



# European Commission priorities for action on dominant companies

On 3 December 2008 the European Commission adopted its 'Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings'. Here we comment on both that guidance and recent US developments in this area, and on the future outlook for companies with strong market positions.

On 3 December 2008 the European Commission adopted its 'Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings'. Commissioner Kroes stated that this 'should leave dominant undertakings in no doubt that they will find the Commission in their way wherever their conduct risks increasing prices, limiting consumer choice or dissuading innovation' and that such rules are crucial 'in times of economic difficulty such as these'.

To describe this document as 'long-awaited' would hardly do justice to its gestation period. Despite, or perhaps because of, this it is a considerably shorter and less detailed text than was originally expected when the review process opened formally in 2005. While some parts inevitably will be controversial, it is welcome insofar as it sets out the type of practices on which the Commission intends to focus its investigations and how it will analyse single-firm conduct in that context.

During this same period the US Department of Justice (DOJ) and Federal Trade Commission (FTC) also held hearings, intended to establish 'sound, clear, objective and administrable' standards for applying section 2 of the Sherman Act. Section 2, like article 82 of the EC Treaty, is intended to prevent companies with a high degree of market power from misusing that power. A few months ago that process concluded in an unusually acrimonious difference of opinion between the two agencies, with the DOJ publishing a policy statement from which a number of FTC Commissioners publicly dissociated themselves.

## New EU Guidance

The EU consultation was formally opened in December 2005 when the Commission's competition services published a 72-page staff Discussion Paper on its application of article 82 to exclusionary abuses of dominance. The Commission received well over 100 written responses from business, law firms, economics consultants and others, as well as a wealth of additional input through the many seminars and conferences at which the subject was debated. At a public hearing in June 2006, the Commission received broad support for its effort to review and summarise in a single document the state of law and policy in relation to article 82, to reflect an effects-based approach, which would take economic principles into account more consistently than previously. During the following two and a half years the Commission continued to be active in bringing individual infringement cases, but the publication of any overall enforcement guidance appeared to remain controversial.

The Guidance that has now emerged is expressly limited in a number of ways, not least in that it is explicitly said to be a statement not of the law, but rather of enforcement priorities, and of the framework of analysis that the Commission will apply in deciding whether to take action. Nevertheless, in some places it does appear to take a position on the law and in practice many EU national courts and competition authorities can be expected to refer to it when interpreting both article 82 and national equivalents.

Like the Discussion Paper, the Guidance covers only exclusionary abuse and not exploitative conduct. However, it is further limited in scope in that it deals only with single-firm dominance and not collective dominance. The Guidance is a third of the length of the Discussion Paper and there are a number of topics that were discussed at length in the earlier document but are barely (or not at all) mentioned in the Guidance. The Guidance is therefore at least as interesting for what it omits (such as refusal to licence intellectual property rights and aftermarkets) as for what it includes. It is open to debate whether such omissions reflect a view that such issues are not priority concerns, or were just too difficult to reach agreement on.

### **Dominance**

The Guidance starts by emphasising both the entitlement of dominant companies to compete on the merits and their 'special responsibility' not to impair competition. The function of article 82 is phrased in terms of benefit to consumers and business, which is to be seen as part of the wider EU-specific objective of internal market integration. Dominance is defined in wording taken from established case law, as being 'a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on a relevant market, by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers'. Three relevant factors are set out and examined in turn.

The first is the 'market position of the dominant undertaking and its competitors'. Market shares are said to 'provide a useful first indication... of the market structure'. Some might have preferred market shares to have been given less prominence, but they will certainly welcome the statement that dominance is unlikely to be found at a market share below 40 per cent, given that the Discussion Paper had suggested a threshold of 25 per cent. However, the Guidance stops short of establishing a 'safe harbour' for companies with a market share below 40 per cent. The second factor is 'expansion or entry', and it is made clear that this will be relevant only where it is of sufficient magnitude and timely enough to deter the allegedly dominant company from raising prices or limiting output. The third factor is 'countervailing buyer power', and for this to counter alleged dominance it is important that it be effective in respect of the market as a whole, and not just benefit one

group of customers. Overall, it appears that the market power threshold for the application of article 82 remains much lower than that for applying section 2 in the US.

### **The concept of abuse**

The main guiding principle for whether the Commission will take enforcement action is whether anti-competitive foreclosure is likely. There is no particular test that the Commission intends to apply to all types of conduct, though the 'as efficient competitor' test is relevant in pricing cases. A number of factors relevant to foreclosure are listed, which are the strength of the dominant position, barriers to entry, the market position of competing companies, and of customers and suppliers, the extent of the conduct in terms of time and sales affected, and any evidence of actual foreclosure. The counterfactual, whether the absence of the conduct in question or another realistic alternative, is also relevant. Finally, and more controversially, direct evidence of an exclusionary strategy is mentioned, as being 'helpful to interpret the dominant undertaking's conduct', whereas intention has until now normally only been relevant in a narrow category of predatory pricing cases. This underscores the importance for companies of avoiding the creation of documents using commercial language that could be misinterpreted.

The Guidance also indicates that the Commission will examine claims put forward by a dominant company that its conduct is justified, either because it is 'objectively necessary' or on the ground of efficiencies. The Commission puts the burden of proof in this area firmly on the dominant company and states that efficiencies arguments are unlikely to be accepted where the dominant firm's market position approaches monopoly level. The Guidance also sets out the specific efficiencies that may result from the different types of potentially abusive conduct. A notable omission in the Guidance is any reference to the extent to which potentially abusive conduct may be justified on the grounds that it is necessary to protect a dominant company's commercial interests.

### **Types of abuse**

#### **Exclusive dealing**

The Commission is most likely to take action against exclusive purchasing arrangements where they hinder actual or potential competitors from exercising a

competitive constraint, for example because the dominant company is an unavoidable trading partner, or because the exclusivity is of long duration.

As to rebates, conditional rebates are likely to be attacked where they foreclose competing firms from the market. However, the Commission recognises that conditional rebates are not uncommon and can benefit consumers. Rather than applying a per se rule, the Commission will look at whether the rebate system may hinder entry or expansion of competitors which are considered to be as efficient as the dominant company. This will generally be the case where the effective price is below average avoidable cost, and where it is higher other factors will be taken into account. It is clear that in setting enforcement priorities, the Commission regards retroactive rebates as more likely to be harmful than those that are incremental, and similarly that individualised rebates are more likely to be considered anti-competitive than are standardised ones. However, the Guidance leaves open the possibility that any of these types of rebate could in some circumstances be harmful.

#### **Tying and bundling**

The Guidance recognises that tying and bundling are common commercial practices that can benefit consumers and says that action will normally be taken against tying and bundling where it concerns two distinct products and is likely to lead to anti-competitive foreclosure. Most controversial here is perhaps the apparently static approach to customer demand, which some might consider inappropriate, particularly where innovative products, or those involving technological integration, are concerned. Where competing firms are selling identical bundles there will only be concern where pricing is predatory.

#### **Predatory pricing**

The discussion of predation focuses on whether the dominant firm has made an economic 'sacrifice', meaning that it has acted in such a way as to incur losses that it could have avoided. The Guidance states that this may occur even where pricing is above average avoidable cost, but there is little further discussion of such cases, nor much discussion of the relevance of predatory intent in this context. In predatory pricing cases the Commission will assess possible foreclosure by reference to 'as efficient competitors', but it will not

do this by mechanically calculating profit and loss, but instead considering all the market circumstances. On the controversial issue of whether proof of ability to recoup or of actual recoupment is required, the Guidance is nuanced, citing the *Tetra Pak* judgment as authority that such proof is not required, but also indicating that the Commission will focus on factors related to competition on the market during the period following the predation. It seems clear that predation remains easier to establish under this EU standard than under US law.

#### **Refusal to supply and margin squeeze**

The section on refusal to supply starts by asserting the general principle of contractual freedom and says that 'intervention on competition law grounds requires careful consideration', because of the need to preserve incentives to invest. It focuses on situations in which the dominant company competes on a downstream market with the potential buyer and sets out three cumulative factors that are likely to result in intervention, without any distinction as regards the subject of the refusal (goods, services, IP rights). These factors are that the refusal relates to a product or service objectively necessary to effective competition on the downstream market, that it is likely to lead to the elimination of effective competition on the downstream market, and that the likely negative effects of refusal on consumers outweigh the negative consequences for them of imposing an obligation to supply. This last balancing test appears especially difficult to apply and no real guidance is given as to how it is to be carried out.

#### **The US review**

The DOJ report 'Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act' is the culmination of a joint DOJ and FTC project that began in 2006 and included a series of public hearings, including oral testimony and voluminous written submissions from business, scholars and practitioners. It provides guidance on the way the DOJ will approach specific business practices that are sometimes challenged under section 2 of the Sherman Act. Throughout the report, the DOJ emphasises the need to identify standards that are administrable and will not over-deter potentially pro-competitive behaviour. The DOJ rejected the establishment of a market share safe harbour, but notes that no court has found monopoly power at a market

share less than 50 per cent. It concludes that a firm that has a market share above 66 per cent over a significant period of time can be rebuttably presumed to have monopoly power.

Like the Commission, the DOJ rejects generalised tests for determining the existence of a violation. Instead it adopts a number of conduct-specific tests for evaluating behaviour most frequently challenged as violating section 2. For example, the DOJ concludes that the modified per se rule that has historically been used to evaluate tying is unwarranted and could deter pro-competitive conduct. Instead, it suggest that tying should be prohibited only when it harms competition in a way that is disproportionate to any benefit from the tie. With respect to bundled discounts, the report suggests a safe harbour for certain categories of discounts. If the entire discount for the bundle is attributed to the product or products that both the alleged monopolist and its competitor offer, and the resulting price for that product exceeds the monopolist's average avoidable cost, the discount is presumptively lawful. If the bundled discount does not fall within this safe harbour, it would be prohibited only if it is shown to cause anti-competitive harm disproportionate to any pro-competitive benefit from the discount.

The report frequently employs this 'disproportionality' test when evaluating different types of single-firm conduct. The DOJ posits that conduct that can have both pro-competitive and anti-competitive effects should only be condemned if its likely anti-competitive effects *substantially* outweigh its likely pro-competitive benefits, and concludes that this test is the best way to ensure that the rules applicable to single-firm conduct are administrable but do not over-deter competitive conduct.

Although the report provides some clarification of the enforcement standards that the current DOJ will use to evaluate single-firm conduct, it also served to highlight the strong divergence in the approach of the two US enforcement agencies. While the FTC had participated in the hearings, it declined to join or endorse the report. Instead, a majority of the Commissioners issued a statement that was sharply critical of the DOJ's conclusions, in particular of the disproportionality test, which they argued distorts the rule of reason standard and would be difficult for a plaintiff to meet. They

said the standards set out by the DOJ 'would place a thumb on the scales in favour of firms with monopoly or near-monopoly power'. Thus firms with a dominant market position will have to consider not only the DOJ's views, but those of the FTC, in evaluating the risks of certain types of conduct. Moreover, President elect-Obama has suggested that he intends to adopt a more aggressive antitrust enforcement policy than that of the Bush administration. Also, there is no guarantee that the people he appoints to head the DOJ will agree with the report's analysis.

### What does this mean for companies with market power?

Controlling the unilateral behaviour of companies with high degrees of market power is fraught with difficulty. Despite the best efforts of policy-makers on both sides of the Atlantic, recent events potentially leave companies with strong market positions facing considerable challenges in establishing what commercial strategies they may legitimately follow. Though in some places it provides a useful summary, the new EU Guidance provides little real direction additional to what was already available in past case law, and the outlook, especially for international companies subject to both the EU and US regimes, remains uncertain. Indeed, such companies will often need to look to a variety of rules, including those of newly important jurisdictions such as China, to determine their conduct. What is certain is that, with a number of court cases in the pipeline, this will remain an area in constant development.

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