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COMMISSION ISSUES GUIDANCE PAPER ON APPLICATION OF ARTICLE 82 EC

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I. INTRODUCTION

On December 3, 2008, nearly three months after the US Department of Justice (DoJ) published its report on single firm conduct under Section 2 of the Sherman Act,[1] the European Commission issued its long awaited guidance paper on enforcement priorities in applying Article 82 EC[2] to exclusionary conduct by dominant firms (Guidance Paper).[3] The Guidance Paper is the result of a review process launched by the Commission staff's Article 82 Discussion Paper in December 2005[4] and included subsequent comprehensive public consultations and discussions with Member States' Competition Authorities.

As stated in the accompanying FAQ memo, the Guidance Paper "is intended to contribute to the process of introducing a more economics based approach in European competition law enforcement" and, as such, embodies a very welcome departure from the past Commission's approach to interpreting Article 82 EC, which has been often criticized as exceedingly formalistic.[5] This is certainly a move towards greater convergence between public antitrust enforcement in the EU and the US. The Guidance Paper nears current US practice by moving away from *per se* prohibitions and establishing an effects-based case-by-case rule of reason framework for analyzing conduct by dominant companies. However, a few not insignificant differences remain. Not only does the Guidance Paper retain several particularly European characteristics, but the DoJ, in its single firm conduct report, adopts a position that was criticized, even by the US Federal Trade Commission (FTC), as excessively lenient.[6]

In line with modern antitrust thinking, the Guidance Paper sets out consumer welfare as the principle on which the Commission should base enforcement policy with respect to exclusionary

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[1] U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008) [hereinafter DOJ REPORT].

[2] Treaty Establishing the European Community, Dec. 24, 2002, 2002 O.J. (C 325).

[3] *Commission Communication for Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* (Dec 3, 2008) [hereinafter Guidance Paper], *available at* http://ec.europa.eu/competition/antitrust/art82/guidance.pdf.

[4] Eur. Comm'n, DG Competition, *Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses* (Dec. 2005), *available at* http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf.

[5] Press Release, Eur. Comm'n, Antitrust: Guidance on Commission Enforcement Priorities in Applying Article 82 to Exclusionary Conduct by Dominant Firms—Frequently Asked Questions (Dec. 3, 2008).

[6] William E. Kovacic, Chairman, Fed. Trade Comm'n, Modern U.S. Competition Law and the Treatment of Dominant Firms: Comments on the Department of Justice and Federal Trade Commission Proceedings Relating to Section 2 of the Sherman Act (Sept. 8, 2008), at 2–3, *available at* http://www.ftc.gov/os/2008/09/080908section2stmtkovacic.pdf.

abuses.[7] Effective competition on the merits, and not simply competitors, should be protected. Therefore a dominant position is lawful unless accompanied by conduct leading to consumer harm.[8]

This laudable proclamation comes, however, with several caveats. First, paragraph 7 states that in addition to exclusionary abuses, which are the focus of the Guidance Paper, "certain behavior that undermines the efforts to achieve an integrated internal market, is also liable to infringe Article 82." This brief statement is a confirmation that apart from the dominant goal of consumer welfare, EU antitrust policy continues to entail—in accordance with the general community principle enunciated in Article 2 EC—market integration as one of its goals. Second, the Guidance Paper's test for dominance with a qualified safe harbor of market share below 40%,[9] as compared with the 50% acknowledged by the DoJ in its report as generally accepted by courts in the US,[10] may increase the risk of false positives with resulting chilling effects on the competitive process. Lastly, with respect to companies approaching near monopoly market position, the Guidance Paper excludes any efficiency defense in favor of protecting the remaining, even if less efficient, competitors.[11] As regards the analytical approach itself, it is based on general considerations and standards specific to individual types of abusive conduct.

II. GENERAL CONSIDERATIONS

A. Market power

The Guidance Paper largely remains on traditional ground with respect to defining market power in order to establish dominance as a first step in finding a violation of Article 82 EC.[12] While not expressly referring to market definition, the dominance assessment standard revolves around considerations familiar to the merger context. Having expressed its wariness of the *small but significant and non-transitory increase in price* test (SSNIP) in light of the cellophane fallacy in the 2005 discussion paper, the Commission abandons it in favor of a materially similar, yet unfortunately more vague test, formulated as follows: "[an] undertaking which is capable of profitably increasing prices above the competitive level for a significant period [depending on market conditions but generally two years is sufficient] of time does not face sufficiently effective competitive constraints and can thus generally be regarded as dominant."[13] As regards competitive constraints, the following factors will be considered: (i) the enterprise's position vis-à-vis its current competitors (with a qualified safe harbor of below 40% market share); (ii) the threat of market expansion or entry; and (iii) the countervailing buyer's power.[14]

B. Foreclosure leading to competitive harm

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7 Guidance Paper, *supra* note 3, ¶ 5.
8 *Id.* ¶¶ 6, 19.
9 *Id.* ¶ 14.
10 DOJ REPORT, *supra* note 1, at 19–31.
11 Guidance Paper, *supra* note 3, ¶ 29.
12 *Id.* ¶¶ 9–18.
13 *Id.* ¶ 11.
14 *Id.* ¶ 12.

The Commission will normally intervene under Article 82 EC only if a particular conduct is likely to lead anticompetitive foreclosure, which is defined as market foreclosure that leads to consumer harm at any levels of the market.[15] General considerations relevant for the assessment of anticompetitive foreclosure are outlined in paragraph 20 and generally reflect common factors used for identifying anticompetitive effects under the rule of reason analysis in the U.S.. These are further complemented by specific standards set out in sections devoted to specific types of exclusionary conduct. If it appears that certain conduct "can only raise obstacles to competition and that it creates no efficiencies, its anticompetitive effect may be inferred" and it may be treated as per se illegal without the need to engage in detailed analysis of anticompetitive foreclosure and possible outweighing efficiencies.[16] Examples of conduct falling into the per se category are (i) preventing or incentivizing customers away from testing competitor's products; or (ii) payments to distributors or customers to delay competitor's products.

C. *Price based exclusionary conduct*

For price based exclusionary conduct the Commission will apply the "as efficient competitor test," under which it will intervene unless evidence clearly suggests that an "as efficient competitor" can effectively compete with the dominant firm's pricing.[17] However, the Guidance Paper also recognizes that from a dynamic efficiency point of view a foreclosure of even a less efficient competitor may in certain circumstances merit intervention.[18] In this case the relevant welfare standard is "total" rather than consumer welfare.

The cost benchmarks to be used for the "as efficient competitor test" are the *average avoidable costs* (AAC) (in line with the DoJ report and the practice of the Canadian Competition Bureau) and *long run average incremental costs* (LRAIC).[19] While overall consistent with contemporary economic thinking, these cost measures are not informative when there is joint production and economies of scope (as they generally do not include common costs, which may be taken into account if they are significant in assessing foreclosure effects[20]), and these are precisely the situations where exclusionary conduct is likely to arise. Also, it remains to be seen whether the effective and predictable application of these cost measures will not be hampered by the difficulty in obtaining the required data (especially in the case of LRAIC), both for the Commission and for the company itself when assessing the legality of its intended conduct.

D. *Objective necessity and efficiencies*

Conduct by a dominant undertaking that leads to anticompetitive foreclosure may be justified on the basis of (i) objective necessity; or (ii) efficiencies to customers that outweigh its anticompetitive effects.[21] The burden of proof is on the dominant undertaking. Objective

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[15] *Id.* ¶¶ 19–20.
[16] *Id.* ¶ 21.
[17] *Id.* ¶ 22.
[18] *Id.* ¶ 23.
[19] *Id.* ¶ 25.
[20] *Id.* ¶ 25 n.18.
[21] *Id.* ¶ 27.

necessity may be based on health or safety reasons relating to the relevant product to which the conduct must be proportionate.[22]

As regards efficiency justifications, the Guidance Paper establishes a four pronged test whereby the undertaking must prove: (i) its conduct results in efficiencies; (ii) the conduct is indispensable to achieving such efficiencies; (iii) the efficiencies outweigh any anticompetitive effects of its conduct; and (iv) effective competition is not eliminated.[23] This general test sets a very high bar for an efficiency based defense as it requires strict balancing of efficiencies against anticompetitive effects in contrast to the disproportionality standard recommended in the DoJ's report for cases where conduct-specific test is not utilized.[24] Moreover, conduct that could lead to the elimination of effective competition can never be justified even if efficiencies clearly outweigh any anticompetitive effects.[25]

III. SPECIFIC FORMS OF ABUSE

A. Exclusive dealing

Both exclusive purchasing and conditional rebates are dealt with under this rubric. As regards exclusive purchasing the Guidance Paper does not provide any substantial conduct specific tests that would trump its general considerations. The Commission is likely to intervene in cases where "it is likely that consumers as a whole will not benefit". In particular this would be the case where the dominant firm has exclusive dealing contracts with many buyers that have the effect of preventing the entry or expansion of rivals.[26] As regards the relevance of length of exclusive arrangements, the Guidance Paper recognizes that the longer the arrangement the more anti-competitive it may be. However even short-lasting arrangements, for example those concerning must-stock items, can have significantly negative effects.[27]

In contrast to the DoJ report, the Guidance Paper does not approach exclusive purchasing with caution. Rather it applies a strict balancing test and provides no safe harbor for affected market share as opposed to the disproportionality test and the less than 30% foreclosed market share in the DoJ report.[28]

For conditional rebates the Guidance Paper abandons the past *per se* approach in favor of foreclosure of an "as efficient competitor" analysis. When assessing foreclosure the Commission will not look only to the loyalty enhancing effect of a rebate with respect to the last individual unit but also to the rebate system as a whole and its capacity to prevent the expansion or entry of rivals.[29] As regards the "as efficient competitor test" the Commission will determine what price a

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22 *Id.* ¶ 28.
23 *Id.* ¶ 29.
24 DOJ REPORT, *supra* note 1, at 45–46.
25 Guidance Paper, *supra* note 3, ¶ 29.
26 *Id.* ¶ 33.
27 *Id.* ¶ 25.
28 DOJ REPORT, *supra* note 1, at 140–42.
29 Guidance Paper, *supra* note 3, ¶ 39.

rival would have to offer a customer as a compensation for the loss of a conditional rebate if the latter would switch part of its demand (relevant range) from the dominant firm.[30]

Comparing this hypothetical "effective price" to the benchmarks of the AAC and LRIAC of the dominant firm, the Guidance Paper sets out three enforcement thresholds. According to these thresholds, an effective price consistently above the dominant firm's LRAIC is not capable of anticompetitive foreclosure,[31] whereas an effective price between the dominant firms AAC and LRAIC where rivals do not have at their disposal any realistic counterstrategies is considered anticompetitive, as is an effective price below AAC.[32] This approach of the Guidance Paper differs significantly from that of the DoJ report as the latter proposes the application of a standard predation test to rebates, that is, pricing below AAC, dangerous probability of recoupment, and a disproportionality standard in efficiency balancing.[33]

B. Tying and bundling

Recognizing that tying and bundling are marketing strategies that often have consumer welfare enhancing effects the Commission will apply the foreclosure type analysis to both types of conduct. Tying is considered abusive where: (i) the firm is dominant in the tying market; (ii) the tying and tied products, based on consumer demand, are distinct products; and (iii) the tying is likely to lead to anticompetitive foreclosure.[34] The Guidance Paper provides (additional) tying specific foreclosure considerations in paragraphs 51–57, of which probably the most significant is the one relating to technological ties, which are viewed as liable to greater anticompetitive foreclosure. Overall, the tying standard in the Guidance Paper is largely similar to the approach advocated by the DoJ in its report (proposing to move away from *per se* liability) with the exception of technological ties which are viewed with much greater tolerance by the DoJ.

As for multiproduct bundling, the Guidance Paper applies the "as efficient competitor test" by comparing the incremental price that customers pay for each of the dominant firm's product in the bundle to the dominant firm's LRAIC. An incremental price below LRAIC warrants Commission intervention as it may lead to foreclosure of "as efficient competitor."[35] However, in the case of bundle-to-bundle competition, the relevant test is whether the price of the bundle as a whole is predatory.[36]

While based in the same economic thinking and analytical framework as the DoJ report (which however does not specify the appropriate measure of cost) the Commission's Guidance Paper sets a stricter standard for bundling. First, it applies the general simple balancing standard with respect to efficiencies in contrast to the DoJ's disproportionality standard.[37] Second, as regards bundle-to-

[30] *Id.* ¶ 40.
[31] *Id.* ¶ 42.
[32] *Id.* ¶ 43.
[33] DoJ Report, *supra* note 1, at 116–117.
[34] Guidance Paper, *supra* note 3, ¶ 49.
[35] *Id.* ¶ 59.
[36] *Id.* ¶ 60.
[37] DoJ Report, *supra* note 1, at 105–06.

bundle competition the guidance predation test is significantly stricter than that of the DoJ report as is shown below.

C. Predatory pricing

The Guidance Paper, clearly attempting to avoid the often criticized under-inclusiveness of the below average variable cost pricing test, bases itself on the standard of sacrifice establishing, in most aspects, a very modern test for predation. Conduct is viewed as abusive where:

> [a] dominant undertaking engages in predatory conduct by deliberately incurring losses or foregoing profits in the short term ("sacrifice"), so as to foreclose or be likely to foreclose one or more of its actual or potential competitors with a view to strengthening or maintaining its market power, thereby causing consumer harm.[38]

Pricing below AAC is a clear evidence of sacrifice. Pricing above ACC but below LRAIC may be also viewed as abusive under specific circumstances.[39]

Recoupment is not expressly mentioned although the Guidance Paper states that consumers are likely to be harmed where the dominant firm is, as a result of its conduct, "likely to be in a position to benefit from the sacrifice."[40] This appears to imply that a possibility of recoupment is required under the Guidance Paper's predation test, which reflects the recent opinion of AG Mazák in the pending Wanadoo case.[41] While a welcome change from the past Commission practice the low recoupment threshold is probably the only problem of the Guidance Paper's predation test, however, one that is magnified by the broadening of the test's scope by focusing on sacrifice. As regards the efficiency defense, it normally will not be available.[42]

The differences between the Guidance Paper and the U.S. test for predation under *Brooke Group*[43] (and that advocated by the DoJ report) are clear. The U.S. test captures only pricing below average variable cost (or AAC in the DoJ report), whereas the Guidance Paper focuses on sacrifice; and while dangerous probability of recoupment is required in the U.S., a mere possibility is sufficient under the Guidance Paper. Also, the efficiency defense that is available in the U.S. cannot normally be invoked under the Guidance Paper.

D. Refusal to supply and margin squeeze

As the starting point of its considerations, the Guidance Paper stresses that even dominant firms should have the freedom to choose whom to deal with, a position strongly accepted in the U.S.[44] However, in the following paragraphs the Commission provides a test that not insignificantly

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[38] Guidance Paper, *supra* note 3, ¶ 62.
[39] *Id.* ¶¶ 64, 66.
[40] *Id.* ¶ 69.
[41] Opinion of Advocate General Mazák, Case C-202/07 P, France Télécom SA v. Comm'n, 2008 WL 4365976, ¶ 74 (Sept. 25, 2008).
[42] Guidance Paper, s*upra* note 3, ¶ 73.
[43] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).
[44] Guidance Paper, *supra* note 3, ¶ 74.

limits the right of dominant firms to choose their trading partners and dispose freely of their property.

The Commission will consider a dominant firm's refusal to deal abusively if: (i) it relates to a product or service objectively necessary to be able to compete on the downstream market; (ii) it is likely to eliminate effective competition on the downstream market; and (iii) it's anticompetitive effects outweigh the consequences of imposing an obligation to deal on the dominant firm.[45] As to margin squeeze, the Commission will plot the price of the input against the LRAIC of the downstream division of the dominant undertaking.[46]

While accepting that cessation of cooperation is more likely to be abusive than a fresh refusal to deal,[47] the Guidance Paper—in marked difference with the approach in *Trinko*[48]—appears to weigh strongly in favor of forcing dominant companies to supply or license IP *de novo* where a potential market for the relevant input can be identified.[49] Even more in contrast to *Trinko*, where a duty to deal is already in place through another regulatory scheme, the Commission considers that imposing an obligation to supply under Article 82 EC is not capable of having negative effects on the dominant firm. Such could also be the case where the upstream position was developed as a result of a legal monopoly. In such circumstances the Commission "may show likely anticompetitive foreclosure without considering whether the above three cumulative circumstances are present."[50]

IV. CONCLUSION

The Guidance Paper certainly constitutes a greatly welcome shift towards an economics-based approach to abusive conduct under Article 82 EC. In most aspects it aptly reflects the current state of economic thinking and, as such, presents a solid and sound base for enforcement in an extremely complex area, where any missteps in enforcement may chill precompetitive behavior to the detriment of economic efficiency and consumer welfare. However, it is in many instances exceedingly vague and riddled with exceptions, thus providing for wide administrative discretion that does not contribute to a climate in which businesses can *ex ante* reliably determine the legality of their intended conduct. It therefore remains to be seen how the Guidance Paper will be shaped by the Commission's future practice.

In comparison to the U.S., the Guidance Paper signifies an important move towards greater convergence. However, as was discussed above, a few not insignificant differences remain, not only with respect to the position of the DoJ, which itself is very lenient even in the U.S. context, but also to the prevailing standards currently applied by U.S. courts. Given the disagreement by the FTC with the DoJ report, it will be interesting to see what approach the former will eventually articulate, but it is unlikely, due to precedential case law in the U.S., that it will come significantly closer to that of the Guidance Paper. In sum, counsel to globally active firms that are

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[45] *Id.* ¶ 80.
[46] *Id.* ¶ 79.
[47] *Id.* ¶ 83.
[48] Verizon Comm'ns v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).
[49] Guidance Paper, *supra* note 3, ¶¶ 77–78.
[50] *Id.* ¶81.

looking for the lowest common denominator among major jurisdictions may continue to look with confidence towards the EU. However, this in itself is not necessarily a bad thing, but a mere reflection of the view of single firm conduct that is considered by the Commission to be appropriate to the structure and characteristics of the EU economy.