competition amongst manufacturers in the primary market for the sale of wall-mounted boilers and the entry and growth of independent service providers in the secondary market for check and maintenance services.

¹ Decision no. 7115 of 22 April 1999, case A248 - FORNITURA PEZZI DI RICAMBIO CALDAIE A GAS.

7. The ICA stated that the recent obligation for periodic check and maintenance had brought about the potential for a dramatic growth of these services. In response, the parties to the proceedings colluded to better control the secondary market and thereby preserve their market shares in the primary market for wall-mounted boilers. The companies agreed to reinforce their networks of maintenance service providers and restrict the access to spare parts by independent firms. The decision highlighted that the conduct was all the more successful because the availability of the entire range of spare parts is a necessary requisite to compete effectively.

2.2. Diagnostic Tests for diabetes (2003)

8. In April 2003, the Authority concluded an investigation concerning a cartel between five producers of diagnostic tests for diabetic patients and their association². The Authority found that the parties, mainly within the trade association, colluded to increase prices and eliminate price competition for sales of the strips. In particular, the companies agreed to elude public tenders carried out by Local Health Units, by not participating or bidding the same price. In some cases, they jointly fixed a common price for strips sold to pharmacies. The association played an active role in this context, since it represented the parties in several negotiations.

9. The relevant product market was defined as the supply of diagnostic tests for the detection and control of glycaemia levels in Italy, which consisted of two complementary products: reader devices (primary product) and reactive strips (secondary product). The reactive strips were not compatible with other reader devices. The Authority explained that the conduct only affected reactive strips, which represented the more relevant product in economic terms, in light of the commercial policy adopted by the parties. In particular, the reader devices were offered for free or at a very low price. As a consequence, *“market rivalry between firms shifts solely on the sale of the secondary product, notwithstanding the complementary nature of the goods that constitute the diagnostic test, insofar as the free provision of the readers eliminates the switching costs arising from the technical constraint”* (point 300 of the decision).

10. It is worth noting that, absent the cited anti-competitive agreement, this market might have been regarded as a positive example of interaction between the primary and the secondary products, similar to the “razor-and-blades” business model. Indeed, the durable goods (the reader devices) were offered at a very low price (close or equal to zero) to attract new consumers. The loss from the primary market was offset by the profits from consumables (the reactive strips) in the aftermarket. However, the reader devices created limited switching costs because they were very cheap, and therefore even the aftermarket – absent the cartel – would have remained highly competitive because consumers were not locked-in and were able to react to price increases of the reactive strips compatible with their reader device.

2.3. Civil Trial System (2017)

11. In 2017, the ICA concluded an investigation on an alleged abuse of dominant position by a company that held the exclusive management of a project launched by the Italian Government for the digitalization of the civil trial system (Processo Civile Telematico). Namely, the party to the proceedings enjoyed a dominant position in the

² Decision no. 11946 of 30 April 2003, case I461 – TEST DIAGNOSTICI PER DIABETE.

market for the development of IT infrastructure for complex organizations, following the award of several tender procedures held by the Italian Ministry of Justice in the course of the process of digitalization of the civil trial system launched in 2001. In addition, the firm was also the main player, in competition with other software houses, in the downstream market for application software addressed to lawyers, judges and other professionals that interact with the civil trial system.

12. The Authority opened a formal investigation in January 2017, on the basis of a complaint by an association of software houses, and claimed that the company was abusing its dominant position in the primary market for the development of IT infrastructure and obtaining undue advantages on software houses competing in the secondary market, by delaying the release of interoperability standards and providing incomplete information needed to update the application software and ensure full interoperability with the digital civil trial system.

13. In order to address the competition concerns, the alleged infringer proposed a set of commitments that included a structural and functional separation between the two businesses active in the primary and secondary markets, as well as full transparency on all technical issues concerning the digital civil trial system. Following a positive market test, the ICA accepted and made binding the proposed commitments.

14. The ICA emphasized that, for operators to be competitive in the supply of application software, timeliness and completeness was crucial. Therefore, in order to guarantee competition in the secondary market, *“the party must ensure full interoperability at all times, under the same conditions as the company applies for itself”*.

15. Remedies enabled to swiftly remove the competition concerns and discipline the behaviour of the manufacturer of the primary good when operating in the secondary markets. It may be assumed that, should the company have leveraged its dominant position in the primary market and foreclosed competitors in the secondary market for application software, the benefits resulting from tender procedures aimed at identifying the most convenient developer of the civil trial system would have been largely lost, due to the supra-competitive prices of application software charged by the vertically integrated dominant firm on professionals, including judges, who interact with the digital civil trial system. Moreover, the Authority maintained that, in light of the high switching costs resulting from the complexity of the digitalization of the Italian trial system and the contracts in force, it was unlikely that the Ministry of Justice would have replaced its IT infrastructure developer anyhow.

3. The opinion on the Guidelines for negotiated procedures without tender for procurement of non-substitutable products or services (2016)

16. Public procurement is often carried out without open tenders. According to the Anti-Corruption Authority, the value of products and services acquired by public administrations without tender procedures in Italy amounted to 15 billion Euros in 2014. Although this figure also includes the award of contracts of little value (for which tender procedures are not obligatory), the main reason put forward by procurement bodies for avoiding open tenders is the lack of substitutable products or services. The Anti-Corruption Authority observed that non-substitutability, which typically stems from technical or IP issues, is often associated with lock-in effects caused by past procurement decisions or strategic behaviours by the supplier. In this context, the life-cycle costs of the purchased product or service, as well as of its secondary goods, play a key role.

17. In order to scale down the number of public contracts that escape open tender procedures, the Anti-Corruption Authority drafted *Guidelines for negotiated procedures without tender for procurement of non-substitutable products or services*, which were submitted to public consultation. Eventually, the Anti-Corruption Authority requested the ICA's opinion on the draft.

18. In its opinion, issued in December 2016, the ICA drew upon the economic literature and its past enforcement practice to set out some general principles with a view to preventing competition concerns that typically arise from monopolization of the aftermarket by the manufacturer of the primary product or service.

19. First and foremost, the ICA supported the Anti-Competition Authority's view that direct award of contracts shall be exceptional and strictly limited to cases in which the specific nature of the product or service in question inevitably restricts the number of potential suppliers. In any event, the ICA clarified that such a competition restriction should be proportionate, justified and offset by efficiency gains, or more generally by higher quality or lower prices.

20. Furthermore, the ICA stressed that the likelihood of anticompetitive effects would be reduced by the availability of sufficient information on the life-cycle costs of the products, on the one hand, and by preferring products or services that give rise to lower switching costs, on the other hand.

21. Against this background, the ICA expressed appreciation for the provisions in the Guidelines that impose the burden on public procurement bodies to formally justify the waive to open tendering and to define the future needs for that product or service. The ICA observed that those provisions may encourage public procurement bodies to develop a specific know-how and adopt informed decisions, possibly avoiding lock-in effects from the outset.

22. In cases where standardized or fully interoperable products or services are not available, the ICA suggested comprising in the public tender the entire life-cycle of the product or service, including, e.g., spare parts, maintenance and ancillary services. Furthermore, the ICA advised that, when evaluating the different bids, public procurement bodies should carefully consider switching costs and might even introduce the size of switching costs as a specific award criterion in the tender.

4. Conclusions

23. Following two formal proceedings carried out more than a decade ago, the Italian Competition Authority had not dealt with competition issues arising from aftermarkets until recent times, when it addressed an alleged abuse of dominant position concerning the digitalization of the civil trial system and issued an opinion on public procurement to the Anti-Corruption Agency.

24. The need to prove that purchasers are locked into proprietary equipment through high switching costs and unable to determine the whole life-cycle costs at time of purchase may render it challenging for competition agencies to successfully tackle anti-competitive behaviours in aftermarkets. That said, growing digitalisation, together with the pervasive presence of IP rights and the widespread use of public procurement, make competition concerns in this area more likely and an in-depth discussion well-timed.