

Some Critical Comments on the Commission's Guidance Paper on art.82 EC

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On the 3rd of December 2008 the European Commission (“Commission”) published its long-awaited “Guidance on the Commission’s Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings” (“Paper”). In its Press Release the Commission notes that the “document provides for the first time comprehensive guidance to stakeholders.....as to how the Commission uses an effects-based approach to establish its enforcement priorities under Article 82 in relation to exclusionary conduct. The guidance paper outlines the analytical framework that the Commission employs.....when assessing the most commonly encountered forms of exclusionary conduct such as exclusive dealing, rebates, tying and bundling, predatory practices, refusal to supply and margin squeeze” by firms in a dominant position.

The Guidance, which was preceded by the 2005 DG-COMP Staff Discussion Paper (DP) on reforming decisional procedures for art.82 EC exclusionary conduct by dominant firms, was particularly needed as the 2005 Paper and a number of recent (sometimes controversial) decisions, have established the Commission’s intention to apply an economics or effects based approach to its assessment but there have been up to now no clear formal guidelines concerning the Commission’s exact objectives and the legal standards to be applied in enforcement. The fact that the Paper “outlines a general framework that the Commission will apply to assess... allegedly abusive conduct” under art.82 EC is in principle very welcome. However, a number of important shortcomings severely limit, in our view, the potential value of the Paper.

Here we would like to concentrate on three specific weaknesses of the guidance paper:

1. Unclear articulation of the Commission’s objectives given its purported aim to adopt an effects-based approach in its decision procedures.
2. While the adoption of an effects-based approach is in our view *generally* welcome, in the Paper: (i) important considerations relevant to the optimal selection of decision

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procedures are not taken into account and (ii) potential efficiencies are not assigned the importance that they should have.

3. The Paper's formulation of legal standards for specific "abuses" may in fact lead at least in some cases to a substantial increase in legal uncertainty.

Below we discuss each one of these in turn.

1. The guidance paper does not provide a sufficiently clear statement as to the objectives of the Commission when assessing potentially abusive conduct under art. 82. This is however extremely important in order to guarantee a minimum of legal certainty when an economics/effects-based approach to assessment is adopted. Under a *Per Se* (formalistic) approach to enforcement a competition authority either allows or disallows an entire class of actions (or conducts) on the basis of some formal characteristics of these actions. Whatever the presumption for deciding to classify a certain class of actions as legal or illegal is then not important² in terms of its impact on firms' understanding about what will be the outcome were they to be investigated. Under an effects-based approach, on the other hand, in order for a firm to be able to form a judgment about whether its conduct will be allowed or disallowed it has, at a minimum, to know the objective or standard (the "substantive standard") on the basis of which the authority decides to allow or disallow. The latter could be consumer welfare or total welfare, or include other considerations such as the impact of the action on competitors, or on employment, or on SMEs, or even on the environment etc.

The Paper is not as clear as it should be on what the Commission's substantive standard will be³. Thus, in para. 5 the Paper states that the Commission "will focus on those types of conduct that are most harmful to consumers"⁴. Then, in the next para 6, it states that the emphasis will be "on safeguarding the competitive process in the

² This presumption will of course be important in selecting whether a *Per Se* rule should be used and which *Per Se* rule (one that allows or one that disallows the entire class of actions).

³ John Vickers (2005) discusses three tests for deciding whether a practice is anti-competitive under art.82 EC: the sacrifice test, the as-efficient competitor test and the consumer welfare test.

⁴ This raises another very important issue: whether consumer rather than total welfare should be CAs substantive standard. Some authorities are already using a total welfare standard (e.g. the CAs in Canada and New Zealand) and there is currently quite an intense debate on this issue, with some eminent economists arguing for a total welfare standard (e.g. Carlton (2008)). As he notes "perhaps the most significant practical problem with a consumer surplus standard (relative to a total surplus one) is that, as commonly applied, it tends to favour short-run price reductions over long-run efficiency gains".

internal market and ensuring that undertakings which hold a dominant position do not exclude their rivals by other means than competing on the merits...”. Nowhere in the Paper is the concept of competitive process or the concept of competition on the merits precisely defined⁵ nor, most importantly, is it made clear anywhere exactly how the concepts of harm to the competitive process and harm to consumers are related and which standard will take priority under any given circumstances.

In paragraph 19 of the Paper the Commission does reiterate that its aim is to protect consumer welfare and does link the concept of “anticompetitive foreclosure” directly to consumer welfare. The Press Release, on the other hand, states that the Commission’s focus will be “on protecting consumers, on protecting the process of competition and not on protecting individual competitors”. The confusion is magnified and becomes more serious by the fact that when we turn to look at how the Commission proposes in the Paper to handle specific potentially abusive business conduct we find little guidance as to how the Commission will assess whether these will also produce consumer harm when they have exclusionary effects. There is quite a lot of discussion about the conditions that will generate exclusion but much less about the conditions that will make it likely that consumer harm will also result. In this respect the Paper has not, unfortunately, improved on the Commission’s 2005 DP which, while stressing the unifying principle of consumer welfare, did not pay enough attention “to the causal relationship between harm to competitors and harm to competition, and to which screens could be used in order to dismiss cases in which this causal relationship is likely to be absent”⁶.

2. With the guidance paper the Commission aims to articulate an economics or effects based approach to art. 82 cases, that will be “fully applied to future cases”, thus converging to the approach governing the assessment of collusion and relevant restrictive business practices and mergers. Adopting an effects-based approach implies that the Commission rejects for the type of business conduct examined by

⁵ It could be suggested that the second part of the sentence – “ensuring that undertakings which hold a dominant position do not exclude their rivals by other means than competing on the merits” – explains what “safeguarding the competitive process” means but then the second part of the sentence should be preceded by the word “by” not by the word “and”. Of course, even if one accepts this suggestion one is left with the main problem which is that of interpreting “competition on the merits” and then carefully relating this, or its absence, to “consumer harm”.

⁶ D. Spector (2006), p. 162.

art.82 the use of *Per Se* rules⁷. This in turn implies that such conduct is neither thought to be always or almost always harmful so as to warrant a *Per Se Illegality* standard (such as in the case of, for example, price fixing agreements) nor is it thought to be always or almost always benign so as to warrant a *Per Se Legality* standard. Instead it is thought that the conduct may have effects that will be potentially harmful but also will give rise to efficiencies and that a balancing of harmful and beneficial effects is needed in order to decide its final effect.

However, in the form proposed in the Paper, the Commission's adoption of an effects-based approach has at least two major shortcomings: (i) it relies on an incomplete analysis of optimal legal standard selection and (ii) it treats potential efficiencies in a very asymmetric way relative to potentially harmful effects, though there is no justification of this in current economic thinking, nor indeed is any offered in the Paper. Concretely:

- (i) The adoption of such an approach and, more specifically, the adoption of the legal standards that the Commission proposes for the assessment of the specific business practices discussed in the Paper, is based on an incomplete analysis. To start with, the choice between an effects-based and a *Per Se* approach and that between alternative legal standards depend on a careful comparison of the decision errors made. A formal analysis of decision errors under alternative legal standards⁸ suggests that this involves a comparison of the *quality of the model/analysis* available to the Competition Authority (CA) in undertaking an effects-based investigation with the *strength of presumption of legality/illegality*. The *quality of the model/analysis* depends on the propensity to make Type I (false convictions) and Type II (false acquittals) errors. The *strength of the presumption of legality/illegality* depends on the frequency with which actions are anti-competitive, the degree of harm they cause if they are and the degree of benefit they create if they are pro-competitive. It is certainly not true in general that under effects-based legal standards decision errors will be lower than under *Per Se* legal standards⁹.

⁷ There are some exceptions to this: for some rather extreme actions such as preventing customers from testing a rival's product or paying distributors to delay the introduction of a rival's product the Commission is essentially proposing a *Per Se Illegality* approach (para.21 of Paper).

⁸ See Katsoulacos and Ulph (2008a).

⁹ As shown in Katsoulacos and Ulph (2008a, b).

Further, a full welfare analysis makes clear that it is not just decision errors that must be taken into account. Decision errors affect only the welfare consequences of the CA's procedures on the cases that come to its attention. A CA's procedures could also affect firms which do not come to its attention, for example by influencing the decision of a firm to engage in potentially anti-competitive actions. These *indirect/behavioural/deterrence* effects could potentially have much more significant welfare effects than the *direct/decision* effects. So the *indirect effects* of different decision procedures adopted by a CA on the behaviour of firms, when the latter are deciding whether or not to take a business action, should be a very important consideration when selecting among alternative procedures.

A welfare analysis of these indirect effects also shows that it is important to take account of certain other *procedural* features of a CA's operations – the coverage rate (i.e. the fraction of actions investigated by the CA), delays in decision-making, and the penalty regime. These procedural factors enter explicitly into the welfare comparison of different legal standards.

The importance of deterrence and procedural factors is shown in Katsoulacos (2008) who applies the above framework to the analysis of legal standards for refusals to license intellectual property rights and to the recent decision by the European Commission and the Court of First Instance in the *Microsoft* (2007) case. Applying a full welfare analysis, Katsoulacos (2008) shows that either a *Per Se Legality* standard should be used to handle such refusals, or for cases involving interoperability information, the “exceptional circumstances test”¹⁰ would be the most appropriate test *because* of its superior indirect / deterrence effects.

- (ii) While the Commission purports to advance an effects-based approach, its reading of the economics literature seems to be rather one-sided: the Paper concentrates quite heavily on the potentially harmful implications of conduct and much less on potential efficiencies. Thus, the discussion of efficiencies omits or just touches on a very large number of potentially beneficial effects that the economic literature has identified especially for tying/bundling, refusal to supply and exclusive dealing practices. It is

¹⁰ See on this Ahlborn C, D. Evans and Jorge Padilla, (2005).

revealing that in the 26 page (89 paragraph) Paper efficiencies are discussed in paragraph 29 and then, in the discussion of specific “abuses”, in paragraphs 45, 61, 73 and 89, taking a total of about one page of the document. It is clear from para. 29 - describing the conditions for efficiencies to be a potential justification - that the Commission is taking a stance on efficiencies that is reminiscent of the exception criteria under para. 3 of art.81 EC. This makes it extremely hard for a dominant company to succeed in having its conduct allowed on efficiency grounds¹¹. This may be an appropriate approach for art.81 EC presumptively harmful practices but it is not so for art.82 EC “abuses” for which current economic thinking suggests that they are presumptively (i.e. on average or *prima facie*) benign and thus presumptively legal.

3. Considering the effects-based decision procedures that the Commission proposes for the specific practices discussed in the Paper we find that, as already noted above, the analysis of potentially harmful effects concentrates on issues of exclusion and not on issues of consumer harm. What is also important, and we wish to stress here, is that the *assessment criteria proposed will make it very difficult for firms to identify whether their conduct will be classified as harmful or as benign by the Commission*. This is particularly true for refusal to supply practices and generally it is a factor that will lead to a substantial increase in *legal uncertainty*. The Commission does not seem to give weight in this respect to appeals by eminent commentators such as John Vickers (2007) who have stressed the importance of “predictability” (and of accountability and administrability) in the enforcement of competition law and have argued against discretionary decision making by CAs¹².

The recent economic literature on optimal decision and enforcement procedures when decision rules are imperfect and subject to Type I and Type II errors, has formalized the notion of legal uncertainty and has made clear how the cost of this legal uncertainty can be formally measured. Specifically, the welfare cost of legal uncertainty that can be produced by an effects-based approach can be measured by the difference in welfare when firms are deterred “correctly”; i.e. through correctly anticipating how the authority will assess their own conduct (as under *Per Se*), and

¹¹ The same point is made by the White & Case “Insight”; Newsflash on the Commission’s guidance paper published on December 3, 2008.

¹² Vickers (2007), p.8.

when firms are deterred on the basis of their information about what on average the authority has done in the past when investigating practices similar to theirs (because they cannot correctly anticipate exactly how their conduct will be assessed by the CA)¹³. In the literature, the first case is referred to as “marginal” and the second case as “average” deterrence¹⁴. Under average deterrence the fraction of firms deterred will be the same irrespective of the type of their conduct (harmful or benign). A firm whose conduct is benign will then perceive that its conduct will be disallowed with higher probability than with marginal deterrence. A firm whose conduct is harmful will perceive that its conduct will be disallowed with lower probability than with marginal deterrence. Considering practices that are *prima facie* benign the cost of legal uncertainty will be higher: (a) the greater the difference between the fraction of firms/conducts deterred under average deterrence and the fraction of benign conducts that would be deterred under marginal deterrence; (b) the greater the difference between the fraction of benign conducts and the fraction of harmful conducts that would be deterred under marginal deterrence; (c) the more accurate the authority’s model in identifying benign and harmful conduct.

To conclude, while the adoption of an effects-based approach in the assessment of unilateral conduct is long due, it is regrettable that after years of practice, internal reflection and public consultation, the Commission’s Communication has still not been able to offer more adequate guidance to the business community as to how the Commission will tackle potentially abusive conducts under art.82 EC.

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¹³ This would certainly be true in the extreme case that Vickers (2007) calls “discretionary decision making” by a CA “based on whatever is thought to be desirable in economic terms case by case”. *Note that an effects-based approach need not necessarily produce legal uncertainty*, as when the CA uses clearly specified models and criteria that allow firms to anticipate correctly how their conduct will be assessed – in the sense of correctly anticipating when the conduct will be allowed or disallowed depending on whether it is harmful or benign.

¹⁴ See Immordino and Polo (2008) and Katsoulacos and Ulph (2008b,c).

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