DG Competition discussion paper on the
application of Article 82 of the Treaty to exclusionary abuses

Telecom Italia’s response to public consultation

1. Introduction and Executive Summary

Telecom Italia welcomes the Commission’s initiative to review the application of article 82 of the Treaty to exclusionary abuses and the opportunity to comment on the discussion paper.

As far as the declared objective of the proposed review, which is aimed at guaranteeing a more economic effect-based approach in the application of article 82, we consider that the abandon of a pure formalistic approach (which could lead to the protection of competitors rather than of competition) would contribute to effectively reach the Lisbon objective of fostering European competitiveness.

Telecom Italia believes that the issuance of Guidelines on the application of article 82 of the Treaty should increase the level of certainty of the European antitrust framework and should also facilitate the harmonised enforcement of European competition law by National Competition Authorities (hereafter NCAs) and National Courts.

Increasing legal certainty in the application of article 82 would represent a relevant achievement for the market. It would be very helpful to provide Antitrust Authorities and market players with clear and workable guidelines about the enforcement of antitrust rules on article 82, following the contributions to this discussion paper.

It is thus necessary that the application of article 82 is consistent with the aim of the competition policy in European markets, which is to increase effective competition.

In our view, this objective cannot be achieved by refraining dominant companies from fiercely competing with other companies in the market.

In particular in industries where competition is mainly driven by innovation, and not by prices, a restrictive application of article 82 may lead to reducing innovation and consequent investments, to the detriment of the consumers and of the whole European economy.

As already stated, we share the general principles stated in the first part of the Commission’s document (such as the adoption of a effect-based approach).

However the analysis of the exclusionary practices carried out in the second part of the document raises some relevant issues that will be commented in this document.

Before doing so, we have to stress that Telecom Italia particularly appreciates the analysis that the Discussion Paper carries out about the tests to be used in order to evaluate predatory practices (in particular the reference to AVC and AAC as appropriate cost benchmarks), the analysis of the characteristics of buyers in order to correctly identify relevant markets and of their countervailing power in order to assess dominance, the proposed criteria for demonstrating the abusive nature of bundling and tying practices.

Therefore our comments will specifically analyse the issues treated in the discussion paper of the DG Competition that we fear may result in a misleading application of article 82 and particularly
some of those presented in the second part of the Discussion Paper, concerning specific exclusionary abuses, which we believe are made without taking into account the correct principles set out in the first part of the Discussion Paper.

As an example, what is stated in § 67, i.e. that Commission intends to protect even competitors that are “not (yet) as efficient as the dominant company”, seems to us to be in contradiction with the general principle of the paper (to protect competition and not competitors, see § 54) and to introduce a high degree of uncertainty for undertakings. Indeed, prohibiting a conduct aiming at lowering prices, only on the basis of allegedly foreclosure effects they might have on the market, without proof of a concrete consumer harm, will negatively affect in the long term competition and consumers.

But let us begin with some general remarks, before entering in specific comments to the discussion paper.

**Implementation of an effect-based approach**

As stated by the Commission itself in the introduction of the Paper, “in applying the article 82 the Commission will adopt an approach which is based on the likely effects on the market.” In this regard we express the view that the analysis of the effects (including the observation of actual effects, in cases in which they can be observed) should become a necessary condition for any alleged abuse of dominant position.

More in particular, we consider that only the proof by the Commission of the foreclosing effects of a specific practice and of the negative effects that have on consumers may lead to the finding of an abuse of dominant position. In this respect, we do not agree with § 60 of the text, where the Commission seems to presume an abuse when conducts create no efficiencies and raise obstacle to residual competition. Indeed, the Commission should in all cases prove both the existence of harm to consumers, and that the Commission’s repression of the dominant operator’s conduct has positive effects on consumers.

Furthermore, Telecom Italia is of the view that the ultimate test for the abuse of dominance should always be “harm to consumers” which is explicitly referred to in article 81. In other words Telecom Italia believes that article 82 should be employed only to condemn a conduct that actually harms consumers while all others practices should instead be considered legitimate by definition.

Nevertheless, the Commission’s discussion paper reflects the persistence of a “structuralist approach” to article 82, in contrast with the objectives stated and with the consolidated United States approach, that does not consider any conducts “per se” abusive. When entering in the analysis of possible abuses, the paper *de facto* follows the Court’s approach in the recent cases (Michelin II, British Airways) by considering that in order to demonstrate an infringement of article 82, it is sufficient that the abusive conduct is likely to have the effect of restricting competition and it is not necessary to demonstrate the concrete effect in the market (§ 58, § 144).

A formalistic per se approach (identifying illegal conducts) is not the best solution for EU competitiveness. An effects-based approach (which prohibits illegal conducts only when a reduction in consumer’s welfare is demonstrated) is to be preferred. Even if the Commission states that this approach should be privileged, there are still many elements in the paper showing that the form based approach is still applied (i.e. § 58: consideration of form and nature of the conduct).

**Identification of Safe Harbours**

The Guidelines do not clearly identify “safe harbours” where companies can act with no risk to be fined and set only “possible principles” for the Commission’s application of article 82 to
exclusionary abuses. The aim of such a discussion paper should be to provide the market with legal certainty, which would not be reached through this tool.

We therefore suggest that the Commission should clearly identify situations and behaviours that should not lead to article 82 infringements, in order to increase legal certainty for undertakings. That should be done by clearly identifying the situations in which there should be a presumption of genuine competition.

**Application of the future Guidelines to the electronic communications markets**

Last, but not least, Telecom Italia considers that some specific attention should be brought to the application of article 82 in regulated industries, in particular when, as it happens in the electronic communications industry, regulation is based on competition policy tools, such as market analysis and the concept of dominance.

We consider that the future Guidelines, insofar as they apply also to our sector, should take due account the specificities of electronic communications markets.

In any case, since the guidelines would apply to all sectors, we consider that a review of the “Notice on the application of the competition rules to access agreements in the telecommunications sector”, dated 1998, is urgently needed, in order to properly reflect the relevant changes that have taken place in the electronic communications market (new services, new forms of competition, new relationship among players, etc.) in the past eight years.

Apart from these general remarks, TI’s answer will concentrate on the following specific issues:

- **Market definition:** we observe that the SSNIP test at market prices remains the most effective tool and we recommend to pay the utmost attention to market granularity based upon a detailed analysis of customer demand. Furthermore we strongly recommend to take into account the specificity of two-sided (and multi-sided) markets (that are particularly relevant in telecommunications) and the innovation and convergence process as which are undergoing electronic communications markets in order not to exclude strong competitors from the assessment of the markets.

- **Dominance:** we observe that the Discussion Paper relies on market shares in order to define a dominant position more than it is required. Telecom Italia observes that other factors, as the analysis of barriers to entry, and the consideration of countervailing power of buyers should be taken in the utmost account. The analysis for collective dominance should be further expanded. In the Discussion Paper, oligopolistic structures lead to the presumption of collective dominance. We express the wish that the future guidelines will provide the market with clear indications that could help to distinguish a competitive oligopoly from a collusive one.

- **Exclusionary abuses:** likely effects on the market and analysis of harm to consumers should become the main tools for identifying abuses. More clarity is needed in identifying an exclusionary conduct, in particular in the field of predatory pricing, where the Commission needs to take into account more clearly the costs of type I error (i.e. deterring or prohibiting a non exclusionary behaviour). It is difficult to accept that actions that have the same effects on the market may lead to different evaluations, depending on their “formal characteristics” (i.e. period of the alleged predatory pricing). When defining exclusionary abuses, the Commission doesn’t take into proper consideration that practices based on usual business behaviour should not be considered abusive. In particular the reaction of dominant companies to the entry or to the aggressive behaviours of competitors are generally considered as abusive, while in fact it is absolutely usual that companies react to competitors, since this is the very nature of
competition. The threat of sanctions in these cases may lead dominant undertakings to compete less aggressively on the market and may result in reducing competition instead of increasing it.

- Price squeeze: price and margin squeezes are considered as a form of refusal to supply, without devoting too much analysis to them. However cases concerning squeezes are often raised, in particular in regulated industries, and a more analytical and comprehensive economic analysis of squeezes and of their relevance in regulated industries should be included in the document, besides, as proposed, updating and expanding the contents of the “Notice on the application of the competition rules to access agreements in the telecommunications sector”.

2. Market definition

TI believes that all enforcement activities of Article 82 should be based upon a detailed market definition, which should fully capture the nature of competitive interaction among different suppliers.

This has not always been the case in electronic communications, where it is rather obvious that very different competitive conditions exist across products, customers and areas, but – quite often – antitrust authorities define very broad markets, and tend to consider the incumbent to be de facto dominant. This may not be the case at all: the supply of telecom services to medium and large firms and the supply of broadband services in areas where several land-based infrastructures exist are, in most European countries, highly competitive business. Only a detailed analysis of demand and supply substitutability for the specific service under consideration in the relevant geographic area can provide a sound foundation for assessing the existence of market power.

On the other hand, markets can be defined too narrowly, if demand complementarities are overlooked. Call termination, for instance, can hardly be considered a relevant market by itself, as there is no stand-alone demand for it. Mobile termination services are consumed in a bundle with other services, such as origination, SMS, and others, and a proper market definition should not overlook such a fundamental demand pattern.

In this sense the Commission, correctly analyses the existence of different categories of end customers. In particular, the paper concludes that “.. if one or more strong buyers are able to extract more favourable conditions from the allegedly dominant undertaking than their weaker competitors, it may be appropriate to define separate relevant markets for, respectively, strong and weak buyers”.(§§ 41 e 42).

TI agrees with the position of the Commission, since it considers that strong buyers substantially behave in a different manner form weak ones, and their demand is different.

This approach has also been adopted by the European Commission in some recent important decisions where the Commission itself has acknowledged, on the basis of a specific demand of services, the likely existence of a market for pan-European mobile telecommunication services to international mobile customers. This market would essentially enable multinational companies to strike better price deals through European-wide requests of proposals, and to rationalize more effectively their mobile phone expenses thanks to the combination of billing systems.

Therefore, TI believes that market analyses in complex markets, such as those in which electronic communications companies operate, should be conducted with an appropriate degree of granularity, based upon a detailed analysis of customer demand.

1 See COMP/M.1795 Vodafone Airtouch /Mannesmann, and case COMP/M.3806 - Telefonica/Cesky Telecom
2.1 The use of SSNIP test

Concerning the use of the SSNIP at competitive prices, as suggested by the Commission’s text, we consider that it would be extremely difficult and artificial to calculate a “competitive” price irrespective of its existence on the market.

TI thinks that the application of the SSNIP test to the telecommunication sector, i.e. a sector that is currently undergoing an intense process of innovation and convergence of players, services and devices, may lead to wrongly defined relevant markets.

The application of the SSNIP test to the current voice communication telephony market may, for example, lead to the exclusion of VoIP services offered by Application Service Providers (hereafter ASP), since a small increase in price (+5%) may not make a substantial number of customers abandon their habit to make their phone calls through the plain telephony devices and network\(^2\).

The above example suggests that the market definition of a sector undergoing a substantial innovation and convergence process calls for a particularly careful analysis since the mechanical adoption of any “traditional” market definition tool, such as SSNIP, may lead to the exclusion from the market of strong competitors.

The application of the hypothetical monopolist test (SSNIP test) is based on the answers to two following questions: first, what volume of lost sales will make the SSNIP unprofitable; and second, what volume of sales will be lost as a result of a SSNIP. The economic literature refers to the answer to the first question as the “critical loss”. Telecom Italia believes that the provision of further details regarding the formula to be used to calculate the “critical loss” and the method to be preferred when trying to answer to the second question (i.e. historical evidence or econometric evidence or affidavit evidence or survey evidence) would improve the consistency of application of article 82 across member states.

2.2 Emerging markets

TI would like to stress that article 82 issues are unlikely to arise in emerging markets, i.e. market for new services where a first mover often acquires quickly a large market share.

The assessment of dominance in such cases is especially difficult, and requires a substantial weight to be placed upon forward-looking analysis. This is usually less necessary when analysing the existence of dominance in other markets, where demand-side and supply-side substitutability can be readily appreciated by looking at recent events, but is unavoidable in emerging markets, where dominance depends crucially upon the ability that consumers will have, in a reasonable time-frame, to substitute new services to the one provided by the (apparently) dominant firm. Equally, in such markets, potential entry is a paramount constraint upon the firm’s behaviour.

The link between a large market share and dominance is thus particularly weak in such markets, and should be subject to thorough analysis in the light of technology and market trends.

Even when dominance is ascertained, the behaviour of the dominant company should be always assessed in the light of the particular characteristics of emerging markets, where e.g.:

\[\text{Ø Tying may be an efficient way of obtaining scale economies, and prohibiting the dominant firm, without proving an exclusionary effect, to sell the tied good without the tying good can increase overall costs and prices;}\]

\(^2\) In this case, a small increase in prices of voice communications services may in fact be insufficient to convince customers that haven’t bought a PC and an internet broadband connection to do so in order to use VoIP while instead the same price increase may be sufficient to determine broadband users to switch from PSTN to VoIP call services.
Setting prices below current incremental cost may not constitute predatory behaviour, taking into account that the firm is willing to attract new customers with prices not strictly based on present costs but on the foreseen “time period” costs (as evaluated in the business plan), which in turn will include the effects of innovation, of economy of scales and of the benefits on the opex of the learning curve.

2.3 Two or multi-sided markets

Two or multi-sided markets are defined as “markets in which one or several platforms enable interactions between end-users and try to get the two sides “on board” by appropriately charging each side”\(^3\). The two-sided nature of the market arises because parties on either side of the market, benefit from having more people available on the other side of the market.

Two sided markets (2SM) are a relevant issue especially in the electronic and media communication industries. Platforms and networks create links between different users: callers and receivers, in the telecommunications markets, or viewers and advertisers in the TV markets etc.

It is worth underlining that the two sided nature of some electronic communications markets has already been taken into account in different competition cases worldwide\(^4\).

Some examples of two-sided markets in media and telecommunication industry are:

- Videogame platforms which need to attract gamers in order to convince game developers to design games to their platform, and need games in order to induce gamers to buy and use their videogame console.

- Software producers which need both users and application developers.

- Portals, TV channels which compete for advertisers as well as for more viewers.

Analysis of two-sided networks produces “some interesting implications for regulators, competition authorities, and public policy practitioners”\(^5\). Therefore anti-trust intervention may be inappropriate if the two-sided nature and the links and interaction between the two sides of the market are ignored.

This is largely because with two-sided markets, the pricing decision of firms is more complex than for firms in more classical one-sided markets. A firm in a two-sided market needs to make a choice about both price structures (how to split cost recovery between the two sides) as well as price levels (what price to charge each side of the market), considering the overall effects. Therefore the price structure (prices on either side of the market) may not bear a relationship to costs (on either side of the market).

For example examining only one side of the market may lead to interpret a subsidy (such as free handsets) as predatory pricing.

The economic literature provides robust results on predatory pricing in 2SM, —“that price below marginal cost may be profit maximizing, not predatory. In theory and in fact many Two Sided Platforms charge one side a price that does not recover direct costs (video game consoles) and may in fact be negative in the sense that one side is paid to stay on board the platform (shoppers at malls through free parking and other amenities). They therefore earn their profits from a side that

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\(^2\) As an example, in the recent Mobile Termination market analysis carried out in 2005 in New Zealand, the Competition Authority considered that two-sided market framework is applicable to mobile termination context since the dynamics of supplying these services together highlight the strong incentives mobile network operators face to strike the right balance of charges between mobile termination and retail mobile services. In such instances, mobile operators must balance their pricing decisions on both sides of the market.

\(^3\) Rochet, J., and J. Tirole, Defining Two-Sided Markets, January 15, 2004, page 31
typically pays a price well in excess of the direct marginal costs. Competing 2SPs in such an industry could earn a risk-adjusted competitive rate of return even though, under European Community competition law for example, a dominant 2SP could be accused of engaging in a predatory pricing abuse in one “market” and an excessive pricing abuse in another “market.”

This issue has come up in a series of cases in Europe in which regulatory authorities have found mobile telephone operators to have charged “excessive” prices for terminating calls on their networks; the authorities acknowledged that the profits from these excessive prices are competed away in part through low prices for handsets and call origination.

The UK’s Office of Communication (OFCOM) admitted that mobile telephone platforms were highly competitive (on the mobile subscriber side at least) and did not overall earn supra competitive returns, although they did not accept that this was a two-sided business.

Having said that, TI reckons that the Commission should address better this kind of markets, in the guidelines or in the review of the Access Notice, taking into account the links and interaction between the customers of the two sides, and how these businesses and industries behave.

The relevance of this approach covers:

- market definition, in order to identify the real dimensions of competition and focusing on sources of constraints;
- coordinated practices, by considering that it is harder to form an effective cartel in an industry with 2SPs than in other industries, all else equal. The cartel requires more agreements and monitoring because of the additional side.
- unilateral practices, such as predatory prices.

3. Dominance

Only undertakings enjoying market power can be liable under article 82 of the Treaty. Therefore finding of dominance is a basic element of the scrutiny of any business conduct under Article 82. The dominance analysis relies on two fundamental steps: the definition of the relevant market and the evaluation of market power based on market shares, existence of barriers to expansion or to entry and the market position of buyers. Telecom Italia believes that this is the appropriate approach to the assessment of dominance.

The description of the criteria used to assess market dominance clearly helps firms understanding the legal framework that surrounds the application of article 82. Telecom Italia however totally disagrees with what it is stated in § 31 i.e. “It is very likely that very high markets shares, which have been held for some time, indicate a dominant position. This would be the case where an undertaking holds 50% or more of the market, provided that rivals hold a much smaller share of the market.”

In markets such as the telecommunications opened up to competition in the last decade where incumbents across Europe easily still enjoy market share in the range of 50% to 70% that are constantly decreasing. Therefore, such market shares above 50% can not be taken as a clear indication of market dominance since it is simply due to the past monopolistic structures of the market. In other words, market trends (i.e. market dynamics) need to be accounted for to a greater extent than market share levels (i.e. static market pictures).

In the assessment of dominance from a dynamic point of view the Commission should consider other factors such as barriers to expansion and entry, fluctuations in the market position of the

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9 D. Evans - R. Schmalensee – The industrial organization of markets with two-sided platforms - August 19, 2005
dominant firm, countervailing buyer power of the buyers. Furthermore in a forward looking perspective the Commission should also consider the competitive constraints exerted by the players operating in other markets which are not strictly linked to the relevant one.

Telecom Italia, hence, totally opposes an approach which uses the 50% threshold as the central practical rule to assess market dominance and believes that a special emphasis should be given to what is stated in § 32 i.e. “Market share is only a proxy for market power, which is the decisive factor. It is therefore necessary to extend the dominance analysis beyond market shares, especially when taking into account the difficulty of defining relevant markets in Article 82 cases.”

3.1 Relevance of the analysis of barriers to entry

Barriers to entry should be considered as the most fundamental part of any dominance assessment. Without substantial barriers to entry, a firm cannot have substantial market power, and as such, barriers are a necessary (though not sufficient) condition for a finding of dominance, regardless of the level of market shares. In other words, a high market shares in presence of either absent or low entry barriers needs to be correctly deemed as a consequence of fair competitive behaviour rather than dominant position. In addition, either absent or low entry barriers do not allow to unfairly exploiting high market presence.

If we define the relevant market of telecom services properly (i.e. without relying on the possess of a network) players capable of entering the voice communications markets without any telecommunications infrastructure and authorisation (before mentioned as ASPs) could be taken as an example of a markets where the presence of an undertaking with a market share exceeding the 50% threshold is nonetheless incompatible with the existence dominant position due to the current absence of barriers of entry.

Moreover in addition to the ownership of network infrastructures, other production facilities should be considered for assessing the presence of barriers to entry or to expand. For instance as stated in §37 “Entry may be particularly likely if suppliers in other markets already possess production facilities that could be used to enter the market in question”.

Furthermore, in assessing barriers to entry, the Commission should also consider existing regulations, that in many cases reduce or eliminate them. For instance, the regulation on local loop unbundling, if properly implemented, eliminates all the barriers to entry due to the minimum efficient scale necessary for the provision of local loops to end customers.

Therefore, TI highlights that in the regulated markets the Commission should take into consideration the remedies imposed ex-ante by Regulators, since their main purpose is that of reducing or eliminating the barriers to entry for competitors.

3.2 Forward-looking dominance assessment

Moreover, the application of standard static approach to market dominance in markets where innovation plays a major role has a main drawback: it fails to recognise that competition occurs outside the relatively short timeframe traditionally used for antitrust market analysis. In some antitrust cases in high-tech industries, it is arguable that the high market power found might be conditioned by the fact that the timeframe of the analysis has been too short. Hence, in markets where a dynamic form of competition takes place, the assessment of dominant positions should be based on a longer time frame. Telecom Italia is of the view that the market analysis in telecommunications markets should be focused on identifying “persisting” rather than “current” dominant positions.
The need for caution when applying competition law to fast moving markets characterized by high rate of technological innovation (particularly high tech and “new economy” industries, such as information technology, internet and telecommunications) has recently been the subject of some debate. The economic literature has also addressed the problem\(^7\). Competition in these markets is dynamic in the Schumpetarian sense i.e. firms compete by innovating and this gives them a temporary monopoly. In this framework market power and dominance imply something that does not necessarily detracts from economic welfare as, for instance, in the case of legal patents which typically bestow market power on patent owners. This is a deliberate legal provision that allows firms which provide a “new innovation” to earn monopoly profits deemed to sufficiently remunerate the incurred risk.

In a Schumpeterian competition, the reward given by the possibility of behaving for a temporary period of time much as a monopolist would, constitutes the main firms’ incentive to innovate and to introduce innovation before competitors. The condemnation of these behaviours aimed to appropriately reward the capital invested to innovate may lead to the abatement of the aforementioned incentive. The lack of innovation will surely end up harming consumers.

In a Schumpeterian context undertakings may have high market share but they are constantly exposed to the threat of “new innovation”. In the light of the foregoing it can be argued that the application of static models to high-tech/new economies industries does not give true reflection of market power.

3.3 Countervailing buyer power

In the assessment of dominance it is very important to examine all the competitive constraints that the allegedly dominant firm must face. In some cases, the constraints can be generated also by the Countervailing Power of the final customers, since also the buyers can be able to constrain the allegedly dominant undertaking. In particular, large customers with a strong countervailing power can constrain the allegedly dominant undertaking, by determining the price, the terms and conditions for bidding, the Service level agreements etc.

TI strongly supports what stated by the Commission at §27, “..., the fact that an undertaking is compelled by the pressure of its competitors' price reductions to lower its own prices is in general incompatible with the independent conduct which is the hallmark of a dominant position. In that case the undertaking concerned is likely to be subject to effective competitive constraints, which is incompatible with the existence of substantial market power”.

3.4 Necessity to clearly identify exemptions

Telecom Italia believes that legal predictability and consequently business certainty will significantly improve only if undertakings are put in a position to understand whether they will or will not be considered as dominant.

The fear of being erroneously found dominant has in so far meant that many firms have chosen to adopt conservative policies that have unduly restricted their pricing freedom or competitive behaviour to the detriment of consumers. With the introduction of categories of undertakings exempt from being liable under article 82 the firms belonging to these categories, freed by the aforementioned fear, will engage in fiercer competition to the benefit of consumers.

The Court of Justice in the United Brands case (27/76 of February 1978) stated that a dominant position is “a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained in the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers.” This definition clearly does not privilege the power of behaving independently in term of price setting but refers to a more general independence.

Telecom Italia is of the view that in markets, such as the telecommunication market, where competition is not limited to the price dimensions but strongly involves other factors (e.g. quality of service, reputation, innovation, customer care, etc.), the independence power should be evaluated with respect to all dimensions of competition and not solely with respect to prices.

As stated by the Court\(^8\), “although price competition is so important that it can never be eliminated, it does not constitute the only effective form of competition or that to which absolute priority must in all circumstances be accorded”.

It is therefore essential to introduce specific circumstances under which undertakings can not be considered dominant. The Commission itself reckons that “the fact that an undertaking is compelled by the pressure of its competitors' price reductions to lower its own prices is in general incompatible with the independent conduct which is the hallmark of a dominant position (§ 27). This circumstance might, for example, be one of the cases where undertakings (even having a high market share), being price follower, should be exempted from being regarded as dominant. Another indication of the market structure and of the unlikelihood of the existence of a single dominance position may be drawn by observing the market share difference between the allegedly dominant undertaking and other firms in the market. Finding of a small difference between the market shares of the biggest firm and competitors, as in the mobile industry, should suggest that the former firm will hardly be able to act independently from competitors and ultimately consumers, and thus it does not enjoy any dominant position.

### 3.5 Collective dominance
The necessity that undertakings should be put in a position to understand whether they will or will not be considered as dominant is even more relevant in the case of collective dominance.

Collective dominance is, in fact, the theoretical hypothesis under which competition law can punish market distortions generated by a (tacitly) collusive oligopoly. The finding of a situation of collective dominance should therefore be based on a market analysis aimed at evaluating the competitive or collusive nature of the oligopoly.

An oligopoly is a market structure where a few companies control the whole market or a large share of it. Companies that are part of an oligopoly are interdependent, in the sense that changes in price or quantity by each of them directly affects other companies in the market, that therefore will react adjusting their price or quantity, till a market equilibrium is reached.

In an oligopolistic market structure companies are interdependent: it is therefore in the nature of the oligopoly that companies react to the behaviour of their competitors. Economic theory gives wide evidence that competitive oligopolies result in market outcomes much more similar to competition than monopoly.

It is also possible that companies in an oligopoly choose a different behaviour: collusion. In this case, whenever collusion is tacit or explicit, companies behave like a monopolistic company, setting

price (and quantity) at a profit-maximising level, reducing consequently consumer welfare. A collusive oligopoly is an undesirable outcome, since operators tend to behave as a monopolist, therefore maximising their overall profit and reducing quantity. The analysis to be carried in order to identify a joint dominance has much to do with the analysis that is necessary in order to distinguish a competitive from a collusive oligopoly.

In this direction Telecom Italia considers that the three cumulative conditions set in the Airtours case are a necessary, but not sufficient tool in order to assess joint dominance in exclusionary abuses. In fact these criteria were set in a merger case, where it was necessary to assess the possibility that market structure could prospectively lead to a situation where companies could behave in a collusive way.

When assessing joint dominance in an exclusionary abuse case, something else should be deemed necessary. In particular, under an *ex post* perspective, the concept of joint dominance seems only applicable where overt agreements between companies are identified.

This approach is confirmed by the recent *Laurent Piau v. Commission*, where the CFI concluded that the clubs were held jointly dominant because of their involvement in an association of undertakings, the FIFA. In particular, paragraph 114 of the judgement clearly says that “[*] Because the regulations are binding for national associations that are members of FIFA and the clubs forming them, these bodies appear to be linked in the long term as to their conduct by rules that they accept and that other actors (players and players’ agents) cannot break on pain of sanctions that may lead to their exclusion from the market, in particular in the case of players’ agents. Within the meaning of the case-law cited in paragraphs 110 and 111 above, such a situation therefore characterises a collective dominant position for clubs on the market for the provision of players’ agents’ services, since, through the rules to which they adhere, the clubs lay down the conditions under which the services in question are provided”.

A different approach, where a pure possibility of tacit collusion can be attacked *ex post*, would have the effect that all the undertakings of an oligopoly could be always considered an example of collective dominance.

Another element that should be taken into account in analysing an oligopolistic market structure is the difference between non differentiated and differentiated oligopoly. Differentiated oligopolies mainly compete in R&D, innovation and advertising. In this case the analysis of market prices may lead to wrong conclusions about the very nature of the oligopoly. For example in the market of mobile services, the mobile operators have developed different technologies for value added services, such as UMTS, EDGE or I-MODE.

Having said that, concerning joint dominance, it should be better clarified that:

- the structure of the market as such is not a proof of a collective dominance: i.e. in an oligopolistic market, the existence of collective dominance is not automatically found;

- active participation of the firms (i.e. in defining a deterrent mechanism or a common policy) is indispensable in order to achieve anticompetitive coordination. In particular the punishment and the deterrent mechanism, must be credible, easy to adopt and sufficiently strong which means that the loss imposed on the deviant must be sufficient large to prevent deviations.

- it is inappropriate to take in consideration the criteria used by the antitrust jurisprudence in merger case (see cited *Guidelines on the assessment of horizontal mergers*, footnote 46, and *Airtours Case*, footnote 47) for assessing collective dominance in case of abuse of dominant position ex article 82..The conditions indicated in the discussion paper are simply indicators

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9 Regarding the concept of collective entity and the three cumulative *Airtours* conditions that must be met for a finding of collective dominance.
of the likelihood that undertakings may behave as a single undertaking or tacitly collude in a dynamic perspective, but can’t be considered a real proof that such a behaviour is taking place. Indeed under article 82 EC, there should arguably be a convincing evidence for saying that such behaviour has occurred.

4. Exclusionary abuses

4.1 Predatory Pricing

Predatory pricing can be defined as “the practice where a dominant company lowers its price and thereby deliberately incurs losses or foregoes profits in the short run so as to enable it to eliminate or discipline one or more rivals or to prevent entry by one or more potential rivals thereby hindering the maintenance or the degree of competition still existing in the market or the growth of that competition… The company will make this sacrifice when it considers that it is likely to be able to recoup the losses or lost profits at a later stage after its actions have had the foreclosure effect” (see §93 and §96 of the Discussion Paper).

From this definition it follows that in order to have a predatory strategy three main conditions must be fulfilled:

- a dominant firm which sets the prices below its own respective costs;
- intention to eliminate a competitor (evidence of a predatory strategy);
- possibility of recoupment of losses in the long run;

4.1.1 Pricing below costs

“Foreclosure of an as efficient competitor can in general only result if the dominant company prices below its own costs.” (§ 63).

This consideration brings to the attention two relevant elements: the definition of an “as efficient competitor” and the definition of “its own costs”.

Beginning from the latter, with reference to the assessment of the pricing strategy, the Commission lists some cost benchmarks, such as MC, AVC, AAC, LAIC and ATC, below which predation can be assessed. These cost benchmarks are normally applied using the cost data of the dominant company.

According to § 64 and §65 both Long Run Average Incremental Costs (LAIC) and Average Avoidable Costs (AAC) take into account the product-specific costs, but while LAIC takes into account the product-specific variable and fixed costs, AAC in general takes into account only the product-specific variable costs (see also §108).

According to § 65 “the LAIC will usually be above AAC because LAIC takes into account all product specific fixed costs, including product-specific fixed costs made before the period of abusive pricing, whereas AAC only takes product specific fixed costs into account that are made in order to foreclose”.

TI agrees upon the Definitions and the concepts in § 64 and believes that they are of the utmost help to national regulators.

However in § 65 it should be clarified that a long run incremental cost is a cost which takes into account prospective technological development and innovation; therefore LAIC cannot include “product-specific fixed costs made before the period of abusive pricing”.

Telecom Italia’s response to the public consultation on the Discussion Paper on art.82 of the Treaty
On the other hand, TI agrees on the fact that, being LAIC an average cost, this cost should include all the product-specific variable and fixed costs which are relevant to the total amount of product produced at “the period of abusive pricing”.

**Therefore the quoted statement in § 65 could be restated in the following way:**

“the LAIC will usually be above AAC because LAIC takes into account all product specific variable and fixed costs related to the total amount of product produced at the period of the claimed abusive pricing, whereas AAC only takes into account product specific variable costs and those fixed costs that are made in order to foreclose.”

Having said that, TI welcomes the assumption that such a cost figure (AAC) is applied when assessing the costs of a dominant firm. However, for the sake of clarity, the Commission should clarify when each of the listed cost benchmarks has to be used in order to have a homogeneous approach towards this issue, from both the Commission and the firms.

For instance, according to the relevant case law, it should be underlined that LAIC figure could be prevailing when used in assessing predatory strategy in an emerging market\(^\text{10}\). In that market, “a firm operating normally cannot set out to recovery its full costs immediately……. It may be that its prices will not fully cover its costs in the first few years of business, without driving off the market competitors with less financial stamina who are likewise investing with a view to reasonable profitability”\(^\text{11}\). It follows that a pricing strategy that could be considered as “predatory” in a static analysis (i.e. using the ATC), becomes fair in a forward-looking analysis (i.e. using the LAIC).

In fact, when new services are delivered through new production chains or platforms it would not be appropriate to use costs other than LAIC; additionally, due to the fact that applying prices based on the cost involved in the start-up years would lead to high prices and that on the contrary in the start-up period lower prices may be required to make more customers familiar with the product, any predation test should take into account the costs produced by reasonable business plans, in order to put together the concept of the return of investments in an appropriate time frame with the concept of forward looking efficient costs.

The same Commission in the “Notice on the application of the competition rules to access agreements in the telecommunications sector” stated that “consideration will have to be given to the appropriate time frame over which costs should be analysed…the Commission will often need to examine the average incremental costs of providing a service, and may need to examine average incremental costs over a longer period than one year”\(^\text{12}\).

On the contrary, while testing a pricing of a mass-market product in a mature market, it could be most useful to use a AVC and ATC figure, according to AKZO case\(^\text{13}\), whilst if the alleged predation affect a specific-client offer or a new line products, it would then be more suitable to use an AAC figure\(^\text{14}\).

Telecom Italia must also express its agreement with §95, that asks for an appropriate time-frame for the analysis. In fact it is quite usual that “An investment in temporarily lower prices may for instance be required to enter a market or to make more customers familiar with the product”.

Concerning costing issues, Telecom Italia must express its disagreement with the whole § 110. The main point is that a mere rule of thumb concerning pricing and costing (price < AAC) is a very bad substitute of the analysis of the existence of a predatory intent and effect (exclusion of the prey with possible recoupment of the effect). Nor the burden of proof can be simply reversed on the dominant

\(^{10}\) See COMP/38.233 - Wanadoo Interactive, 16 July 2003.

\(^{11}\) See case Wanadoo cited in §75 and §76.

\(^{12}\) See par. 114 and 115 of Notice on the application of the Competition Rules (98/C 265/02)

\(^{13}\) Case 62/86, AKZO.

company, which in this case should not give any specific evidence about its cost structure or specific situation (like in the ED or MC defence) but should just conclude the Commission’s analysis, if it wishes.

Secondly, the Commission clarifies that the analysis should take into account an “as efficient competitor”. Even if Telecom Italia agrees with the general principle, the definition of the Document is too restrictive (paragraph 63: “The “as efficient” competitor is a hypothetical competitor having the same costs as the dominant company”); indeed it should be kept in mind that in most cases in high technological and innovative markets competitors have simpler and more efficient organization and cost structure than the dominant company, due to the technological innovation embodied in capital expenditures and to the possibility to target specific market segments.

As an example, in the telecommunication sector the dominant company usually has huge amounts of assets which have been installed in different “technological cycles” and that however have not yet reached the end of their economic life. This implies that competitors which have deployed their networks in the last years have been able to benefit, due to cost savings related to technological improvements, of much lower capex and opex. Similarly, dominant undertakings have legacy costs in terms of work staff typically higher than new entrants.

Therefore the application of the “as efficient as” test without adopting a case by case approach, may lead to an overestimation of costs actually incurred by competitors of the dominant undertaking, in particular in those markets characterized by an high degree of technological innovation, where the newcomers can easily exploit industrial and commercial structures more efficiently.

4.1.2 Evidence of a predatory strategy: the intention to eliminate a competitor

An evidence of a predatory strategy is generally considered essential by the Commission: “…..Such evidence needs to be clear cut about the predatory strategy and for instance indicate the specific steps the dominant company is taking and not just concern company internal general talk that the dominant company “will crush the competition”.(§ 113)

In absence of direct evidence a case can be built on indirect evidence of the predatory strategy, but in this case it must be shown that the pricing behaviour only makes commercial sense as a part of a predatory strategy and that there are not other reasonable explanations (§115).

Telecom Italia agrees with the Commission on both issues and considers that the Commission should also consider to give a wider illustration of the other reasonable explanations cited in § 115. In our understanding, in this case the Commission should also analyse the efficiencies that could derive from the dominant operator’s behaviour, in a forward looking perspective.

Some legitimate commercial reasons for pricing below cost are launching short run promotions in order to put a new product on the market, creating network effects (especially in two sided markets) or generating economies of scale.

4.1.3 The issue of recoupment

The Commission must in the second place show that there is a reasonable expectation that the predator will be able to recoup its losses after the end of its predation (e.g. after competitors are driven out of the market).

Therefore, it’s necessary to provide further separate and realistic proof of recoupment in order to find an abuse.
It’s not sufficient, as stated by the Commission, to prove that the dominant company’s price was lowered upon entry and increased after exit or disciplining of the entrant. This point is crucial because, as pointed out by the Commission (see § 97/98/99), predatory strategy is a risky strategy. For instance, the strategy may fail, if targeted competitors are not as weak as expected, or if competitors driven out of the market are replaced by other low cost competitors. In either cases, this situation forces the predatory pricing period to become prolonged until the period when even the predator itself is forced to forfeit the expected gain.

The analysis of the possible recoupment should also take into account entry barriers. If entry barriers are low or inexistent, there is always the possibility that newcomers (different from present competitors) may enter the market, if the dominant undertaking is earning supra-competitive profits.

4.2 Tying and bundling

Tying is not a particularly relevant problem in electronic communications, as none of its major products (fixed voice, mobile voice, broadband connections, Internet, IP television and other delivery of content) may qualify – under the current regulatory regime – as a tying product, which customers are unable to get from more than one supplier. However, bundling issues might arise in the industry, particularly as a growing number of operators engage in triple and quadruple play. Bundling issues could take the form of pure bundling (products A and B may only be bought together), or of mixed bundling (A and B could be purchased separately, but the bundle is sold at a discount).

As the Commission clearly points out in its Discussion Paper, tying - or bundling policies seeking to achieve the same result - may be deemed to be illegal if four cumulative conditions are fulfilled:

1. the company concerned is dominant in at least one product;
2. the products are distinct;
3. the tying/bundling policy is likely to have a foreclosure effect;
4. the practice is not justified objectively or on efficiency grounds.

As discussed above, while tying *stricto sensu* is not a relevant issue in electronic communications, a commercial policy of joint selling of several products might raise the issue whether “customers are ‘tied’ in the sense that the competitors of the dominant company cannot compete for their business [and] to establish whether these customers ‘add up’ to a sufficient part of the market being tied” (par.188). TI wishes to stress that such a test should be conducted on the basis of the facts of the case, as the CFI has clearly set out in its recent judgment in the General Electric/Honeywell case. This has clarified how the existence of an undertaking’s incentive for pursuing an illegal bundling strategy may not simply be presumed on the basis of behaviour observed in the past, or in other markets, but must be proved to be a rational strategy in the specific case under consideration.

The rationality of the alleged conduct should be established on the basis of appropriate economic tests. Several of them have been proposed in the relevant literature, out of which the test proposed by Nalebuff (2005) could be (if the problem being considered warrants a purely static analysis: see below) particularly useful. If A is the tying and B is the tied product, there may be no exclusionary bundling unless the stand-alone price of B is lower than its long-run incremental cost.

TI wishes however to stress to the Commission that, in a number of cases, a purely static test would not be appropriate.

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15 The same position was indeed taken by the Court on leveraging: as a strategy involving costs and (expected) benefits, its rationality must be assessed in any specific situation.
When an operator offers to a large customer a bundle of services over a period of time (say, a triple play offer to a medium size bank for the three years), the criteria utilised to ascertain the existence of exclusionary bundling may not be static, but should take into account costs and prices over the life of the contract. While TI has no particular test to recommend at this stage, we wish to stress the practical relevance of this issue, particularly if we keep in mind that most costs (including LRICs) are falling in this business: static tests, which would be perfectly acceptable applied to other sectors, are therefore bound to produce many ‘false positives’ when they are applied to electronic communications, where technology generates substantial cost reductions over time.

In any case, any analysis of bundling policies in electronic communications should recognise how:

1. consumers are certainly used to purchase electronic communications products in bundles: traditional voice telephony offers included the provision of access, local and long-distance calls, and often of other services. The success of a bundled offer may thus depend on demand factors, and not upon price alone.
2. technological progress, both in the core and the access parts of electronic communications networks, is making increasingly inefficient the supply of individual services, and difficult to ascertain the cost of providing each service on a stand-alone basis.

4.3 Price Squeezes

The Discussion Paper doesn’t analyse the conditions that are deemed as necessary in order to demonstrate a price squeeze. A price squeeze is considered as a refusal to supply, but any attention is devoted to its analysis.

In our view, since price squeeze allegations occur much more frequently than predatory pricing ones, in particular in regulated industries, a much higher attention should be devoted to their analysis by the Commission.

It seems to us that the entire conceptual framework developed for the analysis of predatory pricing could easily be used also in the analysis of price squeezes.

In fact, in terms of analysis, a price squeeze is a particular case of a predatory pricing, that can occur when a competitor has to buy an essential facility from the dominant operator.

In order to produce evidence of a price squeeze it should be demonstrated that the commercial division of the dominant operator could not trade profitably if it had incurred the costs paid by its competitors to access a given essential facility.

Therefore, a first mandatory step that should be done in order to assess a price squeeze case consists in precisely identifying in the appropriate geographic area and time frame, the existence of an essential facility.

Essential facilities mean facilities of a public telecommunications transport network and service that:
(a) are exclusively or predominantly provided by a single or limited number of suppliers; and
(b) cannot feasibly be economically or technically substituted in order to provide a service

The Commission should clarify that if an essential facility can not be identified, a price squeeze can not occur.

Furthermore, in regulated industries, such as telecommunications, there are different forms of mandatory access that dominant operators are to supply in upstream markets. When assessing a price squeeze case, it should be clear that the appropriate mandatory form should be considered an essential facility, namely the one that requires the minimum use of the network of the dominant
operator and by which the least cost final service can be provided, depending on customer’s demand characteristics.

Telecom Italia believes that the document should give general but precise guidelines on how the test should be built.

The guidelines could be as follows:

- identify the facility that is essential for the provision of the service to the specific target of clients in the relevant geographic area;
- verify in which measure a competitor at least “as efficient as” the incumbent has to rely on this essential facility and therefore identify the cost of acquiring that essential facility by multiplying the price asked for the essential facility (usually a regulated price) by the quantity considered necessary ($C_{ef}$);
- identify other self provided activities (technical and commercial) that are necessary for the provision of the final service and evaluate their long run incremental costs ($C_{oa}$);
- If the price offered by the dominant operator doesn’t cover the sum of the cost paid by other firms for the essential facility and of the long run incremental costs incurred by the other “as efficient” firms for the other activities, then the offer should be deemed to generate a price squeeze.

In other words a price squeeze occurs when total revenues $TR < C_{ef} + C_{oa}$.

Telecom Italia suggests that a specific test for price squeezes, as it is proposed for bundling in the Discussion Paper, should be considered in the future guidelines.

5. Efficiency and Meeting Competition defences

It is positive that the Commission, in the Discussion Paper intends to consider whether the conduct of a dominant company generates efficiencies and whether the other conditions of article 81.3 are fulfilled, before assessing the abusive behaviour. In this sense TI appreciates the efforts made by the Commission to set out, section by section, the possible defences in terms of objective justifications and efficiency defences.

It is also positive that the Commission analyses the situations in which a meeting competition defence may apply.

Telecom Italia, even if it appreciates the Commission initiative, has to make some remarks about these possible defences.

First, we consider that reversing the burden of proof on undertakings is improper. The analysis of efficiencies and the analysis of competition (and of conditions offered by competitors of the dominant company) are part of the analysis that has to be carried out in order to assess an exclusionary abuse and can not be considered applicable once the exclusionary abuse has been assessed.

If the arguments for an efficiency or a meeting competition defence apply, the abuse doesn’t occur at all.

Secondly, once that the conditions in which these defences can apply are set, any other form based consideration should be eliminated.

We refer, in particular, to the evaluation that an efficiency defence shouldn’t apply if the dominant company has a market share higher than 75% (which hasn’t any objective justification) and to the evaluation that a meeting competition defence doesn’t apply when the dominant company prices
below AAC (without specific reasoning) and is unlikely to be applied if the dominant company prices above AAC.

According to the Commission’s approach “exclusionary conduct may escape the prohibition of article 82 in case the dominant company …can demonstrate that its conduct produces efficiencies which outweigh the negative effect on competition”. (§ 77).

Although the draft Guidelines acknowledge that dominant companies may benefit from the exemption of Article 81. 3, the actual treatment of efficiencies displays a hostile approach vis a vis efficiencies. The burden of proof for such an objective justification or efficiency defence will be on the dominant company.

It is still burdensome for a dominant company to demonstrate that efficiency is realized. To demonstrate the efficiency defence, the company must prove that the conditions set out in Article 81(3) EC are satisfied, with the result that there is an objective justification only if it were established that the four cumulative conditions are fulfilled.

When assessing that the efficiencies are likely to be passed on to consumers, the Commission considers it is highly unlikely that the exclusionary conduct of a dominant company with a market position approaching that of a monopoly (market share exceeds 75%) can be justified on the ground that efficiency gains would be sufficient to outweigh the anti competitive effects and benefit consumers [see § 90 and 92].

In this light, it’s a non sense that an efficiency defence, to be evaluated through an effects-based approach, can be excluded on the basis of formal considerations such as high market share (like 75%). This results in a formal limitation of the efficiency defence, without any economic ground.

In addition, in order to evaluate the possible benefits for consumers, long term consumer welfare and dynamic efficiencies should be specifically addressed; the current version of the Discussion Paper is geared towards static efficiencies and do not properly consider innovative and high technological markets.

Finally, according to § 82 and §85, it’s seems that MC and ED can be applied by dominant company to “defend” its own customers to the extent that they are interested by a competitor’s aggressive action. On the contrary, it cannot be used for expanding market share of dominant undertaking.

TI considers that the dominant operator should not be banned in principle from expanding market share, if it can be proved that it has been achieved through competition on the merits (e.g. to the higher quality of its products).

In any case, it should be clarified that, if a competitor launches an aggressive commercial offer towards an entire market, the dominant undertaking reaction directed to the same market has to be considered lawful.

It should also be clarified that if competitor’s price falls below AAC, dominant undertaking should at least be able to replicate competitor’s price.