AEC Criterion and Exclusionary Conduct: Recent Development under EU Competition Law

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Long abstract

1. Introduction

The role, relevance and implications of the AEC criterion for the enforcement of Article 102 TFEU have traditionally been widely debated. The very notion of AEC criterion is somehow ambiguous. In general terms, it is possible to distinguish two notions. A narrow notion makes reference to a quantitative test based on prices and costs of dominant firms, aimed at verifying whether an AEC could match the prices of a dominant player without incurring losses. A broader notion makes reference to a more general criterion, aimed at assessing the possibility for an AEC to replicate, imitate or, in any case, react to the (price or non-price) conduct of a dominant firm. While the terms AEC criterion and AEC test are used ambiguously in case law and decision practice, this paper refers to the narrow notion as AEC test and to the broad notion as AEC criterion. The AEC test may be considered an application of the AEC criterion to price conduct.

This paper analyzed the role, relevance and implications of the AEC criterion, and the AEC test based on such criterion, in the enforcement of Article 102 TFEU, in light of the latest developments in EU case law and the recent Amendments to the Commission Guidance on exclusionary conduct.

2. The AEC criterion in the debate on unilateral exclusionary conduct

The notion of unilateral exclusionary conduct and the definition of an adequate standard of assessment constitute the most controversial issue in contemporary competition law and policy. Antitrust scholars and policy makers have proposed a number of tests, including the full balance of pro- and anti-competitive effects, the exclusion of equally efficient competitors (as efficient competitor or AEC criterion, with some variations), the sacrifice test, the no-economic sense test, the raising rivals' costs test, and the disproportionality test envisaged by the Section 2 Report of the DOJ of 2008. In the 2009 Guidance on exclusionary conduct, the Commission focused on the notion anticompetitive foreclosure, which was based on two elements: (i) the exclusion of competitors, and (ii) the possible harm to consumer interests. The notion of anticompetitive foreclosure was revisited in 2023 by the Amendments to the Guidance on exclusionary conduct, according to which an abuse is a practice that "*adversely impacts an effective competitive structure*", thus allowing the dominant firm to "*negatively influence, to its own advantage and to the detriment of consumers, the various parameters of competition*", such as price, production, innovation, variety or quality.

The AEC criterion has strong appeal, as it is consistent with the principle that antitrust law should ensure the physiological functioning of the competitive process as a means of selecting the most efficient firms, as well as with the idea that competitive initiatives by dominant firms should be allowed where capable of triggering virtuous competitive dynamics through a process of imitation. However, the AEC criterion is not a panacea. Apart from recent expansive trends in antitrust law, commentators and policy makers have identified certain factors that could limit the use of this test, including the need to protect competitors not *yet* as

efficient (not-yet AEC), the possible positive effects of the competitive pressure from less efficient competitors, the need to take into account situations of asymmetry (i.e., positions of competitive advantage of the dominant firm, which cannot be reasonably overcome/reached by competitors), the particular difficulty in applying the AEC test to certain pricing practices (e.g., loyalty discounts), the difficulties in applying the AEC test and, in general, the AEC criterion to non-price practices, and the need to prevent purely exclusionary conduct, which do not result in any positive effects (naked exclusion).

These issues are reflected in doubts about the relevance, scope and content of the AEC criterion in the enforcement of Article 102 TFEU. A first general question is whether, under EU competition law, the AEC criterion should only applied as a quantitative test based on prices and costs of dominant firms, or can be considered a criterion with a broader scope, based on the possibility to replicate, imitate or, in any case, react to (price or non-price) conduct of dominant firms. A second, related question is whether the AEC criterion can be considered a generally valid standard of assessment for abusive practices, or at least some of them (namely, pricing conduct, or some of such practices). A third question is whether, where applicable, the AEC criterion operates as a safe harbor, or the contested conduct can anyway be found abusive on other grounds.

3. The *SEN* and *Unilever* rulings

Recent developments in the case law of the European courts on Article 102 TFEU (including, in particular, *Intel*, *SEN* and *Unilever*) address some of the above issues and provide some guidance, even though many questions and doubts remain open.

The ruling delivered in 2022 in *SEN* (C-377/20) is probably the case in which the Court most directly addressed the controversial issue of the notion of abusive conduct, by analyzing different aspects, such as the relevance of actual and potential effects, the need to prove the use of means other than competition on the merits, the role of the AEC criterion, and the relevance of intent. The *SEN* ruling identified two requirements for establishing abusive conduct. The contested conduct must be (i) "*capable of producing*" exclusionary effects (para. 69), and (ii) based on means other than those coming "*within the scope of 'normal' competition*", *i.e.* "*competition on the merits*" (para. 75).

Thus, according to the ECJ, the mere exclusionary capacity of a practice is not sufficient to find an abuse. To this end, it is necessary to demonstrate an additional element of unlawfulness, *i.e.* that the contested conduct is not in line with the paradigm of competition on the merits. Even though the notion of competition on the merits is considered too vague by most scholars and is frequently neglected in antitrust practice, it is an essential element of the notion of abuse of dominance, which would deserve more attention and adequate reflection.

Based on *SEN*, the AEC criterion can be relevant for the assessment of both requirements for a finding of abuse (foreclosure and use of means other than competition on the merits). The ECJ specified that, in general, conduct capable of excluding an AEC has exclusionary capacity (para. 71). Moreover, the AEC test is "*one of the criteria which make it possible to determine whether that conduct must be regarded as being based on the use of means which come within the scope of normal competition*" (para. 82). Conduct likely to exclude an AEC is not consistent with competition on the merits.

The ECJ provided some further clarifications on the practices that do not fall within the scope of competition on the merits. The Court specified that the notion of competition on the merits does not include "[a]*ny practice the implementation of which holds no economic interest for a dominant undertaking, except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position*" (para. 77; citing *AKZO*). The wording of the judgment recalled the AEC criterion, as well as the no-economic sense test.

Moreover, according to the ECJ, the notion of competition on the merits does not include "*a practice that a hypothetical competitor – which, although it is as efficient, does not occupy a dominant position on the market in question – is unable to adopt, because that practice relies on the use of resources or means inherent to the holding of such a position*" (para. 77). Even in this case, the wording of the judgment recalled the AEC criterion, but the ECJ seemed to suggest that such criterion may need to be adjusted to take into account possible situations of asymmetry or competitive advantage that cannot be replicated by minor operators.

In any case, the ECJ clarified that the AEC is not the only criterion to identify competitive initiatives not based on the merits. According to the Court, the AEC criterion "*is merely one of the ways to show that an undertaking in a dominant position has used means other than those that come within the scope of 'normal' competition, with the result that competition authorities do not have an obligation to rely always on that test in order to make a finding that a price-related practice is abusive*" (para. 81). However, the ECJ did not specify how to identify the other practices not falling within the notion of competition on the merits. It is reasonable to assume that these additional hypotheses include the cases of naked exclusion, which do not have any positive effects on competition and consumers, but in other cases it may be difficult to determine whether a given practice may be considered a legitimate form of competition on the merits.

In 2023, in *Unilever* (C-680/20), the ECJ addressed, among other things, the question of whether the AEC criterion is also relevant in the case of exclusivity clauses in distribution contracts, or conduct characterized by a multiplicity of abusive practices (i.e., loyalty discounts and exclusivity clauses). The ECJ recalled the EU case law according to which exclusivity clauses constitute, "*by their very nature, an exploitation of a dominant position*" (para. 46). However, the Court held that it was necessary to clarify the case law on exclusivity clauses in light of the *Intel* ruling, because "*their ability to exclude competitors is not automatic*" (para. 51), and they may also give rise to positive effects. This requires their exclusionary capacity to be assessed in light of all relevant circumstances, including any economic analysis produced by the dominant firm to demonstrate that the practice is not capable of excluding an AEC. Moreover, the duty to take into account possible analyses produced by the dominant firm finds further justification in the need to guarantee the right of defense.

In the specific case of exclusivity clauses, the AEC test (intended as a price-cost test) "*may theoretically serve to determine*" whether an AEC would be able to profitably offer its products or services to distributors "*if it had to bear the compensation which the distributors would have to pay in order to switch supplier, or the losses which they would suffer after such a change following the withdrawal of previously agreed discounts*" (para. 59). In line with *Intel*, the Court clarified that the use of the AEC test is not mandatory for competition authorities, as such test is an "*optional*" tool at their disposal. However, if the results of an AEC test are submitted by the firm concerned during the administrative procedure, the competition authority is "*required to assess the probative value of those results*" (para. 62).

4. <u>The relevance of the AEC criterion for the analysis of price and non-price conduct</u>

The *SEN* and *Unilever* rulings provide some indications on the relevance of the AEC criterion, and the AEC test based on the AEC criterion, for the assessment of price and non-price practices.

In *SEN*, the Court acknowledged that the relevance of the impossibility for an AEC "*to imitate the practice in question*", in order to determine whether the practice is based on means coming within the scope of competition on the merits, "*is clear from the case-law on practices both related and unrelated to prices*" (para. 79).

The relevance of an AEC test based on the AEC criterion is well established for price conduct. In particular, in *SEN*, the ECJ recalled that price conduct (such as "*loyalty rebates*", "*selective or predatory pricing*" and "*margin-squeezing practices*") "*must be assessed, as a general rule, using the 'as-efficient competitor' test*", which aims at assessing whether a hypothetical AEC is capable of replicating, or reacting to, the pricing policy of the dominant firm (para. 80). The ECJ specified that the AEC test "*is merely one of the ways*" to show that an undertaking in a dominant position has used means other than competition on the merits (para. 81), but underscored the "*significance generally given to that test*" in the analysis of pricing practices (para. 82).

The analysis is more complex for non-price conduct. In *SEN*, the Court seemed to consider the AEC as a broader criterion ("*impossibility ... to imitate the practice*" for a hypothetical AEC), which goes beyond a price-cost test and may also be relevant for the analysis of non-price practices. In particular, the Court made reference to the case law on "*refusal to supply*", according to which the choice of an dominant firm to reserve to itself its own distribution network does not constitute a refusal to supply contrary to Article 102 TFEU where "*it is possible for a competitor to create a similar network for the distribution of its own goods*" (para. 83).

However, in *Unilever*, the ECJ seemed to consider the narrow notion of the AEC criterion, understood essentially as a price-cost test, and stated such a test may be inappropriate "*in the case of certain non-pricing practices, such as a refusal to supply*" (para. 57). Nevertheless, the Court held that, "*even in the case of non-pricing practices, the relevance of such a test cannot be ruled out*", and pointed to a possible application of the AEC test (understood as a price-cost test) to exclusivity clauses (para. 59).

A joint reading of the two rulings suggest that the AEC criterion is relevant for both price and non-price conduct. It may be relevant for the assessment of both elements of abusive conduct under Article 102 TFEU, i.e. whether the contested conduct (i) is capable of having exclusionary effects, and (ii) does not constitute a form of competition on the merits. An AEC test based on the AEC criterion must be applied, as a general rule, to determine whether a price conduct is abusive. This price-cost test may not be appropriate and relevant for non-price practices, but even in these cases it may provide useful indications on whether the conduct is capable of having exclusionary effects, and does not constitute a form of competition on the merits.

5. <u>The implications of the AEC criterion for a finding of abuse</u>

A further question is what are the implications of the AEC criterion for establishing a price or non-price abuse. In particular, the issue is whether, and in which cases, the AEC criterion (or at least the price-cost test based on such criterion) may be decisive to find or exclude an abuse.

In general terms, the AEC criterion can be decisive in the affirmative, to find an abuse, as a practice capable of excluding an AEC is, in principle, (i) capable of having exclusionary effects and (ii) not consistent with the competition on the merits standard (see *SEN*).

A more complex question is whether the AEC criterion can be decisive in the negative, by operating as a safe harbor that rules out an abuse. At first glance, some statements in the *SEN* and *Unilever* rulings suggest that the AEC criterion does not operate as a safe harbor. The AEC criterion is considered "*optional*", and "*only one of the ways*" to prove an abuse, even for price conduct. If a dominant firm produces evidence that a practice is not capable of excluding an AEC, the antitrust authority "*is required to assess the probative value*" of such evidence, but the ECJ did not specify to what extent the authority is bound by it.

In *SEN* and *Unilever*, the ECJ acknowledged and endorsed the relevance of the AEC test and, more in general, of the AEC criterion in the enforcement of Article 102 TFEU, for both price and non-price conduct. However, the Court used a very cautious and nuanced language, which avoided the introduction of limiting principles and binding requirements.

Following the annulment of certain important decisions (such as *Intel* and *Qualcomm*) for failure to carry out an appropriate price-cost analysis, the Commission seems to have used the nuances in the recent rulings of the ECJ to lighten some of the burdens it had placed on itself through the Guidance on exclusionary conduct. This allowed the Commission to significantly scale back the role of the AEC test not only for non-price conduct, but also for price abuses.

This is reflected in the Amendments to the Guidance on exclusionary conduct adopted by the Commission in 2023. By making reference to the latest case law developments, the Commission stated that:

- "*it is not appropriate* […] *to pursue as a matter of priority*" only price conduct that may lead to the exclusion of AECs, as "*in certain circumstances genuine competition may also come from undertakings that are less efficient than the dominant firm in terms of their cost structure*" (para. 2);
- The AEC test "*is only one of a number of methods for assessing, together with all other relevant circumstances, whether a conduct is capable of producing exclusionary effects*". The use of the AEC test "*is optional*" and "*may be inappropriate depending on the type of practice or the relevant market dynamics*". Accordingly, "*a generalised use of such test to determine which cases of price-based exclusionary conduct to pursue as a matter of priority is not warranted and, if such test is carried out, its results should in any event be assessed together with all other relevant circumstances*" (para. 3).

The Commission modified accordingly the Guidance on exclusionary conduct to clarify that: (i) the AEC is only one of the methods at the disposal of antitrust authorities to identify exclusionary conduct; and (ii) its results are not conclusive, as they must be assessed together with all other relevant circumstances. It is reasonable to expect that the same changes will also

be reflected in the forthcoming Guidelines on Article 102 TFEU, which should replace the Guidance on exclusionary conduct.

Interestingly, the Amendments to the Guidance on exclusionary conduct did not mention the principle established by the ECJ and the GC in *Intel* and subsequent rulings, according to which, if a dominant firm produces evidence that a practice is not capable of excluding an AEC, the antitrust authority "*is required to assess the probative value*" of such evidence.

6. What role for the AEC criterion in the enforcement of Article 102 TFEU?

The recent case law of the ECJ has acknowledged the relevance of the AEC criterion not only for pricing practices, but also for non-price conduct. However, the cautious and nuanced wording used by the ECJ seems to have fostered the emergence of an interpretation that weakens the role an relevance of the AEC criterion under EU competition law.

In particular, in the Amendments to the Guidance on exclusionary conduct, the Commission used the Court's recent rulings, which extended the AEC criterion to non-price conduct, to downplay the role and relevance of the AEC test in the analysis of pricing practices. This approach is not convincing. The risk is the use of an approach possibly based on economic analysis, but unstructured and difficult to predict, which could disincentivize potentially procompetitive conduct.

The AEC criterion should continue to be the reference test for pricing practices. EU case law confirms that a price-cost analysis based on the AEC criterion is essential to verify whether certain pricing practices, such as predatory pricing and margin squeeze, constitute an abuse of dominance. Even for other pricing practices, such as loyalty discounts, which have been traditionally considered inherently capable of raising competition concerns, the ECJ has clarified that antitrust authorities must take into account the results of an AEC test, if they are produced by firms under investigations.

Moreover, the AEC criterion may be relevant, more generally, for assessing and, possibly, ruling out non-price abuses, especially if the AEC criterion is understood in a broad sense, as the possibility of replicating, imitating or, in any case, react to the practice of the dominant firm. A competitive initiative that could be replicated by other operators is likely to trigger a virtuous mechanism of competition on the merits, which should not be prevented by the enforcement of antitrust rules.

However, the AEC criterion must be applied taking into account the circumstances of the case, as well as the practical problems that may arise in defining and applying an appropriate price-cost analysis for certain practices.

In particular, in some cases, it may be necessary to adjust the AEC criterion to account for possible situations of asymmetry between the dominant firm and competitors (exclusive availability of certain resources, network effects, presence of a non-contestable share of demand, etc.). The dominant firm should not be allowed to use certain non-replicable advantages to exclude other operators from the market.

Moreover, for certain practices (such as loyalty discounts), there may be considerable difficulties in applying a price-cost test based on the AEC criterion. However, these difficulties could be managed not by eluding the AEC test *tout court,* but by adopting a reasonable

evidentiary standard. In many cases, a price-cost test cannot provide a definitive answer, but it can provide useful indications about the possible exclusionary effects of the practice, which could be examined in conjunction with the additional evidence to assess the risk of exclusion of an AEC.

Finally, there may be cases in which the application of the AEC criterion is not appropriate. In particular, the AEC criterion appears unnecessary in the case of naked exclusion, i.e. conduct exclusively aimed at excluding competitors or increasing their costs, without providing any benefit to consumers or resulting in any positive effect on competition. In these cases, there is no reason to safeguard dominant firms' ability to compete. At the same time, requiring competitors to replicate or react to the conduct of the dominant firm would simply result in an increase in their costs, without any positive effects.