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Agenda

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The new guidance on Article 82—does it do what it says on the tin?

The European Commission's long-awaited document on abuse of dominance was published in December 2008 as guidance on 'enforcement priorities'. The Commission's review, which began three-and-a-half years ago, was aimed at bringing the policy approach to Article 82 more in line with the effects-based approach now employed in other areas of EU competition policy. Has the Commission achieved this? And how does its guidance compare with a similar document published recently by the US Department of Justice?

For much of the half-century following its introduction, European competition law was applied in a form-based, legalistic way, by both the European Commission and the courts. Under the form-based approach, more emphasis is placed on the form of the behaviour in question, such as a refusal to supply customers or offering certain types of loyalty rebate. Less attention is paid to the effects of that behaviour on competition or consumers.

In the other core areas of competition policy—merger control and anti-competitive agreements—the approach of the European Commission has become more effects-based in recent years. The approach to abuse of dominance, as set out in Article 82 of the EC Treaty, has lagged behind.

A key argument in favour of an effects-based approach is that it allows competition law to target those actions of dominant firms that are genuinely likely to harm competition, while permitting other behaviours that are less likely to have adverse effects. An argument against the effects-based approach is that it may reduce legal certainty for businesses trying to operate within the law. The form-based approach has been perceived as providing certainty in as much as it gave a clear set of dos and don'ts for dominant firms to follow, even though the prohibited behaviours were not always necessarily harmful to competition.

The reform of Article 82 was launched by the Commission in mid-2005 with the aim of making its decisions on abuse of dominance more effects-based, and at the same time more understandable. At the end of 2005, the Commission published a staff discussion paper on Article 82, which set out its proposed approach for public consultation.[1] This was followed by public hearings and much debate among economists, lawyers, and policy-makers about the way forward. In the meantime, a number of key Article 82 judgments by the Court of First Instance (CFI) influenced the debate (and not always in the same direction as the Commission paper). These included judgments upholding the Commission's finding against Microsoft for tying and refusal to supply; its predatory pricing decision against France Telecom; and its margin squeeze case against Deutsche Telekom.[2] In another important case the European Court of Justice (ECJ) upheld the Commission's decision concerning loyalty rebates offered by British Airways.[3]

In December 2008, the Commission published guidance on what it called its enforcement priorities in applying Article 82.[4] Although not the full set of guidelines that some had anticipated, the guidance demonstrates the Commission's further push towards an effects-based approach.

A few months prior to this, the US Department of Justice (DoJ) published guidance on the application of Section 2 of the Sherman Act, which deals with monopolisation.[5] Section 2 is similar in some respects to Article 82: it prohibits single-firm conduct that undermines the competitive process and that thereby enables a firm to acquire, credibly threaten to acquire, or maintain monopoly power.

A further push towards a more effects-based approach

The Commission's new guidance broadly reflects the approach set out in the 2005 staff discussion paper, with some subtle and other more substantive changes reflecting comments made to the Commission. It emphasises the following general principles.

– **The degree of dominance matters** (para 20). The Commission's willingness to go beyond a simple binary approach to dominance recognises that market power is a question of degree. This makes sense from an economic perspective: practices such as below-cost pricing and refusal to supply are more likely to have an anti-competitive effect if the perpetrator has a very high degree of dominance than if it just passes the threshold.

– **The degree of foreclosure matters** (para 20). The guidance states that the greater the proportion of total sales in the relevant market affected by the conduct, the longer the duration of the conduct, and the more regularly it is applied, the greater the likely foreclosure effect. This principle is economically sound, and is a clear departure from the previous 'per se' approach to certain types of abuse, such as retroactive rebates and tying, where the degree of foreclosure was rarely assessed once dominance was found.

– **Use of the 'as-efficient competitor' test for pricing cases** (Section C). This principle seeks to draw a line between conduct that simply reflects competition on the merits and exclusionary conduct that is harmful to consumers. The logic behind the test is that the law should not hinder the normal market process whereby inefficient firms fail and efficient ones succeed. Therefore, dominant firms can set low prices even where this excludes less-efficient rivals as long as they do not cut prices to the level where a competitor that is at least as efficient as the dominant firm is harmed or foreclosed from the market.

– **Exclusionary conduct can in some cases be justified on the grounds of objective necessity or efficiency benefits** (Section D). The inclusion of an explicit efficiency defence seems to be intended to bring Article 82 into line with Article 81, where the EC Treaty explicitly sets out conditions under which otherwise anti-competitive behaviour can be beneficial to consumers (see discussion below).

– **The importance of the counterfactual** (para 20). The counterfactual is the state of the world in the absence of the alleged abuse. It is used to understand the extent of any harm to competition. Establishing the correct counterfactual has also been a key aspect in some of the major Article 81 cases in recent years.

– In other areas, such as the assessment of specific types of abuse, including loyalty rebates, tying, bundling, and predatory pricing, there is also a significant push towards a more effects-based approach compared with the 2005 discussion paper. To give an example, in its discussion about conditional rebates (para 38), the Commission stresses the importance of establishing whether there is actually a 'non-contestable' portion of demand for which rivals of the dominant firm compete, as opposed to assuming from the outset that rivals are hampered in that way.

Still some bumps in the road

One criticism of the guidance is that it does not exactly do what the title suggests. Rather than being a set of guidelines on the application of Article 82, as many in the competition community had expected at some stage, the Commission describes it as 'enforcement priorities' for the application of Article 82. However, the text of the document, despite citing circumstances in which the Commission is likely to intervene, does not attempt to prioritise its enforcement activities going forward. The general (and not surprising) message is that it will target those abuses that are harmful to consumers, but it says nothing about such enforcement policy questions as pursuing cases in consumer markets, pursuing larger cases, or prioritising exclusionary abuses over exploitative ones.

A second criticism is that the guidance could have done more to provide certainty for businesses, which could potentially be achieved without losing the benefits of an effects-based approach. For example, the Commission states that dominance is not likely if the undertaking's market share is below 40% in the relevant market, which could represent a useful safe harbour (para 14). However, it goes on to claim that there may be circumstances where firms with market shares of less than 40% may be found to be dominant.

The guidance takes a similarly broad approach to pricing abuses. Although, as described above, the Commission sees the 'as-efficient competitor' test as the appropriate one to use, it also argues that in some cases it is better for consumers to have a less-efficient competitor in the market than for the competitor to be excluded altogether. While true in some circumstances—eg, where, over time, the competitor can be expected to become more efficient through network or learning effects—it makes it more difficult for dominant firms to distinguish permitted conduct from prohibited conduct.

Another area where the Commission's guidance might be clarified is with respect to the degree of foreclosure that is necessary for conduct to be harmful. The guidance correctly states that, in general, the larger the proportion of the market that is foreclosed, the more likely it is that the behaviour constitutes an abuse, but it does not provide clear guidance on how much of the market must be foreclosed for competition to be harmed. Clearly this will depend on the facts of each case, but it seems unlikely that the Commission would want to

pursue many cases where, for example, the foreclosure affects less than 10% or even 20% of the market.

In the area of efficiencies, although the introduction of an explicit defence is a welcome development in principle, it is not clear that the wholesale adoption of the structure used for agreements between firms under Article 81(3) is the appropriate approach. Whether the efficiency defence should be a separate exercise at the end of the effects analysis is questionable—some efficiencies are simply inherent in the conduct being examined, and could be assessed as part of the counterfactual analysis. An example of this is predatory pricing, where the alleged abuse normally provides immediate benefits to consumers in the form of lower prices.

Finally, it is not always consistently set out in the guidance about which is the appropriate test to use in the context of a particular abuse. For example, in general, the Commission concludes that the 'as-efficient competitor' test is the right one to use for price-based abuses, yet when discussing predation, it appears to employ a profit sacrifice test first (para 30). In addition, there are some discrepancies where the guidance discusses the appropriate price–cost test to analyse a particular abuse. Both long-run average incremental cost (LRAIC) and average avoidable cost (AAC) are suggested as appropriate standards for assessing predation, but for bundled rebates, refusal to supply and margin squeeze, LRAIC appears to be the Commission's preferred standard. These distinctions are not fully explained, and are not necessarily in line with the 'as-efficient competitor' approach.

Comparing the enforcement priorities with the DoJ report

The DoJ's 2008 guidance on single firm conduct under Section 2 of the Sherman Act deal with many of the same issues as the Commission guidance on enforcement priorities under Article 82. However, the DoJ's document is more in-depth, running to over 200 pages, compared with the Commission's 26 (the 2005 staff discussion paper was 72 pages).

Part of the reason for this is that the DoJ's document aims to set out the views of leading experts in the field, both practitioners and academics, and contains detailed footnotes, which give insights into the debates and discussions involved in reaching the DoJ's final view. By contrast, while the Commission's guidance seems to be implicitly based to some degree on external views, as a result of the public consultation, there is no evidence of how, and to what extent, those views were taken on board or rejected.

One area where the DoJ report differs from the Commission guidance document is in seeking to provide certainty for businesses. As described above, in a number of key areas the Commission's document attempts to cover all the eventualities that could lead to abuse of market power, and this comes at the expense of legal certainty for businesses keen to operate within the law. The US report makes more use of clear thresholds and safe harbours, which, as well as being based on economic reasoning and evidence, aim to provide certainty for businesses operating under the regime. For example, like the European Commission, the DoJ concludes that the greater the proportion of the market that is foreclosed to competition, the greater the likelihood that there will be harm to competition. However, unlike the Commission, the DoJ puts in place a safe harbour whereby exclusive-dealing arrangements that foreclose less than 30% of existing customers should not be illegal.

That said, the DoJ's aim of providing legal certainty does not appear to have been fully achieved, since the other US competition enforcement agency, the Federal Trade Commission (FTC), has stated in no uncertain terms that it disagrees with the DoJ document, particularly as regards its safe harbours. The FTC considers the DoJ safe harbours to be too 'hands-off'.[6]

Transatlantic convergence on the recoupment test in predation cases?

In the past, one clear difference between the European Commission and the US authorities has been in the approach to predation. Despite this, there is a general consensus that the alleged predator's prices must be below an appropriate measure of its costs—the DoJ favours AAC. However, on the issue of whether the alleged predator will be able to recoup its initial losses following the exit or capitulation of the competitor, there have historically been differences. Traditionally, EU case law has held that there is no need to show recoupment, since it can be inferred from the fact that the alleged predator is dominant. On the other side of the Atlantic, recoupment is a key part of the predation test. On the face of it, the two recent publications suggest a continuing divergence in approach.

European Commission:

> Identifying consumer harm is not a mechanical calculation of profits and losses, and proof of overall profits is not required. Likely consumer harm may be demonstrated by assessing the likely foreclosure effect of the conduct, combined with consideration of other factors, such as entry barriers. (para 70)

Department of Justice:

> Without a dangerous probability that the investment in below-cost prices will be recouped

> through later, supracompetitive pricing, below-cost prices most likely reflect nothing more than intense price competition that is in the interest of consumers. (p. ix)

However, looking beyond these two headline quotes at the details of the two reports reveals what may be a significant narrowing of the gap between the European and US approaches. The US guidance discusses the court's reasoning on recoupment in *Brooke Group*, which set the bar for establishing predation sufficiently high that no successful case has been brought in the 15 years since it was published.[7] In its own conclusions, rather than discussing the recoupment test as a rigid mathematical exercise, the DoJ refers to it as 'a valuable screening device to identify implausible predatory-pricing claims' (p. 69). This may suggest that the DoJ sees the place of the recoupment test more as a reality check to weed out claims that have little or no merit, thus avoiding the need for detailed analysis of costs and revenues in such cases.

For its part, the European Commission's guidance document, while making clear that it believes that a 'mechanical calculation of profits and losses' is not necessary to show predation, does agree that consumers are more likely to be harmed where the predation can be expected to increase the predator's market power in the long run (para 69). This is closer to the idea of a recoupment test than some interpretations of the previous EU case law on the subject.

Although not referred to in the Commission's document, a recent opinion by Advocate General Mazák of the ECJ may prompt a further move towards recognising the importance of recoupment in the analysis of predation.[8] His opinion concerns the appeal to the ECJ of a judgment by the CFI (referred to above), which upheld a decision by the Commission against France Telecom for predation in the French broadband market. The opinion argues that the CFI and the Commission misinterpreted earlier case law by concluding that in order to find that predation had occurred it was not necessary to show that recoupment was possible.

From an effects-based perspective, the idea of the recoupment test as a reality check or initial screen in predation cases is an approach that is workable and economically sound, and one on which the DoJ and the Commission may eventually be able to agree.

Conclusion

The Commission's guidance on enforcement priorities represents a further push towards the stated goal of making Article 82 more effects-based and more understandable. Its overarching conclusions are based on sound economic reasoning and evidence. In some areas, however, the Commission attempts to cover all eventualities that could possibly lead to an abuse and, in doing so, risks reducing the value of the guidance to businesses trying to operate within the law.

Providing legal certainty is an area where the DoJ has sought to lead the way. They provide clear rules based on the view of leading practitioners and academics. However, some aspects of the report are controversial and have been criticised for being too 'hands-off' and making it difficult for monopolisation cases to be brought in future. The fact that the FTC was one of the harshest critics of the DoJ indicates that the debate in the USA is far from over.

In Europe, the future of competition enforcement in abuse of dominance cases is an open question. The publication of the enforcement priorities guidance closes the latest chapter on the reform of Article 82, but there is more work to be done, not least in terms of working with the European courts to overturn the old, form-based precedents with new judgments that reflect a more effects-based approach. It may ultimately be the courts, such as the ECJ in its forthcoming *France Telecom* judgment, that make the final push.

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[1] European Commission (2005), 'DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses', December.
[2] Court of First Instance (2007), *Microsoft Corp. v Commission*, Judgment Case T-201/04, September 17th; Court of First Instance (2007), *France Telecom SA v Commission*, Judgment Case T-34/03, January 30th; Court of First Instance (2008), *Deutsche Telekom AG v Commission*, Judgment Case T-271/03, April 10th.
[3] European Court of Justice (2007), '*British Airways plc v Commission*', Judgment Case C-95/04 P, March 15th.
[4] European Commission (2008), 'Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings', December 3rd.
[5] US Department of Justice (2008), 'Competition and Monopoly: Single-firm Conduct Under Section 2 of The Sherman Act', September.
[6] Federal Trade Commission (2008), 'Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice', September 8th.
[7] Supreme Court of the United States (1993), '*Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*' (92-466), 509 U.S. 209.
[8] European Court of Justice (2008), '*France Télécom SA v Commission*, Opinion Of Advocate General Mazák', Case C-202/07 P, September 25th.

If you have any questions regarding the issues raised in this article, please contact the editor, Derek Holt: tel +44 (0) 1865 253 000 or email d_holt@oxera.com

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