

INSIGHTS

THE PRICE-COST TEST IN THE ART 102 NEW DRAFT GUIDELINES

When and how to use it

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The European Commission has published the long-awaited new draft Guidelines on the application of Article 102. The document provides clarification on the application of price-cost tests to determine whether a price-based conduct is abusive. Will the Commission change tack on the use of economic analysis of pricing abuses?

On 1 August 2024, the European Commission launched the public consultation on draft Guidelines on exclusionary abuses of dominance (hereinafter 'draft Guidelines'). The draft Guidelines aim at setting out a potential analytical framework applicable to certain types of exclusionary conduct by dominant firms.

The Commission announced the initiative to draft Guidelines last year in March 2023, together with an [amending communication](#) with changes to its guidance paper on enforcement priorities in applying Article 82 and the publication of the competition policy brief titled "[a dynamic and workable effects-based approach to abuse of dominance](#)". At that time, the amendments and the policy brief had sparked many commentators to raise the concern that the Commission would depart from an effect-based approach by, for example, deviating from or reducing the use of an economic price-cost test - and specifically the as-efficient competitor "AEC"

test - to assess the likelihood of exclusionary effects.

At that time, [we considered the application of the AEC test](#) and concluded that it maintains an important role (at least in the context of postal operators). The use of the AEC test as part of the compliance work of dominant firms allows for ex-ante certainty in their pricing decisions and encourages competition with efficient entrants.

In this Article we focus on how the price-cost (AEC) test is set out in the draft Guidelines and present our initial impressions on whether the Commission is seeking to bring changes to the economic assessments of exclusionary abuses.

The draft Guidelines provide “*the Commission’s interpretation of the EU courts’ case law on exclusionary abuses and the Commission practice*”.¹ Besides defining the main principles applicable to the assessment of both single and collective (joint) dominance, the draft Guidelines provide instructions for determining whether conduct by a dominant firm is likely to constitute exclusionary abuse and gives guidance on defining the abusive conduct through two key concepts: “*competition on the merits*” and “*exclusionary effects*”.

The Commission defines competition on the merits as conduct which is normal competition based on the performance of economic operators and in which, at least in principle, consumers benefit from lower prices, better quality or wider choice of goods and services.² Exclusionary effects refer to any effect on competitors’ ability or incentive to exercise competitive constraint on the dominant firm and includes excluding, marginalising or constraining growth of the dominant firm’s competitors.³

In addition to providing a general description of exclusionary abuse and how dominant firms’ conduct should be evaluated, the draft Guidelines provide more prescriptive definitions for specific conduct. One important element, which is expected to generate extensive discussion in the coming months, is the introduction of a list of conducts presumed to be capable of producing exclusionary effects.

Price-cost test not required in the assessment of all price-based conducts

The draft Guidelines provide clarification on the use of price-cost tests such as the AEC test. This test has been historically used to quantitatively assess the risk of anti-competitive foreclosure.

The key economic rationale of the price-cost (AEC) test is to protect as-efficient competitors while preserving dominant firms’ ability to compete on the merits. Put simply, the price set by the dominant firm is compared with its own costs to determine whether an equally efficient competitor with the same cost structure would be able to compete against the dominant firm.⁴ The underlying principle is that when competition is based on the economic efficiency of the dominant company on its own merits, it may lead to foreclosure of less-efficient competitors, and, therefore,

only those at least as efficient as the dominant firm should be protected.

The test already featured in the Guidance on the Commission’s enforcement priorities in applying Article 82 (“Guidance”) as generally relevant for the assessment of all price-based conduct. The Guidance does not specify the use of the test and its relevance for specific conducts, especially different types of conditional rebates.⁵

The draft Guidelines seem to provide this clarification with clearer indications on the applicability of the test in each type of price-based conduct. Specifically, with the draft Guidelines the Commission define explicitly the set of price-based conducts (and conditional rebates) for which the test is required compared to instances where the test can be considered as one informative element part of the broader assessment and provide more instruction on the application of the test with different types of rebates.

The role of the price-cost (AEC) test does not appear to be drastically limited, as feared by some commentators. However, according to the draft Guidelines the test may not be considered necessary or appropriate for the assessment of exclusivity rebates where there is now a presumption of abuse. This appears to mark a change (or at least additional clarity) compared to the Guidance paper, which said that the Commission would typically not intervene if an as-efficient competitor could compete.

In the Table below, we present the different price-related conducts described in the draft Guidelines and summarise the use of the price-cost test in the assessment of each of the conducts. Following the structure provided in the draft Guidelines, we distinguish between how the price-cost test is used to appraise a) whether the conduct itself departs from competition on the merits and b) whether the conduct has the capability of producing exclusionary effects.

We note that even for conducts where price-cost test is not required, the draft Guidelines clearly state that the Commission is still required to assess any evidence submitted by the dominant firm to rebut the presumption of abuse.

¹ See https://ec.europa.eu/commission/presscorner/detail/en/ip_24_3623

² Draft Guidelines, paragraph 51.

³ Draft Guidelines, paragraph 6.

⁴ In practice, the relevant cost benchmark is the cost of the dominant firm, but as noted in the draft Guidelines, other costs may be used as the benchmark where costs of the dominant firm are not available.

⁵ Draft Guidelines, paragraphs 23-27.

Table 1 Use of the price-cost test in the assessment of price-related conducts

	Conduct departs from competition on the merits	Capability to produce exclusionary effects
Conducts with a defined legal test in the draft Guidelines		
Exclusivity rebates	Test not required. Conduct can be presumed to depart from competition on the merits.	Test not mentioned. However, dominant firm may still submit analysis on presence and relevance of exclusivity rebates to prove conduct is not capable of producing exclusionary effects.
Predatory pricing	Test is required. With prices below AAC/AVC presumption of competition not on the merits while between AAC/AVC and LRAIC further evidence is needed to prove intention of exclusion or marginalisation.	Conduct can be presumed to produce exclusionary effects. Test can still be a relevant factor in the assessment.
Margin squeeze	Test is required. With negative spread between upstream and downstream prices presumption of competition not on the merits, while positive spread requires further analysis.	Conducts can be presumed to produce exclusionary effects if test indicates negative spread. ⁶ No presumption and further assessment required if test shows positive spread.
Conducts without a defined legal test in the draft Guidelines		
Conditional rebates (single product)	Test is required only for standardised volume-based incremental rebates. Test may not be appropriate when there are non-monetary benefits and when as-efficient competitors cannot emerge.	The test can be used, among several other element, in the assessment.
Conditional rebates (multi-products)	Assessment similar to single-product conditional rebates unless exclusivity requirements are applied to one product.	Assessment similar to single-product conditional rebates unless exclusivity requirements are applied to one product.

Source: Copenhagen Economics based on the draft Guidelines on exclusionary abuses of dominance.

As presented in the table above, under the right circumstances the price-cost test alone can provide conclusive evidence. This is both on the conduct departing from competition with the merits and the conduct's capability of producing exclusionary effects in case of predatory pricing and margin squeeze. Under both types of conduct, in line with established practice, pricing below a set benchmark establishes definitively an abuse of dominance: on predatory pricing when the price is below the firm's average avoidable cost (AAC) or average variable cost (AVC) and on margin squeeze when the difference between the downstream and upstream price is negative.

In line with established practice, the guidelines further recognise the possibility of a grey zone where the existence of abuse of dominance cannot be definitively ruled out. For example, in the case of suspected predatory pricing, prices between AAC and long-run average incremental costs (LRAIC) may still be found predatory but only if further evidence is found on exclusionary intention. Similarly, even with a positive difference between downstream and upstream prices, a margin squeeze may exist if other evidence proves the intention to depart from competition on the merits.

On the other price-related conducts, the draft Guidelines do not clearly require the application of a price-

cost tests. For example, on rebates tied to exclusivity, the conduct alone can be presumed to depart from competition on the merits and to have the capability of producing exclusionary effects. However, our interpretation of the draft Guidelines is that a dominant firm may still submit analysis on the presence and relevance of its exclusivity rebates to prove that its conduct is not capable of producing exclusionary effects.

Uncertainty remains on the as-efficient competitor as the right benchmark

Finally, another contentious point generated by the Commission's earlier communications was the fear that the Commission would take an approach towards the protection of less or not-yet-as-efficient competitors, thus departing from the "as-efficient" competitor principle. Commonly cited downsides of this include increased legal uncertainty for firms and the reduced ability for dominant firms to pass-on their efficiencies to consumers.

The possibility of taking the competitive constraints from less efficient competitors into account in certain circumstances was already present in the guidance paper of 2008.⁷ However, there was no clear delineation of these borderline cases. The draft Guidelines take a broadly similar approach.

When discussing the general approach to assess exclusionary abuse, the draft Guidelines allow for abuse to be found even in situations where the firms affected by the conduct are not as efficient as the dominant firm.⁸

In the context of conditional rebates, the draft Guidelines are more specific and indicate that price-costs test may not be appropriate for the assessment of whether the conduct departs from competition on the merits when: "*the emergence of an as-efficient competitor would be practically impossible, for instance, because of the dominant undertaking's very large market share or the presence of significant barriers to entry or expansion in the market, or the existence of regulatory constraints*".⁹ We note that these conditions appear quite broadly defined, which may create uncertainties on whether or not a specific case fulfils them.

Overall, we see that the Commission has broadly maintained the principle of as-efficient competitor in the draft guidelines. However, a degree of legal uncertainty remains on how to identify special circumstances where market structure may grant protection

to less efficient competitors and limit the relevance of the price-cost (AEC) test.

⁷ Communication from the Commission: Guidance on its enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings. (hereinafter "Guidance paper of 2008"), paragraph 24.

⁸ Guidance paper of 2008, paragraph 23.

⁹ Draft Guidelines, paragraph 144 (b).

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