Chapter 8: Will Efficiencies Play an Increasingly Important Role in the Assessment of Conduct Under Article 102?

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After a considerable consultation process, the European Commission has finally issued the final version of its Article 102 guidelines,[1] largely analyzed in other chapters of this volume.[2] Among other things, the new Article 102 guidelines set out a two-step process for the identification of the Commission's enforcement priorities in assessing exclusionary conduct under Article 102 EC. Under the first step, the Commission must explain how the allegedly abusive conduct is likely to restrict competition and thereby harm consumers. Under the second step, the Commission will allow the undertaking to rebut this finding of a likely negative effect by showing that the conduct creates efficiencies which leave the consumers overall better off than before.[3]

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[1] Guidance on the Commission's enforcement priorities in applying Article 102 EC of the EC Treaty to abusive exclusionary conduct by dominant undertakings, C(2009) 864 final (hereafter the "Article 102 Guidelines") [2009] OJ C45/7.

[2] See Chapter 2 by Geradin and Chapter 6 by Art and Ibanez and Colomo in this Volume.

[3] Antitrust: Guidance on Commission enforcement priorities in applying Article 102 to exclusionary conduct by dominant firms – frequently asked questions, MEMO/08/761, question 2.

This paper focuses on the second step of the Commission's process of identifying enforcement priorities. Part I of this paper will briefly summarise the previous practice of the Commission and Community Courts in this area, and identify some possible explanations for why efficiencies historically have not played a significant role in the assessment of conduct under Article 102 EC. Part II of this paper will then examine the test to be applied by the Commission as set out in the Article 82 Guidelines. Finally, Part III of this paper will offer some conclusions on whether the Commission's approach is likely to lead to efficiencies playing an increasingly significant role in the assessment of conduct under Article 102 EC. The tentative conclusion reached is that efficiencies are unlikely to play a significant factor in the outcome of future cases.

I. The Role of Efficiencies in Previous Article 102 Cases

The Commission's remarkable winning record in Article 102 cases before the Community Courts, which has only increased in recent years, demonstrates that, at least on appeal, arguments based on claims that the Commission has neglected to consider efficiencies or objective justifications have met with little to no success. Of course, focussing on appeals reveals a theoretical sample bias in that the cases necessarily exclude any investigations whereby the Commission dropped proceedings after having been convinced of the validity of a defence that overcame its theory of a likely restriction of competition. However, anecdotal evidence, such as the general absence of any discussions of such cases by the Commission in the Annual Reports on Competition Policy or the tri-annual Competition Policy Newsletters, and the general absence of any discussions of cases by the lawyers responsible in the specialised competition law press, would appear to suggest that any such sample bias would be quite minimal.

Why has it been so difficult to justify conduct under Article 102 EC? Perhaps one reason is that arguments based on efficiencies and other objective justifications are generally presented as a defence against an existing claim of anticompetitive conduct. Indeed, dominant undertakings are not confronted with the need to provide any justification for their conduct unless an allegation is made that such conduct is anticompetitive (which can come in the form

of a Statement of Objections or a third party complaint). However, when such an allegation is made, it can be just as difficult for a dominant undertaking to justify conduct that is already seen as foreclosing competition as it would be to justify a hard-core cartel. In effect, efficiency-based arguments are treated as a request for an exemption,[4] an almost impossible burden to meet. Indeed, as the Court of First Instance put it, "because Article [102] of the Treaty does not provide for any exemption, abusive practices are prohibited regardless of the advantages which may accrue to the perpetrators of such practices or to third parties."[5]

This approach of considering efficiencies only after establishing that conduct is liable to foreclose competition has become firmly established in the case law. This is demonstrated by, in particular, the *Microsoft* case.[6] On appeal to the Court of First Instance, Microsoft introduced its challenge to the tying infringement by first identifying the efficiencies generated by its conduct. After having demonstrated these efficiencies, Microsoft then addressed the Commission's foreclosure theory. This approach allowed Microsoft to more easily contrast the proven efficiencies of the tie from the Commission's unproven market assumptions regarding its foreclosure theory. In rejecting Microsoft's appeal, the Court of First Instance eschewed Microsoft's structure and only considered Microsoft's efficiency arguments after it had concluded that the Commission met its burden of otherwise proving an infringement.

Another reason why dominant undertakings have found it historically difficult to justify conduct on the grounds of efficiencies, particularly cost-based efficiencies, may be that the traditional definition of a "dominant position" can only generate scepticism over whether any efficiencies will be passed onto customers. By definition, a dominant undertaking is able "to behave to an appreciable extent independently of its competitors, it customers and ultimately of consumers".[7] Under that view, it is not clear that a dominant undertaking would necessarily pass on efficiencies to customers.[8] This reasoning may explain, at least in part, the historically

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[4] Indeed, as demonstrated in Section II below, the Commission's approach to considering efficiencies in Article 82 proceedings is directly modelled on the test for an individual exemption under Article 101(3) EC.

[5] Joined Cases T-191/98 and T-212/98 to T-214/98 *Atlantic Container Line AB and Others v Commission* [2003] ECR II-3275 (para. 1112).

[6] See Chapter 5 by Komninos and Czapracka in this Volume.

[7] Case 27/76 *United Brands Company and United Brands Continentaal BV v Commission* [1978] ECR 207 (para. 65).

[8] Of course, such an analysis is flawed in that it assumes not only a correct assessment of "dominance" so defined, but also awareness by the dominant undertaking that it is in such a position. In practice, it may be quite

very sceptical view taken by the Commission[9] and Community Courts in response to efficiency arguments.[10]

The Court of First Instance in *Microsoft* also appears to add a further hurdle to an undertaking's ability to rely on efficiencies, making it even more difficult to justify conduct seen as exclusionary. In particular, the Court seemed to suggest that a dominant undertaking cannot rely on efficiencies when these efficiencies are specifically identified as giving rise to the anti-competitive harm. For example, Microsoft argued that offering a uniform platform resulted in greater efficiencies for third parties seeking to rely on technology in that platform. The Court of First Instance acknowledged that this "may have advantages" for some third parties, but rejected this efficiency because such uniformity was "precisely one of the main reasons why the Commission correctly took the view that the bundling led to the foreclosure of competing media players".[11] Thus, the Court concluded that "Microsoft is not entitled to rely on" this efficiency claim.[12]

Even assuming that these conceptual problems can be overcome, dominant undertakings face further hurdles in justifying their conduct because they must demonstrate that their conduct is no more restrictive than necessary to achieve these efficiencies. This problem can perhaps best be illustrated by considering the Commission's treatment of discount and rebate schemes. On the one hand, the Commission has generally recognised that discounts and rebate schemes may reflect efficiencies. On the other hand, however, the Commission has also subjected dominant undertakings to a very demanding test to justify the particular features of its discount or rebate scheme. This is shown by, for example, the following statement from former Competition Commissioner Van Miert :

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rare that a company believes itself to be in a position whereby it can behave independently of its competitors, customers and consumers, and that, e.g., it need not strongly compete on price.

[9] In other contexts, such as the application of Article 81 EC, the Commission has directly questioned whether efficiencies are passed on to customers in situations where there is less intensity of competition. *See, e.g.*, Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, [2001] OJ C3/2 (point 34).

[10] This is in contradiction with the lessons from the economic approach to exclusionary abuses as presented, for instance, in Chapter 1 by Etro and Kokkoris in this Volume.

[11] Case T-201/04 *Microsoft v Commission* [2007] ECR II-3601(para. 1151).

[12] *Id.*

"According to European Court of Justice jurisprudence, the only rebates or incentives which a dominant company may grant are rebates which pass specific savings on to its customers. The most common example of an acceptable rebate to a dominant company's customer is a volume discount if indeed greater volumes are cheaper to supply to that customer." (Emphasis added.)[13]

Although the application of such a demanding test is in itself problematic for dominant undertakings wishing to justify their discount or rebate schemes, the situation is made much worse by the fact that the Commission has at times taken different positions on whether certain aspects of such schemes are permissible or not.[14] One aspect of such schemes on which the Commission has not taken a consistent line is the period of time deemed appropriate for aggregating purchases to determine the applicable discount or rebate. In general, the longer this reference period, the more likely it is that the Commission will reject an efficiency justification based on a claim that savings are being passed onto customers. While it is sensible to conclude that the permissible amount of time will differ depending on the products involved, there are some inconsistencies in the Commission's approach which would not seem to be easily explained by such differences. For example, the Commission appeared to allow reference periods of up to one year[15] in some cases. Subsequently, in *Michelin II*, the Commission reversed its position, claiming that "the Court of Justice has ruled against the granting of quantity rebates by an undertaking in a dominant position where the rebates exceed a reasonable period of three months,"[16] a statement that obviously was intended to rule out any reference period of longer than three months regardless of the specific products at issue.[17]

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[13] Statement by Commissioner Karel Van Miert – 'Fidelity bonuses by dominant companies are simply not on', MEMO/99/42.

[14] Indeed, the problem of consistency is not limited to discount and rebate schemes. See, e.g., Chapter 7 by Waelbroeck on the assessment of efficiencies under Article 102 and the Commission's Guidance Paper in this Volume.

[15] See the Commission's Article 19(3) Notices in *British Gypsum* [1992] OJ C321/9-12 (in this regard, *see also* the Court of First Instance's discussion of the particular facts of British Gypsum in Case T-203/01 *Manufacture Française des Pneumatiques Michelin v Commission* [2003] ECR II-4071 (para. 84)). It also appears that a one-year aggregate period was found to be permissible in the Commission's settlement with Interbrew. Commission closes probe concerning Interbrew's practices towards Belgian beer wholesalers, IP/04/574.

[16] *Michelin II* [2002] OJ L143/1, recital 216.

[17] On appeal, the Court of First Instance clarified that such a bright-line rule had not been adopted by the Community Courts. Case T-203/01 *Manufacture Française des Pneumatiques Michelin v Commission* [2003] ECR II-4071 (para. 85).

II. The Role of Efficiencies Under the Article 82 Guidelines

One of the purposes underlying the Article 102 Guidelines was to allow for the greater use of efficiencies in the Commission's analysis. Indeed, as Commissioner Neelie Kroes stated in 2005, "we must find a way to include efficiencies in our analysis."[18]

In its Article 102 Guidelines, the Commission notes that a dominant undertaking may justify its conduct "either by demonstrating that its conduct is objectively necessary or by demonstrating that its conduct produces substantial efficiencies which outweigh any anticompetitive effects on consumers".[19] With respect to the latter type of justification, the Article 82 Guidelines state that dominant undertaking will be expected to demonstrate such efficiencies "with a sufficient degree of probability, and on the basis of verifiable evidence".[20]

The approach identified in the Article 102 Guidelines is expressly compared to the four requirements for an exemption under Article 101(3) EC.[21] In particular, the dominant undertaking will need to show that the following cumulative test is met:

(i) the efficiencies have been, or are likely to be, realised as a result of the conduct (e.g., there are technical improvements in the quality of goods, or a reduction in the cost of production or distribution);

(ii) the conduct is indispensable to the realisation of those efficiencies (i.e., there are no less anti-competitive alternatives to the conduct in question that can produce the same efficiencies);

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[18] Preliminary Thoughts on Policy Review of Article 82, SPEECH/05/537.

[19] Article 82 Guidelines, para. 27.

[20] *Ibid.*, para. 29.

[21] Article 82 Guidelines, n.22. *See also* Preliminary Thoughts on Policy Review of Article 82, SPEECH/05/537.

(iii) the likely efficiencies outweigh any likely negative effects on competition and consumer welfare in the affected markets, and

(iv) the conduct does not eliminate effective competition[22] "by removing all or most existing sources of actual or potential competition".

One interesting aspect of this test is that there is no express requirement that the efficiencies must be passed on to customers or consumers. Thus, for example, this test would not appear to exclude conduct that generates efficiencies which are enjoyed only by the undertaking's shareholders. In theory at least, conduct that results in significant cost savings which are not passed onto customers could therefore still justify conduct that has a limited foreclosure effect.

However, it appears that the Commission may intend to read such a requirement into the fourth part of the test. In this regard, the Article 102 Guidelines provide:

"Rivalry between undertakings is an essential driver of economic efficiency, including dynamic efficiencies in the form of innovation. In its absence the dominant undertaking will lack adequate incentives to continue to create and pass on efficiency gains." (Emphasis added.)[23]

This reasoning could be read to undermine the accepted definition of a dominant position. As noted in Section I of this paper, dominant undertakings by definition can act to an appreciable extent independently of their competitors, customers and ultimately of consumers. Accordingly, one cannot assume that a dominant undertaking will pass on cost savings derived from efficiency gains to its customers. If an undertaking is passing on these cost savings, this would suggest that it is either not acting in the interests of its shareholders, or, more probably, that it is not dominant in the first place.

Another interesting aspect of this test is that the Commission has modified the "indispensability" element from the manner in which it was applied in its *Microsoft* Decision. As noted in Part I, Microsoft argued that tying Windows Media Player was an indispensable

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[22] The Article 102 Guidelines help confirm that the Commission has apparently moved away from its previous position that the fourth part of the test under Article 101(3) precluded individual exemptions for dominant undertakings. *Cf.* Guidelines on the applicability of Article 101 of the EC Treaty to horizontal cooperation agreements, [2001] OJ C3/2 (point 36).

[23] Article 102 Guidelines, para. 30.

condition for simplifying the work of applications developers, since it is more efficient for them to call on functionality in a platform than to redistribute the functionality themselves. The Commission rejected this argument, concluding that applications developers could still rely on functionality offered by Microsoft even if it was not uniformly made available in Windows.[24] What the Commission ignored, however, was that Microsoft argued that it was more efficient for developers to rely on the platform, and that platform uniformity was therefore indispensable to producing these greater efficiencies (a claim that the Commission did not seek to rebut in its Decision).[25] Thus, the Commission seemed to conclude that efficiency justifications could be rejected if there were less restrictive means of achieving broadly similar efficiencies, even if they did not result in the same level of efficiencies.

In the Article 102 Guidelines, however, the Commission has apparently now rejected this approach, noting that the less anti-competitive alternatives must produce "the same efficiencies".[26] Interestingly, the Commission does not appear to recognise this turnabout, as it refers to Microsoft as an example of its new approach in the press release accompanying the initial adoption of the Guidelines.[27]

III. Conclusion: Will the Article 102 Guidelines Lead to a Greater Reliance on Efficiencies in Dominance Cases?

There is no reason to believe that the Article 102 Guidelines will lead to a greater reliance on efficiencies in assessing dominance cases unless the Guidelines reflect a change in the Commission's analysis. Put simply, if the Commission's analysis of cases is the same before and after the adoption of the Article 102 Guidelines, then efficiencies will likewise play the

[24] *Microsoft* [2007] OJ L 32/23 (summary only; a complete non-confidential version of the decision is available at: http://ec.europa.eu/competition/antitrust/cases/decisions/37792/en.pdf), recital 965.

[25] As demonstrated in Part I, the Court of First Instance also rejected this efficiency argument, concluding that it could not be taken into account because it led to the claimed foreclosure.

[26] Article 102 Guidelines, para. 30.

[27] Antitrust: consumer welfare at heart of Commission fight against abuses by dominant undertakings, IP/08/1877.

same role in the Commission's assessment after the adoption of the Guidelines as they did beforehand.

This raises the fundamental question whether the Article 102 Guidelines genuinely reflect a change in analysis. It would seem that the answer to this question is no. Indeed, the Commission has stated this directly in the Frequently Asked Questions accompanying the initial adoption of the Guidelines:

"7. With this shift to a more effects-based approach, is the Commission admitting that some of its decisions adopted in the past were flawed?

"No. The Commission should always work to improve its decisions and its policies, if only to adapt them to changes in market realities, such as those caused by innovation and technological development.

"As mentioned above, the Commission has effectively already applied an effects-based approach in its latest Article 102 cases. Like in these cases, and in application of the Guidance Paper, the Commission will certainly argue its cases by resorting to more refined economic analysis than it did in the past. <u>However, this does not mean that the decisions it has taken in the past were wrong, only that the argumentation would be different if it dealt with those cases today.</u>

"The approach set out in the Guidance Paper will be fully applied to future cases, i.e. to those cases where the Commission has not yet initiated proceedings for the application of a decision to find and terminate an infringement, to order interim measures or to agree on binding commitments." (Emphasis added.)[28]

Thus, what the Commission appears to be saying is that while its approach and arguments may be different today, its overall analysis will remain the same (and thus its past practice remains unchanged). This view is also echoed by the change in scope to the Article 82

[28] Antitrust: Guidance on Commission enforcement priorities in applying Article 102 to exclusionary conduct by dominant firms – frequently asked questions, MEMO/08/761.

Guidelines. Originally, the Article 102 review process was intended to give added clarity on the application of Article 102.[29] However, the Commission ultimately decided on a narrower scope, and the Article 102 Guidelines only identify the general framework of analysis "which the Commission employs in determining whether it should pursue cases" and "help undertakings better assess whether certain behaviour is likely to result in intervention".[30] They expressly are "not intended to constitute a statement of the law".[31] Since the Article 82 Guidelines do not constitute a statement of the law, they obviously cannot represent any change in analysis.

There is also another reason to believe that the Article 102 Guidelines will not lead to a greater reliance on efficiencies. As in previous cases, efficiencies will only be considered as a second step, after the Commission has already explained how the allegedly abusive conduct is likely to restrict competition and thereby harm consumers. Thus, the dominant undertaking will still effectively need to defend itself against a finding that it has engaged in conduct harmful to consumers, a task that has historically proven to be been next to impossible.

Rather than merely confirming its existing analysis, it therefore would have been more useful for the Commission to examine why efficiencies have not historically played a significant role in its analysis, and consider possible solutions to that problem. One obvious defect in the approach followed thus far is the significant imbalance between the way in which alleged anti-competitive effects are assessed and that in which efficiencies are assessed. Indeed, when weighing up anti-competitive effects against efficiencies, the Commission has significantly tipped the scales in favour of finding an infringement. Whereas anti-competitive effects can be presumed without any supporting quantitative evidence,[32] efficiencies are

[29] *See, e.g.,* Submission of the European Commission to the OECD Directorate for Financial and Enterprise Affairs – Competition Committee, DAF/COMP(2007)43, p. 60: "Issuing guidelines would thus bring clarity to businesses in an area where many commentators feel that the Commission's policy is not sufficiently transparent."

[30] Article 102 Guidelines, para. 2.

[31] *Id.*, para. 3.

[32] *Id.*, para. 19.

subject to a cumulative four-part test, each part of which must be established "with a sufficient degree of probability, and on the basis of verifiable evidence".[33]

Until the Commission and Community Courts require a more balanced approach between the treatment of anti-competitive effects and efficiencies/objective justifications under Article 102, it seems unlikely that efficiencies will play an increasingly significant role in the Commission's actual assessment of such cases.

[33] *Id*., para. 30.