Konkurrensverket Working Paper Series
in Law and Economics

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Working Paper 2013:1

KONKURRENSVERKET
Swedish Competition Authority

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Konkurrensverket Working Paper 2013:1
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Konkurrensverket, May 2013

The Role of the ‘Equally Efficient Competitor’ in the Assessment of Abuse of Dominance

Martin Mandorff and Johan Sahl[1]

Abstract

In a series of recent cases – most notably in *TeliaSonera*[2] and *Post Danmark*[3] – the equally efficient competitor principle[4] has been explicitly recognised by the Court of Justice of the EU; more clearly so than by courts in the US, where the principle originates. However the exact scope of application of the principle in the EU remains to be defined. While its use in cases concerning predatory pricing and margin squeeze appears to be settled, it is still unclear to what extent the standard applies to other price-based forms of exclusion. And is the principle at all useful in the assessment of non-price-based exclusionary conduct? This article discusses the conceptual basis for the equally efficient competitor principle, and attempts to define its role in the assessment of exclusionary abuse in the EU.

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2 *Konkurrensverket v TeliaSonera Sverige AB* (Case C-52/09) [2011] ECR I-527.

3 *Post Danmark A/S v Konkurrencerådet* (Case C-209/10), judgment of 27 March 2012 (not yet reported).

4 Also known as the ‘as efficient competitor’ principle, or test.

Introduction

Finding a single, unifying principle for the assessment of exclusionary abuse is arguably the holy grail of competition law. The difficulty lies in the contradiction inherent in all monopolisation rules – to strive to safeguard rivalry by curtailing it, or as Lord Bowen found in the seminal *Mogul* case of 1889:

> 'To say that a man is to trade freely, but that he is to stop short at any act which is calculated to harm other tradesmen, and which is designed to attract business to his own shop, would be a strange and impossible counsel of perfection.'[5]

While *Mogul* effectively removed exclusionary conduct as an offence in English law for more than half a century, modern competition law explicitly recognises the violation, although it still grapples with the logic of this 'strange and impossible counsel of perfection'.

In attempts to define an underlying logic to the prohibition of exclusionary abuse, three main principles (or variations thereof) have been put forward over the last few decades: the *consumer welfare test*, the *no economic sense test*, and the *equally efficient competitor test*.[6] The aim has been to avoid using a plethora of different rules for different types of unilateral conduct, allowing firms to predict the legality of conduct that is not easily classified, as well as improving the consistency and accuracy of enforcement.[7] The latter objective is often phrased in terms of designing rules that minimise the occurrence of false positives (over-enforcement) and false negatives (under-enforcement).[8]

The *consumer welfare test* directly balances all effects on a case by case basis, and deems the investigated conduct exclusionary if it 'reduces competition without creating a sufficient improvement in performance to fully offset these potential adverse effects on prices and thereby prevent consumer harm'.[9] Offering no simplifying standard but a full inquiry into the welfare effects in each particular case, this approach has been criticised for not being administrable, imposing undue burden and uncertainty on firms, as well as potentially biasing findings towards short-run effects (which are easier to measure).[10]

The *no economic sense test* – and the closely related *profit sacrifice test* – simplifies the inquiry by considering only the objective *intent*, or rationale, of the conduct in question: it is deemed exclusionary if it 'would make no economic

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[5] *Mogul Steamship Co v McGregor, Gow, & Co* (1889) 23 QBD 598, affirmed [1892] AC 25.

[6] AD Melamed, 'Exclusive dealing agreements and other exclusionary conduct—Are there unifying principles?' (2006) 73(2) *Antitrust Law Journal* 375.

[7] Ibid, at pp 384–385.

[8] To identify these errors, an overall objective has to be defined. This objective is often defined as consumer welfare or total welfare.

[9] SC Salop, 'Exclusionary conduct, effect on consumers, and the flawed profit-sacrifice standard' (2006) 73(2) *Antitrust Law Journal* 330.

[10] US Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act* (2008) (the DOJ Report), at pp 36–38. Subsequently withdrawn.

sense for the defendant but for its tendency to eliminate or lessen competition'.[11] This approach has been criticised both for its tendency to yield false positives, calling into question for example above-cost price cuts and innovation, as well as false negatives in situations where conduct is independently profitable, but nevertheless gives rise to substantial exclusionary effects.[12]

In contrast to this intent-based approach, the *equally efficient competitor test* focuses on the *effects* of the conduct: it is deemed exclusionary if it is 'likely in the circumstances to exclude from the defendant's market an equally or more efficient competitor', thus bypassing the question of rationale.[13] This test has gained particular traction in the EU as of late, in a series of margin squeeze cases,[14] as well as *Post Danmark*, a selective pricing case.

The equally efficient competitor test's scope of application, its usefulness and appropriateness to various types of conduct is our focus in this article. We briefly describe the principle's roots in law and economics, its origins in US academic debate and antitrust enforcement; we then discuss its adoption in EU case-law and, finally, we conclude by discussing its scope and applicability as we see it.

The origins of the equally efficient competitor

While the US prohibition against monopolisation dates back to 1890 and the Sherman Act, it was especially in the period following the Robinson-Patman Act of 1936 that exclusionary abuse was litigated on a wide scale.[15] This was the 'populist era', when enforcement aimed to protect small firms from being out-competed on price by larger ones.[16] The courts focused mainly on whether conduct was intended to harm rivals,[17] using undefined formulae to identify abuse such as 'below-cost pricing' and 'ruinous competition'.[18]

The problem with this intent-based approach was that, since the very essence of competition is to attempt to take business away from one's competitors, the case-law offered no principle that could distinguish pro-competitive from exclusionary conduct, with the resulting tendency towards over-deterrence. The risk that enforcement could be chilling competition was further aggravated by instances of

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11 Brief for the US and the FTC as Amici Curiae Supporting Petitioner at 15; *Trinko*, 540 U.S. 398 (2004) (No 02-682); GJ Werden, 'Identifying exclusionary conduct under section 2: the "no economic sense" test' (2006) 73(2) *Antitrust Law Journal* 413.

12 DOJ Report op cit n 10, above, at pp 39–42; E Elhauge, 'Defining better monopolization standards' (2003) *Stanford Law Review* 267; Salop op cit n 9, above.

13 RA Posner, *Antitrust Law* (University of Chicago Press, 2001), at p 195 (Posner 2001).

14 *Deutsche Telekom v Commission* (Case C-280/08 P) [2010] ECR I-9555, *TeliaSonera* see n 2, above, and *Telefónica SA and Telefónica de España SAU v Commission* (Case T-336/07), judgment of 29 March 2012 (not yet reported) (appeal pending, Case C-295/12 P).

15 WE Kovacic, 'Intellectual DNA of modern US competition law for dominant firm conduct: the Chicago/Harvard double helix' (2007) *Columbia Business Law Review* at p 17.

16 P Bolton, JF Brodley, and MH Riordan, 'Predatory pricing: strategic theory and legal policy' (1999) *Georgetown Law Journal* 88 at p 2250.

17 Elhauge op cit n 12, above, at p 268.

18 P Areeda and DF Turner. 'Predatory pricing and related practices under Section 2 of the Sherman Act' (1975) *Harvard Law Review* 699, at p 699.

prosecution of monopolisation as a criminal offence.[19]

A test introduced by the Supreme Court in *Grinnell* in 1966[20] defined exclusionary abuse as 'the willful acquisition or maintenance of [monopoly power] as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident'. But this added little clarity as there was no standard by which to judge terms such as 'superior product' or 'business acumen'.[21]

By the mid-1970s, the Chicago and Harvard schools, starting from very different viewpoints, began to converge on the need for a more principled approach.[22] In a 1974 article, Chicago law scholar Richard Posner used the concept of the equally efficient competitor in the context of predatory pricing.[23] Posner argued that, for reasons of economic efficiency, only two forms of pricing should be deemed predatory. First, prices below the cost incurred by a sale were not in the interest of efficiency and could 'only have the purpose and effect of excluding *an equally or more efficient rival*'.[24] Secondly, while prices below the (generally higher) cost that had to be recovered in order to stay in business indefinitely, at times could be in the interest of efficiency, if the conduct was linked with intent to exclude, also these prices would have 'the purpose and likely effect of excluding an equally efficient competitor'.[25]

In this way Posner suggested a method for reducing the reliance on intent, introducing rules pertaining to exclusionary effects derived from efficiency considerations instead. And the benchmark he proposed for measuring exclusionary effects was that of the equally efficient competitor.

At Harvard, Phillip Areeda and Donald Turner also made reference to the equally efficient competitor in their influential 1975 article, 'Predatory pricing and related practices under Section 2 of the Sherman Act'.[26] However, they derived their test for predation from reasoning mainly based on objective intent.[27] Noting that 'a firm which seeks to [profit maximise] is normally responding to acceptable economic incentives and not engaging in predatory behavior', Areeda and Turner argued that (short-run) *profit sacrifice* by the dominant firm should be a necessary condition for predation.[28]

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19 In the 1960s for example, indictments were brought against United Fruit Company employees for oversupplying Los Angeles with bananas; Kovacic op cit n 15, above, at p 17.

20 *United States v Grinnell Corp*, 384 U.S. 563, 570–571 (1966); Elhauge op cit n 12, above, at p 257.

21 Elhauge op cit n 12, above, at p 263.

22 RA Posner, 'The Chicago School of antitrust analysis' (1979) 127(4) *University of Pennsylvania Law Review* 925 (Posner 1979).

23 RA Posner, 'Exclusionary practices and the antitrust laws' (1974) *University of Chicago Law Review* 506 (Posner 1974).

24 Ibid, at p 519. Own emphasis.

25 Ibid, '… equally efficient because if the "predator" is more efficient he can and will exclude his competitor by charging a price equal to or higher than his own long-run marginal costs'.

26 Areeda and Turner op cit n 18, above.

27 WJ Baumol, 'Predation and the logic of the average variable cost test' (1996) 39(1) *Journal of Law and Economics* 49 at p 53.

28 Areeda and Turner op cit n 18, above, at p 703.

This principle yielded its clearest result for pricing below marginal cost[29] which as a rule entails a profit sacrifice.[30] For pricing above marginal cost the results were less clear. Since even pricing above average total cost can constitute a sacrifice relative to the profit-maximising price, such pricing could be caught by the profit sacrifice rule even though it enhances economic efficiency. Areeda and Turner therefore chose to introduce additional principles to avoid prohibiting pricing above cost. In addition to citing administrability problems with above-cost benchmarks, they argued that pricing above average total cost is 'competition on the merits and excludes only *less efficient rivals*'.[31]

For pricing above marginal cost but below average total cost, Areeda and Turner acknowledged that such pricing risks excluding an equally efficient rival. Worrying more about false positives however, they concluded that they could 'see no satisfactory method of eliminating this risk' while not at the same time unwarrantedly protecting less efficient rivals.[32] In their test based on profit sacrifice, Areeda and Turner were thus more permissive of low pricing than Posner was in his original suggestion based on the equally efficient competitor principle.

The Areeda-Turner approach had an immediate impact on US case-law.[33] Although the Supreme Court has declined to endorse any particular cost test for predation,[34] in 1986, in *Matsushita*,[35] and again in 1993, in *Brooke Group*,[36] the Court required not only that a cost test is performed, but also evidence of full recoupment of the profit sacrificed; thus evidence of a profitable exclusionary strategy in line with Areeda and Turner's reasoning.[37]

Based on this success, there have been several attempts to generalise the profit sacrifice principle to forms of abuse other than predation,[38] leading up to what today is referred to as the no economic sense test – deeming as exclusionary any conduct that makes no sense but for exclusion.[39] In the area of refusal to supply, evidence of sacrifice contributed to the Supreme Court's finding of exclusion in

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29 As a measurable approximation of marginal cost, Areeda and Turner used average variable cost.

30 Areeda and Turner op cit n 18, above, at p 712.

31 Ibid, at p 707. Our emphasis.

32 Ibid, at pp 710–711.

33 Within months, two courts of appeals had endorsed the Areeda-Turner rule; Kovacic, op cit n 15, above, at p 45.

34 '[W]e again decline to resolve the conflict among the lower courts over the appropriate measure of cost', *Brooke Group Ltd v Brown & Williamson Tobacco Corp*, 509 U.S. 209 (1993) at p 222.

35 *Matsushita Electric Industrial Co v Zenith Radio Corp*, 475 U.S. 574.

36 *Brooke Group* see n 34, above.

37 H Hovenkamp, 'The Harvard and Chicago Schools and the dominant firm', U Iowa Legal Studies Research Paper 07-19 (2010), at p 3.

38 Already in 1978, Robert Bork, in *The antitrust paradox: A policy at war with itself* (Basic Books, 1978), defined exclusionary conduct as conduct that could not be considered profit maximising except for the expectation that rivals be driven from the market or chastened, or that entry would be blocked.

39 The approach has been argued by the US Department of Justice in several recent cases; Werden op cit n 11, above, at pp 413–414.

Aspen Skiing,[40] while the absence of sacrifice contributed to the converse finding in *Trinko*.[41]

As a competing approach, Posner instead advocated for the equally efficient competitor as a general principle for all exclusionary conduct, suggesting a test where:

> '... in every case in which [an exclusionary practice] is alleged, the plaintiff must prove first that the defendant has monopoly power and second that the challenged practice is likely in the circumstances to exclude from the defendant's market an equally or more efficient competitor.'[42]

The uptake in US case-law of the equally efficient competitor principle has been slower than of the profit sacrifice test, however, with only limited application in lower courts,[43] and none by the Supreme Court. In *LePage's*,[44] the US Department of Justice discussed the potential for applying the equally efficient competitor test to multi-product bundled rebates in an *amicus curiae* brief,[45] but ultimately the Supreme Court declined to hear the case. In *linkLine*,[46] in the context of how to calculate margin squeeze, the Court did discuss the 'transfer price test', which had been referred to as an equally efficient competitor test in an *amicus curiae* brief.[47] The Court concluded however, that '[w]hether or not that test is administrable, it lacks any grounding in our antitrust jurisprudence'.[48]

The adoption of the equally efficient competitor principle in EU competition law

Early indications

Similarly to in the US, the Community Courts' early approach to exclusionary abuse was also in search of defining standards. In *Hoffman-La Roche*, the definition of abuse as conduct hindering rivals and not reflecting 'normal competition',[49] offered little more clarity than *Grinnell*'s 'superior product' and 'business acumen'.[50]

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40 *Aspen Skiing Co v Aspen Highlands Skiing Corp*, 472 U.S. 585, 610–611 (1985).

41 *Trinko* see n 11, above.

42 Posner 2001 op cit n 13, above, at p 194.

43 It has been referred to by lower courts in some cases involving predatory pricing and conditional rebates; see cases cited in DOJ Report op cit n 10, above, at p 44.

44 *3M Co v LePage's Inc*, 124 S. Ct. 2932 (2004).

45 Amicus Brief for the United States (No 02-1865).

46 *Pacific Bell Telephone Co v linkLine Communications Inc*, 129 S.Ct. 1109 (2009), at p 14.

47 Amicus Brief for American Antitrust Institute (AAI), at pp 9–10.

48 *linkLine* see n 46, above, at para 14.

49 *Hoffmann-La Roche v Commission of the European Communities* (Case 85/76) [1979] ECR 461, at para 91.

50 Elhauge op cit n 12, above, at p 264.

In 1991 however, the Court of Justice settled its current doctrine on predatory pricing in *Akzo*,[51] in what was the Court's first predatory pricing case. In doing so, it set out a much clearer exclusionary standard than had been seen in the EU before. And, in choosing a standard, the Court made reference to the equally efficient competitor.

In *Akzo*, the Commission had argued before the Court that where anti-competitive intent was established, there should be no requirement to examine whether the dominant company's prices were above or below cost.[52] The Court declined to adopt an intent-only standard however, and formulated a cost-based test for predatory pricing using both intent and effect. It held that (i) prices below average variable cost were abusive since '[a] dominant undertaking has *no interest* in applying such prices except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position';[53] and that (ii) prices above average variable cost but below average total costs were abusive if they formed part of an exclusionary plan, since such prices could eliminate a competitor '*perhaps as efficient* as the dominant undertaking'.[54]

In its two-pronged test, the Court in (i) creates a presumption of unlawfulness taking the same profit-sacrifice approach as the Areeda-Turner test, while in (ii) applying the less permissive Posner approach of 1974, combining the (potential) exclusion of an equally efficient competitor with evidence of intent. The inclusion of 'perhaps', in 'perhaps as efficient' in (ii), indicates an acknowledgement that – just as Areeda and Turner warned – less efficient rivals may, somewhat paradoxically, benefit from the protection which the equally efficient competitor test offers, even if only incidentally.

In the 1998 *Oscar Bronner*[55] case, the Court of Justice's reasoning in developing its essential facilities doctrine would appear to resonate with the equally efficient competitor principle, albeit only for one of the criteria in the evaluation. On the issue of indispensability and, in particular, duplicability of the facility – in this case a newspaper distribution system – the Court concluded that, in order to show that the creation of a parallel system:

> '... is not a realistic potential alternative and that access to the existing system is therefore indispensable, it is not enough to argue that it is not economically viable by reason of the small circulation of the daily newspaper or newspapers to be distributed. … For such access to be capable of being regarded as indispensable, it would be necessary at the very least to establish … that it is not economically viable to create a second home-delivery scheme for the distribution of daily newspapers *with a circulation comparable to that of the daily newspapers distributed by the existing scheme*.'[56]

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[51] *Akzo Chemie BV v Commission* (Case C-62/86) [1991] ECR I-3359.

[52] Ibid, at para 64.

[53] Ibid, at para 71. Our emphasis.

[54] Ibid, at para 72. Our emphasis.

[55] *Oscar Bronner GmbH & Co KG v Mediaprint Zeitungs-und Zeitschriftenverlag GmbH & Co KG* (Case C-7/97) [1998] ECR I-7791.

[56] Ibid, at paras 45–46. Our emphasis.

The benchmark used for considering duplicability is thus the viability, for a hypothetical competitor *of equal scale* to the dominant firm, to duplicate the facility. Although the Court makes no explicit mention of the competitor's overall efficiency in setting up the facility, since scale appears to be the central factor in determining efficiency, the Court's duplicability test arguably shares significant common ground with the equally efficient competitor principle.[57]

The Commission's Guidance

In 2005, the Commission launched an extensive Art 102 review,[58] resulting in the 2009 guidance on the Commission's enforcement priorities (the Guidance).[59] The Guidance endorses consumer welfare as the basis for prioritisation,[60] and acknowledges that by protecting an effective competitive process rather than competitors, '[t]his may well mean that competitors who deliver less to consumers in terms of price, choice, quality and innovation will leave the market'.[61]

In the Guidance, the Commission comes close to endorsing the equally efficient competitor principle as a *necessary* condition for price-based exclusion, stating that the Commission 'will normally only intervene if the conduct concerned has already been or is capable of hampering competition from competitors which are as efficient as the dominant undertaking'.[62] The test itself does not constitute a *sufficient* condition for finding an abuse however: if the Commission does establish exclusion on the basis of an equally efficient competitor analysis, it will then 'integrate this in the general assessment of anti-competitive foreclosure'.[63] The Guidance also adopts *Akzo's* price-cost analysis approach in the broader context of price-based conduct, explaining both prongs of the test by reference to, inter alia, the exclusionary effect on an equally efficient competitor.[64]

As for *predatory pricing* specifically, the Guidance emphasises both profit

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[57] Advocate General Jacob, in his opinion in *Oscar Bronner*, arguably applied a similar principle to the indispensability criterion as a whole, stating that in deciding whether a facility is essential: '[t]he test applied is an objective one, concerning competitors in general. Thus a particular competitor cannot plead that it is particularly vulnerable'. *Oscar Bronner* see n 55, above, at para 51.

[58] At the time the relevant provision was Art 82 of the EC Treaty (prohibiting the abuse of dominance), which was superseded by Art 102 of the Treaty on the Functioning of the European Union (TFEU) at the entry into force of the Lisbon Treaty in 2009.

[59] Communication from the Commission, *Guidance on the Commission's enforcement priorities in applying Article [102 TFEU] to abusive exclusionary conduct by dominant undertakings* (2009) OJ C 45/7. Prior to the Guidance the Commission issued a discussion paper on the application of Art 82 of the Treaty to exclusionary abuses, 19 December 2005. The US Department of Justice also issued a report in 2008 on its intended application of Section 2 in the Sherman Act (DOJ Report), but it was subsequently redacted with the new presidential administration, op cit n 10, above.

[60] Ibid, at para 5.

[61] Ibid, at para 6.

[62] Ibid, at para 23.

[63] Ibid, at para 27; that general assessment could include, inter alia, the position of the dominant undertaking, the degree of foreclosure (share of the relevant market foreclosed by the conduct), evidence of actual foreclosure and direct evidence of any exclusionary strategy, at para 20.

[64] Ibid, at para 26. The Commission refines the cost measures used in *Akzo*, substituting average avoidable cost for average variable cost and long-run average incremental cost for average total cost.

sacrifice[65] – where it opens the door for a more general application of the no economic sense test to pricing that, although above cost, involves a loss compared to the (short-run) profit-maximising price[66] – as well as the equally efficient competitor test, which then serves as a safeguard, as the Commission normally only considers pricing below long-run average incremental cost as capable of foreclosing an equally efficient competitor.[67]

Regarding *conditional rebates*, the Commission proposes to calculate the 'effective price', ie the price a rival has to match to win the contestable portion of a customer's demand, and to evaluate whether this price excludes an equally efficient competitor.[68] A similar analysis will be applied to *multi-product rebates* by comparing the incremental price with the incremental costs of each of the bundled products.[69]

The Guidance does not refer to the equally efficient competitor principle in the context of the non-price-based abuses discussed: *exclusive dealing*, *tying and bundling* and *refusal to supply*. However for *margin squeeze*, a pricing conduct discussed in the Guidance as a variation on refusal to supply,[70] the Commission describes the practice as a pricing scheme which does not allow an equally efficient competitor to trade profitably on a lasting basis.[71]

The Courts' recent assessment

Following the Commission's adoption of the Guidance in 2009, with its endorsement of the equally efficient competitor approach, the Community Courts have shown a growing tendency to incorporate the principle in their assessment of exclusionary abuse.

Margin squeeze

The most dynamic subset of the Court of Justice's recent application of Art 102 has been margin squeeze. This is also the area in which the equally efficient competitor principle has been most prominently used, and from where it has spread to become applicable to price-based conduct more generally.

The first EU margin squeeze case was *Deutsche Telekom*. Originating in a 2003 Commission decision,[72] the case was ultimately settled by the Court of Justice in 2010. In its ruling, the Court stated that Art 102:

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65 Ibid, at paras 63–66.

66 Ibid, at para 65.

67 Ibid, at para 67.

68 Ibid, at paras 41–45.

69 Ibid, at paras 59–61.

70 Ibid, at para 80. Cf *TeliaSonera* see n 2, above, where the Court of Justice subsequently held that margin squeeze is a type of abuse distinct from refusal to supply and is not predicated on a (regulatory or other) duty to supply.

71 Guidance, op cit n 59, above, at para 80. The cost benchmark which the Commission will generally rely on to determine the costs of an equally efficient competitor are the long-run average incremental costs of the dominant company's downstream division.

72 Commission Decision 2003/707/EC of 21 May 2003 relating to a proceeding under Article 82 of the EC Treaty (Case COMP/C-1/37.451, 37.578, 37.579 – *Deutsche Telekom AG)* (2003) OJ L 263/9.

> '... prohibits a dominant undertaking from, inter alia, adopting pricing practices which have an exclusionary effect on its *equally efficient actual or potential competitors*, that is to say practices which are capable of making market entry very difficult or impossible for such competitors … thereby strengthening its dominant position by using methods other than those which come within the scope of *competition on the merits.*'[73]

This constituted a much stronger endorsement of the equally efficient competitor principle than its mere use in deriving a cost measure in *Akzo*. Furthermore, the Court linked the equally efficient competitor principle to the vaguer term 'competition on the merits', which had previously been used in case-law building on the concept of 'normal competition' in *Hoffman-La Roche*.[74]

On the facts of the case, the Court considered that the insufficient spread between Deutsche Telekom's wholesale and retail prices was 'capable of having an exclusionary effect on its equally efficient actual or potential competitors'.[75] The Court clearly placed special emphasis on competition by equally efficient competitors, explaining that:

> '... consumers suffer detriment as a result of the limitation of the choices available to them and, therefore, of the prospect of a longer-term reduction of retail prices as a result of competition exerted by competitors who are at least as efficient in that market.'[76]

The equally efficient competitor principle also appears instrumental in the Court's finding that margin squeeze is an abuse requiring neither an excessive wholesale price nor a predatory retail price:

> '... margin squeeze is capable, in itself, of constituting an abuse … in view of the exclusionary effect that it can create for competitors who are at least as efficient as the [dominant firm].'[77]

In 2011, the Court of Justice was again called upon to rule on margin squeeze, in *TeliaSonera*, a preliminary reference from the Stockholm City Court.[78] The Court of Justice confirmed margin squeeze as a stand-alone abuse, again referring to the equally efficient competitor principle.[79] As in *Deutsche Telekom*, the Court makes the connection between the equally efficient competitor principle and competition on the merits:

> 'If [the dominant firm] would have been unable to offer its retail services otherwise than at a loss, that would mean that competitors

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[73] *Deutsche Telekom AG v Commission* (Case C-280/08) [2010] ECR I-9555, at para 177. Our emphasis.

[74] *Irish Sugar plc v Commission* (Case T-228/97) [1999] ECR II-2969, at para 111; *Michelin v Commission* (Case T-203/01) [2003] ECR II-4071 (*Michelin II*), at para 97.

[75] *Deutsche Telekom* see n 73, above, at para 178.

[76] Ibid, at para 182.

[77] Ibid, at para 183.

[78] The Court's most important finding in the case was arguably that a margin squeeze abuse is not predicated on a regulatory obligation to supply, see *TeliaSonera* see n 2, above, at para 59.

[79] Ibid, at paras 30–31.

> who might be excluded by the application of the pricing practice in question could not be considered to be less efficient than the dominant undertaking and, consequently, that the risk of their exclusion was due to distorted competition. Such competition would not be based solely on the respective merits of the undertakings concerned.'[80]

In *TeliaSonera*, the equally efficient competitor principle is not only applied to obtain a cost measure so as to establish the existence of a margin squeeze (ie the *conduct*). The Court also puts forward the principle as a simplifying tool for establishing the anti-competitive *effects* of the conduct. Noting that the very existence of a margin squeeze cannot constitute an abuse, but that it is also necessary to demonstrate an anti-competitive effect in the particular circumstances of the case at hand,[81] the Court stated:

> '... the effect does not necessarily have to be *concrete*, and it is sufficient to demonstrate that there is an anti-competitive effect which may potentially exclude competitors who are *at least as efficient* as the dominant undertaking.'[82]

Finding abuse is thus a two-step process, with the equally efficient competitor principle applicable in both steps. First, the principle applies when establishing that the pricing gives rise to a margin squeeze, and secondly, in the absence of concrete anti-competitive effects, it can be used to demonstrate that this margin squeeze causes potential anti-competitive effects.[83]

Conditional rebates

The Community Courts have historically taken a strict stance on conditional rebates,[84] applying ambiguous standards for exclusion such as, as mentioned above, rebates not constituting 'normal competition' [85] or 'competition on the merits'.[86]

The first conditional rebates case in which the Court of Justice ruled on substance[87] following the Guidance was *Tomra*.[88] In a 2006 decision, the Commission had found that Tomra's rebate scheme was exclusionary using, inter

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[80] Ibid, at para 43.

[81] Ibid, at para 61 (referring to *Deutsche Telekom* see n 73, above, at paras 250–251).

[82] Ibid, at para 64. Our emphasis.

[83] In March 2012, the General Court confirmed the approach to assessing margin squeeze established in *Deutsche Telekom* and *TeliaSonera*, including the use of the equally efficient competitor test, in the *Telefónica* case, see n 14, above. Telefónica's appeal of the judgment is pending in the Court of Justice (Case C-295/12 P).

[84] See eg *Hoffmann-La Roche* see n 49, above; *Michelin v Commission* (Case 322/81) [1983] ECR 3461 (*Michelin I*); *Michelin II* (see n 74, above); *British Airways v Commission* (Case C-95/04) [2007] ECR I-2331.

[85] *Hoffmann-La Roche* see n 49, above, at para 91 (quoted above).

[86] *Michelin II* see n 74, above, at para 97.

[87] Cf *Solvay SA v Commission* (Case C-110/10 P), judgment of 25 October 2011 (not yet reported), in which the Court of Justice overruled the General Court's judgment without ruling on substance.

[88] *Tomra Systems ASA and others v Commission* (Case C-549/10 P), judgment of 19 April 2012 (not yet reported).

alia, an economic analysis not consistent with the 2009 Guidance. The Commission did not calculate an effective price as set out in the Guidance, nor did it compare the price to Tomra's costs in order to evaluate whether an equally efficient competitor could have matched the rebates.

In 2012, the Court of Justice upheld the finding of abuse, concluding that a number of factors contributed to the exclusionary effect of Tomra's rebates, including retroactive bonus thresholds and thresholds individualised to each customer's estimated volume requirements.[89] The Court did not specifically address whether the rebates could exclude an equally efficient rival, but dismissed Tomra's contention that the Commission was required to examine Tomra's prices in relation to its costs.[90] Furthermore, the Court held that the approach set out in the Guidance had no relevance to the legal assessment of the contested decision, which was adopted in 2006.[91]

In its next conditional rebates decision, *Intel*,[92] adopted after the Guidance in May of 2009, the Commission did perform an equally efficient competitor analysis in line with its Guidance – complete with a price-cost test showing that an equally efficient competitor could not match Intel's offer. However, the Commission presented this analysis alongside a more traditional analysis grounded in the previous, form-based case-law on rebates; stating that it is not required by case-law to perform the tests advocated in the Guidance in order to establish abuse. Having nevertheless included such an analysis for the sake of completeness, the Commission has presented the General Court (and, perhaps, ultimately the Court of Justice) with an opportunity to rule on the issue on appeal.[93]

Selective pricing

The *Akzo* test, using the equally efficient competitor principle in its second prong, would seem to indicate that pricing above average total cost would not be capable of anti-competitive exclusion. Yet in the interim between *Akzo* and the 2009 Guidance, the EU Courts made findings of selective predatory pricing in two cases without recourse to the principle and without benchmarking the dominant firm's prices against its costs.

In 1999, in *Irish Sugar*,[94] the General Court upheld the Commission's decision that Irish Sugar had cut its prices selectively for the most important customers of its rival, and that this amounted to an exclusionary abuse without the need to establish below-cost pricing. And in 2000, in *Compagnie Maritime Belge Transports*,[95] the Court of Justice held that a liner conference had abused its dominance by sailing so-called fighting ships, specifically intended to coincide

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89 Ibid, at para 75.

90 Ibid, at para 80.

91 Ibid, at para 81.

92 Commission Decision of 13 May 2009 relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement (COMP/C-3 /37.990 – *Intel*).

93 E Rousseva and M Marquis, 'Hell freezes over: A climate change for assessing exclusionary conduct under Article 102 TFEU' (2013) 4(1) *Journal of European Competition Law and Practice* 32–50, at p 46.

94 *Irish Sugar* see n 74, above.

95 *Compagnie Maritime Belge Transports SA v Commission* (Case C-395/96) [2000] ECR I-1365.

with those of its only competitor and matching its prices. Noting that CMBT's conduct was admittedly aimed at eliminating its only competitor,[96] the Court upheld the Commission's finding of abuse without examining the relation between the conference's prices and costs.

These two decisions appeared to signal a departure from the equally efficient competitor reasoning used in *Akzo*, favouring instead a more intent-based approach to predatory pricing. However, in the 2012 *Post Danmark* case,[97] a preliminary reference concerning selective pricing, the Court of Justice took several steps to endorse the equally efficient competitor principle more broadly than ever before.

In its ruling, the Court elaborates on its distinction in *Deutsche Telekom* and *TeliaSonera* between exclusion due to competition on the merits on the one hand, and anti-competitive exclusion on the other hand:

> 'It is in no way the purpose of Article [102] to prevent an undertaking from acquiring, on its own merits, the dominant position on a market … *Nor does that provision seek to ensure that competitors less efficient than the undertaking with the dominant position should remain on the market.*[98]
>
> Thus, not every exclusionary effect is necessarily detrimental to competition … Competition on the merits may, by definition, lead to the departure from the market or the marginalisation of competitors that are less efficient …'[99]

The Court's formulation, that Art 102 does not 'seek to ensure that competitors less efficient … should remain on the market', appears to limit the purpose of the provision so as to offer no more than an incidental protection to less efficient competitors. It can also be noted that the Court's statement, at least on a broad interpretation, does not limit this principle to price-based abuses only.

Against that backdrop, the Court considered that selective pricing, or price discrimination, *cannot* of itself amount to an exclusionary abuse.[100] It went on to state that some of the prices concerned in the case were above Post Danmark's average total cost and, as such, 'cannot be considered [to] have anti-competitive effects';[101] thus affirming a price-cost standard that, going back to Areeda and Turner's reasoning, has been motivated by such pricing's inability to exclude an equally efficient competitor.[102]

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[96] Ibid, at para 119.

[97] *Post Danmark* see n 3, above.

[98] Ibid, at para 21. Our emphasis.

[99] Ibid, at para 22. This statement is very close to para 6 of the Guidance, as pointed out by Rousseva and Marquis op cit n 93, above, at p 42.

[100] *Post Danmark* see n 3, above, at para 30.

[101] Ibid, at para 36.

[102] The Danish Supreme Court eventually ruled in favour of the appealing Post Danmark, holding that the Danish Competition Authority had failed to establish that the firm's selective prices had been capable of producing anti-competitive effects; *Post Danmark v Konkurrencerådet*, judgment of the Danish Supreme Court of 15 February 2013. For a comment on the case, see C Bergqvist, 'Post Danmark – more than just one case' (2013) *Chillin'Competition*, 28 February.

These rather categorical statements by the Court raise the question whether *Irish Sugar* and *Compagnie Maritime Belge Transports* remain good law.[103] Outside the area of selective pricing, there is also apparent tension between the Court of Justice's rulings in *Post Danmark* and *Tomra*, delivered within weeks of one another.[104]

Scope of application of the equally efficient competitor principle

With the exception of *Tomra*, the Court of Justice consequently appears to find increasing merit in the equally efficient competitor principle for evaluating price-based conduct. And in *Post Danmark*, there is arguably an indication that the principle may be relevant also to the overall objective of Art 102 – in other words, that the equally efficient competitor test, as a matter of principle, is not necessarily limited to price-based conduct only.

In view of its recent application in the EU, how does the principle fare, in terms of meeting the objectives of a unifying principle for exclusionary abuse put forward at the outset of this article: avoiding different rules for different types of conduct, providing legal certainty, as well minimising the occurrence of both false positives and false negatives?

False negatives – what about effective competition from less efficient competitors?

The most fundamental critique of the equally efficient competitor test in terms of under-deterrence and false negatives is that economic efficiency, as well as consumer welfare, *in some circumstances* can benefit also from the existence of less efficient competitors; either in a static sense by the restraint that inefficient rivals may exert on the dominant firm's pricing, or in a dynamic sense where new rivals have the potential, but need time, to reach sufficient efficiency.[105]

The Commission acknowledges this in its Guidance, and makes allowances for taking a more dynamic approach in its enforcement of pricing conduct if exceptional circumstances so require.[106] The Court of Justice in *Post Danmark*, on the other hand, offers no such nuance. With regard to the latter stance, this at least has the merit from a public policy perspective that, although strict adherence to the equally efficient competitor principle brings with it the risk of false negatives, it also avoids the false positives that the principle is designed to eliminate; i.e. not

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[103] Rousseva and Marquis op cit n 93, above, at pp 38–39, discuss this issue in some depth; referring inter alia to the opinion of AG Mengozzi in *Post Danmark*, who considered the latter case to be distinguishable from *Irish Sugar* and *Compagnie Maritime Belge Transports* on the respective facts of the cases.

[104] Rousseva and Marquis op cit n 93, above, at pp 47–48, propose alternative interpretations of *Tomra*.

[105] DOJ Report op cit n 10, above, at p 44; J Vickers, 'Abuse of Market Power' (2005) *The Economic Journal* 115.504, at pp 249–250; R O'Donoghue and AJ Padilla, *The law and economics of Article 82 EC* (Hart, 2006), at p 189.

[106] Guidance op cit n 59, above, at para 24.

to require dominant firms ‘to hold a price umbrella over less efficient entrants’.[107]

False positives – preventing exit or protecting entry?

As apparent already in the work of Posner and Areeda and Turner, the equally efficient competitor principle risks being less permissive of low prices than many price-cost tests applied today, for example the test in *Akzo*, by potentially condemning prices below average total cost, even though such pricing policies often has no objective exclusionary intent and is to the benefit of consumers. This risk of false positives can perhaps be reduced however, by careful consideration of what is meant by the concept ‘equally efficient’.

As the first mover, the dominant firm has often incurred entry costs which are already *sunk* from the firm’s (and society’s) perspective. In the interest of efficiency, it must be the case that such costs are not always included in what constitutes the costs of the ‘equally efficient competitor’.[108] To always hold otherwise risks inducing false positives, inadvertently encouraging inefficient market entry. On the other hand, in industries where entry cost is the only relevant cost component, such as in network or software industries, it may at times be justified for competition enforcers who aim at enabling entry to include the incumbent’s sunk costs in the equally efficient competitor analysis.[109] In this choice, however, the equally efficient competitor principle itself offers little guidance, but is instead merely the initial step of the analysis.

Extending the principle to non-price conduct

Except for one possible interpretation of *Post Danmark* given above, as well as our interpretation of the duplicability analysis in *Oscar Bronner*, there have been no attempts to apply the equally efficient principle to non-price-based conduct. And such an extension is indeed less straightforward than the application to price-based conduct.

The question of whether an equally efficient competitor is foreclosed from a particular customer through *tying* or *bundling* can in principle be meaningfully assessed with similar methods as for multi-product rebates, i.e. by comparing incremental prices with incremental costs for the various products included in the bundle. But this is in practice much more difficult than for rebates, since there is generally no way of knowing what the counterfactual (untied/unbundled) price would have been. And this counterfactual is essential in order to derive the incremental price.

Similarly, whether *exclusive dealing* forecloses an equally efficient competitor from a particular customer can in principle be evaluated with similar methods as for conditional rebates, i.e. by calculating effective prices and evaluating whether an equally efficient competitor could match them. But also this is in practice very difficult, since there is generally no way of knowing what the counterfactual (non-

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[107] Posner 2001 op cit 13, above, at p 196.

[108] Cf Baumol op cit n 27, above, who shows how the equally efficient competitor principle and profit sacrifice principle can coincide when using an average avoidable cost measure.

[109] Bolton et al op cit n 16, above, at p 2285.

exclusive) price would have been.

Absent unusual evidence, there is consequently no direct, *administrably* workable extension of the price-cost approach to these non-price-based practices, even though in principle they can be considered to have price-based equivalents.

As for *refusal to supply* on the other hand, it is often in practice possible to, at least to some extent, evaluate whether a refusal has the potential to exclude an equally efficient competitor. The duplicability condition is one part of this analysis, and applying the principle to the broader analysis of indispensability could be another. However, in the context of the essential facilities doctrine, the equally efficient competitor principle is perhaps less relevant to the fundamental economic problem at hand; that of balancing firms' investment incentives with the potential for effective competitive pressure. Furthermore, the potential for effective competitive pressure is often more closely related to the terms of access than to the efficiency of the rival.[110]

A final category of non-price-based exclusion is conduct that can be *presumed* to have anti-competitive effects, without the possibility of any efficiency defence. This type of conduct is often non-market conduct, such as false declarations, or the *reductio in absurdum* example of burning of the competitor's factory.[111] To the extent that competition law is the right remedy for this type of conduct, clearly there is no need for the equally efficient competitor standard in these cases.

Going from foreclosure of individual customers to market foreclosure

Quite apart from the issue of the equally efficient competitor principle's application to various types of conduct, is the issue of whether it is also instructive in other steps of the analysis of exclusionary conduct. Having established that a certain conduct forecloses rivals from individual customers, whether by means of the equally efficient competitor test or not, could the principle also have a role to play in the subsequent assessment of whether such foreclosure leads to anti-competitive exclusion or, in other words, *market* foreclosure?

Again, one needs to consider more carefully what is meant by 'equally efficient'. Since the exclusionary effect of foreclosure is to deprive a rival of scale, scale economies necessarily introduce an element of complexity in an equally efficient competitor analysis.[112] For example, according to standard economic theory, exclusive dealing can in some circumstances exclude a rival that is equally efficient, in the sense that it has an identical cost curve to the dominant firm (i.e. that scale of production is the only differing factor between the two firms' actual unit costs) but a higher marginal cost simply by reason of being denied a critical scale of business.[113]

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[110] Cf 'single monopoly profit' or 'one monopoly rent' arguments in the context of leveraging theories associated with the Chicago school; Posner 1979, op cit n 22, above; A Director and EH Levi, 'Law and the future: trade regulation' (1956) *Northwestern University Law Review* 51, at p 281.

[111] The Commission gives two examples of this type of conduct in the Guidance op cit n 59, above, at para 22.

[112] Vickers op cit n 105, above, at p 257.

[113] Ibid, at p 257; see also EB Rasmusen, JM Ramseyer, and J Wiley, 'Naked exclusion' (1991) 81(5) *The American Economic Review* 1137; IR Segal and MD Whinston, 'Naked exclusion: comment' (2000)

The question is thus whether the foreclosing conduct in question covers a sufficient portion of the relevant market to deprive the competitor of minimum efficient scale[114] – the scale needed to be able to exercise effective competitive pressure. Such an analysis can in principle be performed either on the basis of actual competitors' costs, or of a hypothetical equally efficient competitor's costs.

In the Guidance, the Commission considers competitors 'less likely to enter or stay in the market if the dominant undertaking forecloses a significant part of the relevant market'[115] (regarding markets with economies of scale). It considers that 'the higher the percentage of total sales in the relevant market affected by the conduct, … the greater is the likely foreclosure effect'.

In *Tomra*, the applicants argued that the Commission ought to have established that the conduct foreclosed a sufficient part of the market so as to prevent an equally efficient competitor from reaching minimum viable scale, thus excluding such a competitor from the market. The Court of Justice rejected the need for a 'minimum viable scale' test, and determined that it was not essential to establish a precise threshold for what portion of the relevant market had to be foreclosed.[116] The Court did however consider what portion of the market was covered by the conduct, and concluded that foreclosure of two fifths of the market in the case at hand 'in any event' proved foreclosure to the requisite legal standard.[117]

In *TeliaSonera*, with the Court of Justice having prescribed potential exclusion of an equally efficient competitor as sufficient for establishing anti-competitive effects, in the final instance in the Swedish Market Court, that Court also considered the portion of the relevant market covered by the squeeze as relevant to establishing the anti-competitive effect.[118]

Since in neither case the discussion of the portion of the relevant market covered by the conduct was motivated by underlying principles, it is difficult to say what standard is applied in determining what degree of coverage is sufficient for market foreclose. It is clear that evidence of actual foreclosure is taken into account irrespective of the efficiency of the foreclosed rival; the potential foreclosure of an equally efficient competitor is presented in *TeliaSonera* as a fall-back.

Legal certainty

One of the great advantages of the equally efficient competitor principle is that it, just like the Areeda-Turner test, offers legal certainty in terms of evaluating conduct on an objective basis. Dominant firms need only know their own cost structure and not those of their rivals. Applied beyond predatory pricing, the test does require more information however. With regard to conditional rebates and multi-product rebates, the test requires information also about market structure,

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90(1) *The American Economic Review* 296.

114 DOJ Report op cit n 10, above, at p 137.

115 Guidance op cit n 59, above, at para 20.

116 *Tomra* see n 88, above, at paras 37–49.

117 Ibid.

118 Also when reducing the fine imposed at first instance, the Swedish Market Court gave weight to the limited scope of the market coverage; Marknadsdomstolen, A 8/11, judgment of 12 April 2013, at 273–280 and 301–305.

such as contestable shares, in order to calculate effective prices; thereby introducing additional uncertainty.[119] And for non-price based conduct, the test's principal benefit in providing legal certainty is perhaps not in evaluating individual contracts at all, but instead in its potential application to the assessment of market foreclosure and a possible calculation of minimum viable share, which again could allow dominant firms to consider mainly their own costs when evaluating legality.

Conclusion

In the absence of a single, superior standard by which to define exclusionary conduct, the equally efficient competitor principle captures an important insight; that by protecting less efficient competitors, there is the unavoidable risk of protecting competitors, rather than the competitive process.[120] And, by largely avoiding reference to the form of the conduct, it ideally allows firms to take full advantage of their efficiency. This advantage applies especially to pricing practices, where the test is most obviously administrable.[121]

The equally efficient competitor principle is not a fully satisfying unification of the assessments of different forms of exclusionary conduct. But, despite its imperfections, the test offers some compelling advantages, both in comparison to other test, and to a more form-based approach. In the EU, the principle has added stringency and predictability to the enforcement by both the Commission and the Courts.

In favour of principled approaches more generally; while each has its strengths and weaknesses, when taking them all together – the equally efficient competitor test, the consumer welfare test and the no economic sense test – perhaps so much can be said: that the case for exclusionary abuse is weak if a conduct does not fall foul of a single one of the three tests and, conversely, the case is strong if a conduct fails to pass all three. The principles thus complement each other, and, taken together, offer valuable, but not complete, guidance to both enforcement agencies and firms.

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[119] O'Donoghue and Padilla op cit n 105, above, at pp 389–393.

[120] Ibid, at p 191.

[121] DOJ Report op cit n 10, above, at p 45.

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