# Implementing an effects-based approach to Article 82

Luc Peeperkorn and Katja Viertiö

## Introduction

On 3 December 2008, the Commission issued Guidance on its enforcement priorities in applying Article 82 to abusive exclusionary conduct by dominant undertakings. (1) In so doing, the Commission formally endorsed an effects-based approach to exclusionary conduct by dominant undertakings.

The Guidance outlines the analytical framework that the Commission applies in determining whether to intervene against exclusionary conduct under Article 82 as a matter of priority. This will be the case if the conduct of a dominant undertaking is likely to restrict competition in such a way as to have harmful effects on consumers, whether in the short or the longer term.

The Guidance is not a statement of law. It is nonetheless an attempt to place existing case law in a coherent analytical framework. While case law can also be interpreted as allowing a more form-based approach, the assessment of exclusionary conduct under Article 82 in the way described in the Guidance ensures that the Commission intervenes where it most matters, that is, where consumer welfare is at stake.

Three main principles underpin the effects-based approach formulated in the Guidance. First, dominant companies too should be free to compete fiercely on the market as long as this competition is ultimately for the benefit of consumers. Such competition on the merits (2) may well mean that competitors who deliver less to consumers have to leave the market.

Secondly, the Commission must assess the likely effects of the conduct of the dominant undertaking, which requires sound economic analysis and cogent and convincing evidence. The Guidance assists in this task by providing a general analytical framework for the most common types of exclusionary conduct which makes it possible to identify the circumstances in which the conduct is likely to restrict competition in such a way as to harm consumers.

Thirdly, although Article 82 does not expressly provide for the possibility of exempting exclusionary conduct because of efficiencies, it would be difficult to apply an effects-based approach and effectively protect consumers without carefully examining any efficiency defences put forward by dominant undertakings. The Guidance recognises the possibility of the existence of such efficiencies and explains how they will be taken into account in the assessment.

These principles crystallise in the expression "anticompetitive foreclosure". According to the Guidance, there is anticompetitive foreclosure where effective access of actual or potential competitors to supplies or markets is hampered or eliminated as a result of the conduct of the dominant undertaking whereby the dominant undertaking is likely to be in a position to profitably increase prices to the detriment of consumers. The notion of "increasing prices" is shorthand for the various ways in which the dominant undertaking can influence the parameters of competition — such as prices, output, innovation, the variety and quality of goods and services — to the detriment of consumers.

Anticompetitive foreclosure is foreclosure that results in consumer harm, and is the overarching test to be used in assessing whether the Commission should intervene against exclusionary conduct by dominant undertakings.

## Brief summary of the content of the Guidance — general approach

### Assessment of dominance

The Guidance confirms the Commission's recent practice of not relying only or primarily on market shares when assessing dominance, but rather of making a comprehensive analysis of whether or not the allegedly dominant firm is constrained by existing competitors and their output, by expansion or entry of competitors and/or by countervailing buying power. As regards market shares, the Guidance does not refer to the *Akzo* case law that market shares in excess of 50% can be considered a strong indication of dominance; rather, based on the Commission's experience in handling cases, the Guidance states that dominance is not likely if the market share of the firm is below 40%.

(1) The text can be found at: http://ec.europa.eu/competition/antitrust/art82/index.html

(2) Competition on the merits is a concept that has often been described in terms of proportionality of the dominant undertaking's conduct. Such an approach does not provide a clear standard for the assessment of conduct, whereas an approach that looks into the effect of the dominant undertaking's conduct on competition and thereby consumers allows an objective meaning to be given to the term competition on the merits. Competition on the merits is competition that increases consumer welfare.

## Anticompetitive foreclosure

The Guidance sets out a two-step approach to assessing allegedly abusive exclusionary conduct by dominant undertakings: the first step entails determining whether the allegedly abusive conduct is likely to restrict competition and thereby harm consumers, while the second step consists in analysing whether any efficiency defences by the dominant undertaking are such as to outweigh the identified negative effects of the conduct.

Assessing the likely effects of the conduct of the dominant undertaking is not an easy task. It entails comparing the current or likely future situation in the relevant market with an appropriate counterfactual. This requires a comprehensive analysis of a number of factors described in paragraph 20 of the Guidance (the so-called "paragraph 20 factors"), such as the conditions on the relevant market (for example the existence of economies of scale and/or scope), the duration of the conduct of the dominant undertaking and the part of the market affected by it, any direct evidence of an exclusionary strategy or of actual foreclosure, and also the situation of the dominant undertaking's competitors, customers and input suppliers.

In the case of pricing conduct — such as rebates and predatory pricing — the Guidance provides that the Commission will in addition investigate whether the pricing conduct is capable of foreclosing (hypothetical) competitors that are as efficient as the dominant undertaking ("equally efficient competitor test"). The Guidance establishes a soft safe harbour for where the prices of the dominant undertaking cover its long-run average incremental costs (LRAIC). If the dominant undertaking's prices do not cover its costs, the Commission will still look at the above-mentioned "paragraph 20 factors" before determining whether there is likely anticompetitive foreclosure.

Notwithstanding the "equally efficient competitor test" the Commission may intervene against conduct that can exclude only less efficient rivals in certain particular circumstances, namely where restriction of less efficient competitors is likely to result in consumer harm, in particular in the longer term. Such situations may arise, for example, if the dominant undertaking is super-dominant (for example owing to economies of scale and scope and network effects) and there is reason to preserve the very low level of competition still remaining on the market and prevent complete monopolisation.

## Objective necessity and efficiency defences

Where the Commission has found that the conduct of the dominant undertaking is likely to restrict competition and result in harm to consumers, the dominant undertaking can seek to rebut this finding by presenting evidence that its conduct is objectively necessary or justified by efficiencies which are such as to outweigh the negative effects identified by the Commission. The Guidance recognises the possibility of the existence of such an objective necessity only in rather limited circumstances, while it recognises the possibility of an efficiency defence in more general terms and mentions a series of possible examples of efficiencies. ([3])

The criteria that the Commission will use in assessing efficiencies mirror those that it applies under Article 81. The efficiencies must be the result of the conduct in question. The conduct must be indispensable for achieving the efficiencies, i.e. there must not be a less anticompetitive way of achieving the efficiencies. The conduct must not eliminate effective competition by removing all or most sources of actual or potential competition. Last, but not least, the likely efficiencies must outweigh any likely negative effects on competition and consumers that the Commission has established.

## **Brief summary of the content of the Guidance — specific types of conduct**

The Guidance applies the above-mentioned general framework to those types of conduct that are the most common in the Commission's experience. These conduct-specific sections cover exclusive dealing, tying and multi-product rebates, predatory pricing and refusal to supply. Each section describes factors, arguments and efficiencies which are specific to that conduct and will be integrated in the general framework of assessment.

## Exclusive dealing

The section of the Guidance on exclusive dealing covers both exclusive purchasing and conditional rebates. For both, the Commission will investigate whether the customers of the dominant undertaking are able or willing to switch their entire demand to alternative suppliers. If they are, i.e. if the dominant undertaking's competitors are able to compete for the full demand from customers, exclusive purchasing and conditional rebates by the dominant undertaking are unlikely to raise competition concerns, unless the duration of the exclusive purchasing obligation or rebate scheme hinders entry or expansion by competitors. The situation is different if the dominant undertaking is an unavoidable trad-

([3]) However, in the Commission's assessment, it is unlikely that predatory conduct will create efficiencies. Also, as the overall test is a consumer harm test, any argument presented by the dominant undertaking that its conduct is only aimed at meeting competition ("meeting competition defence") is irrelevant.

ing partner for at least part of the demand in the relevant market. This may be the case if its brand is a "must stock" item or because its competitors are capacity constrained. In such a situation, exclusive dealing, even if of short duration, is more likely to lead to anticompetitive foreclosure.

An individual customer may have an interest in entering into an exclusive purchasing obligation where the dominant undertaking rewards him or her for the exclusivity. However, the compensation given to an individual customer for the loss of competition does not make up for the fact that the cumulative effect of the exclusive purchasing obligations entered into by many customers may be such as to prevent the entry and expansion of competing undertakings and thereby to restrict competition so that consumers are harmed overall.

For conditional rebates, the Commission will investigate whether equally efficient competitors are able to compete with the rebate scheme of the dominant undertaking. This requires establishing the part of the sales that is affected by the rebate (the so-called "relevant range"). Whereas for incremental rebates the relevant range comprises all the sales above the threshold, for retroactive rebates the Commission will have to estimate how much of the demand of the dominant undertaking's customers can realistically be switched to competitors. The rebate is then deducted from the price paid for the relevant range. This gives the effective price, and the equally efficient competitor test entails checking how this effective price compares with the relevant cost benchmark. If the effective price is below average avoidable costs (AAC), then the rebate is capable of foreclosing equally efficient competitors. The opposite holds true where the effective price is above LRAIC. If the price is between AAC and LRAIC, the Commission will have a closer look at whether and to what extent competitors can resort to any counterstrategies. Even if the rebate does not involve a sacrifice (indicated by pricing below AAC) on the part of the dominant undertaking, it may still restrict competition in such a way as to harm consumers.

## Tying and multiproduct rebates

This section of the Guidance deals with situations where the dominant undertaking ties or bundles two or more distinct products in order to prevent customers from switching to competitors and thereby foreclose competition. The foreclosure will in the first place affect the tied market, but may ultimately also affect the tying market. The Guidance provides that the Commission will intervene where the undertaking is dominant in the tying market, the products concerned are distinct, and the conduct leads to anticompetitive foreclosure on either the tied or the tying market or both.

As with single-product rebates, the Commission will investigate whether equally efficient competitors are able to compete with the multi-product rebate of the dominant undertaking. Here the "relevant range" consists of the sales of the bundled product. The equally efficient competitor test is applied by checking whether the incremental price that the customer pays for a particular product in the bundle (the tied product) is above or below the incremental cost (LRAIC) of producing that product. However, if competitors can also compete with bundles, the Commission will investigate whether the price of the bundle of the dominant undertaking as a whole is predatory.

## Predatory pricing

According to the Guidance, the dominant undertaking engages in predatory pricing where it deliberately incurs losses or foregoes profits in the short term in order to foreclose competitors and thereby strengthen or maintain its market power to the detriment of consumers. Predation thus differs from the above-mentioned types of conduct in that it always involves a sacrifice. Pricing below AAC is a clear indication of sacrifice. If a dominant undertaking charges a price below AAC for all or part of its output, it is not covering the costs that could have been avoided by not producing that output, i.e. it is incurring a loss that could have been avoided. But sacrifice may take other forms and pricing above AAC may in certain circumstances also be indicative of sacrifice if there clearly were more profitable alternatives available to the firm. For instance, direct evidence obtained from the dominant undertaking during an inspection may reveal a predatory strategy, such as documents containing a detailed plan to sacrifice in order to exclude a competitor.

Whatever its form, the Commission will investigate whether the sacrifice incurred by the dominant undertaking is likely to foreclose competition and thereby allow the dominant firm to maintain and/or strengthen its market power. In this context, the Commission will investigate whether the prices applied by the dominant undertaking are capable of foreclosing equally efficient competitors. This entails checking whether the dominant undertaking is pricing below LRAIC. If this is the case, the Commission will have a look at the "paragraph 20 factors" to assess whether the conduct of the dominant undertaking is likely to result in anticompetitive foreclosure.

The Guidance does not require the Commission to show that after having foreclosed its competitors, the dominant undertaking increased its prices above the level obtained before the conduct, or that the dominant firm actually recouped its losses. Consumer harm may also result if the conduct prevented or delayed a decline in prices that would likely have occurred absent the conduct. However, the Commission will investigate whether the dominant undertaking can reasonably expect its market power after the predatory conduct comes to an end to be greater than it would have been had the undertaking not engaged in that conduct, that is to say, whether the undertaking will be in a position to benefit from the sacrifice and thereby harm consumers.

## Refusal to supply

This section of the Guidance deals with situations where the dominant undertaking refuses to supply an input requested by undertakings that compete with it on a downstream market. It covers both outright refusals to supply and constructive refusals to supply.

If a refusal to supply is considered to infringe Article 82, then the remedy entails imposing an obligation to supply on the dominant undertaking. Such an obligation may induce free-riding by the downstream competitors on the dominant firm's investments and may reduce the incentives of the dominant undertaking and its competitors to invest and innovate, which would be detrimental for consumers. The Guidance therefore emphasises that the consequences of imposing an obligation to supply must be carefully considered.

As it is inherently difficult to balance the incentives to invest and innovate of the different firms and the resulting effects on competition and consumers, the Commission applies a stricter standard for its intervention in case of refusal to supply than for other types of conduct. The Guidance sets out three strict cumulative conditions for the Commission to intervene in such situations. The three conditions that have to be met are that the refusal (1) must concern an input that is objectively necessary to be able to compete effectively on the downstream market, (2) must be likely to lead to the elimination of effective competition on that market, and (3) must likely lead to consumer harm. Such harm may arise, for instance, if the refusal to supply prevents competitors from bringing new products to the market or stifles innovation.

This stricter standard for intervention and in particular the first condition — that the input must be objectively necessary to be able to compete on the downstream market and that there is thus no actual or potential substitute or source of supply on which the competitors could rely — provides a practical tool for the Commission to balance the incentives to invest at stake and to establish whether the negative consequences of the refusal to supply outweigh the negative consequences of imposing an obligation to supply. The requirement that the input should be indispensable eliminates the risk that the obligation to supply undermines the incentives of the downstream competitors to invest in the input market, while the dominant undertaking can assert possible negative effects on its own incentives to invest as part of the efficiency defence.

## Conclusion

The Guidance focuses on exclusionary conduct and not on exploitative conduct: this is because it is better to prevent than to cure. If markets are not functioning properly, it makes more sense to prioritise unilateral conduct which undermines the structure and functioning of the market itself than to address the symptoms.

While therefore the Guidance does not cover all categories of possible abuse, it is fair to say that it is a major step in the process of introducing a more economics- and effects-based approach to European competition law enforcement. Such an approach has already been formulated and implemented in the area of Article 81 and mergers since the late 1990s. And in recent Article 82 cases, such as *Microsoft* and *Telefónica*, the Commission already applied an effects-based approach, but what was lacking thus far was a document that provided guidance to stakeholders, in particular the business community and competition law enforcers at national level, on how the Commission articulates such an effects-based approach to exclusionary conduct under Article 82. The Guidance fills this void.