For Official Use DAF/COMP/WD(2005)11

Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

26-May-2005

English text only

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

ROUNDTABLE ON COMPETITION ON THE MERITS

-- Note by Turkey --

This note is submitted by the Turkish Delegation to the Competition Committee FOR DISCUSSION at its forthcoming meeting (1-2 June 2005).

JT00185023

DAF/COMP/WD(2005)11
For Official Use

English text only

1. This paper aims to contribute to the discussions in the Roundtable on the Competition on the Merits to be held on June, 2005.

1. Act on the Protection of Competition No 4054

2. The Act on the Protection of Competition No 4054 (the Act) has been enacted in 1997. The provisions of the Act are compatible with Articles 81 and 82 of the Rome Treaty and Merger Regulation of the EU as part of Turkey's aim and commitments towards becoming a member of the EU. The principles contained in the case-law of the European Commission, Court of First Instance (CFI) and the European Court of Justice (ECJ) are taken into account as precedent in the decisions of the Turkish Competition Board (the Board), the decision making body of the Turkish Competition Authority.

3. Purpose of the Act is to prevent anticompetitive agreements, decisions and practices and abuses and ensure protection of competition. The reasoning of the Article concerning the purpose foresees that aim of the Act is to protect competition because competition is the driving force for efficient use of resources, decrease in prices of rival products, use of new technology by the undertakings, increase in the quality of the products, continuous and balanced growth of the economy and achievement of social benefit that is the protection of consumers. Therefore, the ultimate purpose of the Act is protection of competition rather than competitors as the cases decided by the Board prove.

4. The term dominance is defined in the Act as "the power of one or more undertakings in a particular market to determine economic parameters such as price, supply, the amount of production and distribution, by acting independently of their competitors and customers." The Act does not prohibit dominance because it is desirable for an undertaking to gain dominant position as a result of its growth through its own internal dynamics. However, the abuse of a dominant position is prohibited when a dominant undertaking abuses its dominant position if the purpose or the effect of its behaviour is to prevent, restrict or distort competition. The purpose of the dominant undertaking is overtly mentioned apart from effect in the reasoning of the Article, therefore intent of the dominant undertakings can also be determinative in the analysis of abusive behaviour. Article 6 (the Article) of the Act entitled "Abuse of Dominant Position" cites some non-exhaustive abusive practices as complicating the activities of competitors in the market or preventing new entry; discrimination; tying; distorting competition in another market by abusing dominance in a certain market and restricting production, marketing or technological development to the prejudice of consumers.

5. As the reasoning of the Article implies, any conduct by a dominant firm as a result of its internal dynamics will not be prohibited (therefore will be seen as behaviour on the merits) even if the competitors in the markets face difficulties in remaining in the market or they are obliged to exit the market. To determine whether a behaviour is caused by internal dynamics of a dominant firm or by anticompetitive purpose or effect is a delicate matter and requires sensitive analysis of the market conditions. However, while determining abuse, it should also be kept in mind that dominant undertakings have a special responsibility not to impair competition in the market and this causes some conduct to be deemed abusive when pursued by a dominant firm, whereas it is not regarded so when conducted by a non-dominant one.

6. It is imperative to analyse some of the important decisions of the Board to have possible conclusions about the boundaries of the term competition on the merits.

2. Decisions by the Turkish Competition Board

2.1. Excessive prices

2.1.1. Belko

7. Belko Ankara Coal and Asphalt Ltd (Belko) is the only organization that has the right and authority to sell coal in the provincial centre of Ankara and its environs. It was alleged that the prices it charged were excessive and therefore constituted abusive practice in violation of the Article.

8. This case is important because it highlighted the position of the Turkish Competition Board (the Board) vis-à-vis pricing policy of a dominant firm.

9. Turkish Competition Board referred to the definition of monopolistic price as "*the price set above competitive prices as a consequence of the use of one's market power*" while stating that there does not exist a rule for determining what proportion of the price should be qualified to be excessive and therefore it should be assessed on a case-by-case basis and many factors like the degree of barriers to entry; positions of other enterprises; and prices of relevant products in different geographical markets should come into play.

10. The Board took into account as the most important criterion the prices *(charged by the dominant enterprise, that is Belko)* with the prices of identical or equivalent products in other geographical markets, that are relatively more competitive but otherwise have comparable market characteristics to establish monopolistic price. The Board also analysed cost-price relationship and ruled that " *... while, along with high prices, a large margin between the sale price and the total cost (excessive profit) could be considered a sign of excessive pricing, monopolistic pricing is also possible in situations where the profit margin turns out low or even negative due to establishment of real or fictitious costs in excessively large magnitudes (along with prices set at relatively high levels).*"

11. The Board in this case mentioned that a firm in a dominant position had special responsibilities and cited prudent and efficient management as the leading one. In contrast to that special responsibility, the state of affairs surrounding the case, especially the concession granted to Belko to sell coal in Ankara without necessary legal checks against abuses in the form of pricing, led to lack of maximum care and diligence in protecting the Company's interests in making purchases; overstaffing; costs higher than what they should have been, due to ineffective style of management; and finally high prices. Therefore, the high levels of the costs incurred by the Company stemmed to a large extent from failure to act with care and diligence in coal purchases and the Company operations outside of the coal trade.

12. As a result, it has been established that Belko's sale prices have been set at levels 50-to-60 percent higher, on the average, relative to prices for the same or equivalent coal being sold in other geographic markets that were open to competition and the undertaking was held responsible for abusing its dominant position. The Board dismissed the theory that monopolistic prices would attract new entry in the long run and therefore they should not be condemned as abusive due to the fact that there was absolute barrier to entry to the coal market in Ankara in the form of legal concession.

13. In preventing excessive pricing, the Board presumed that there would be improvement in income distribution as well as allocative efficiencies that could contribute to betterment of social welfare. The practice of monopolistic pricing was seen as within the scope of the Act due to its exploitative character especially at consumer level while not directly harming the competitive environment in the relevant market.

14. The Board, in this case, accepted that the special responsibility of the dominant firms obliges them to avoid cost-increasing practices and that excessive profits that might come as a result of efficient management and effective cost control along with price levels that could be considered normal as not incompatible with the Act. Therefore, competition on the merits in this case refers to conduct by dominant firms involving efficient management and effective cost control and inefficient management is seen as an important element lacking merit. Moreover, prices charged by dominant firms 50-60% higher than those in comparable competitive markets are excessive enough to be abusive when the peculiarities of the case is taken into consideration.

2.2. Selective pricing

2.2.1. Anadolu Cam

15. In another case, pricing policy of Anadolu Glass Industry Inc. (Anadolu Cam), the dominant undertaking in glass packaging market, against its rival Marmara Glass Industry and Trade Co. Ltd. (Marmara Cam) in a tender by Tekel Tobacco, Tobacco Products, Salt and Alcohol Enterprises Incorporated Company (Tekel) reflects the Board's attitude regarding selective pricing.

16. The case is about the application of a pricing policy by Anadolu Cam that would complicate the market activity of Marmara Cam which is perceived as a threat by it against its "overwhelming superiority" in the glass packaging market, but that would also not reduce the overall proceeds sought to be attained by it. In other words, two goals are intended to be attained as a result of this practice:

1. Complicating the market activities of Marmara Cam,

2. The absence of reduction in the overall proceeds sought to be attained while complicating the market activities of Marmara Cam.

17. The Board takes into account the fact that it would be the consumers who would suffer under both goals.

18. Under the first goal, the competitive process defined in Article 3 of the Act as *"the contest between undertakings in markets for goods and services, which enables to take economic decisions freely"* would be distorted; this situation would affect consumers in the long term and when analysed ultimately.

19. On the other hand, the second goal prevents Tekel from benefiting as well. In other words, should Anadolu Cam had made a reduction in other products too, Tekel and consequently consumers would have benefited from it as well in the short term and when analysed ultimately.

20. As a result, both goals were attained in the relevant event, and consumer loss emerged due to both the distortion of the competitive process and the increased purchasing cost of the relevant buyer; therefore, the welfare of the society at large diminished. These explanations also prove that it is the competition that is protected, not the competitors in the Board decision.

21. The Board took into account the cases of Hilti[1], Cewal[2] and Irish Sugar[3] concluded by the European Commission and approved by CFI and ECJ and cited the elements of selective pricing as granted in the literature as follows:

1. The undertaking in dominant position should have the opportunity of being able to complicate the activities of its competitors with strategic behaviour independent of costs,

2. The relevant undertaking should explicitly be in a dominant position,

3. The undertaking in a dominant position should have only one competitor,

4. There must be evidence indicating the goal of the undertaking to complicate the market activity of its competitor.

22. All the 4 elements above existed in this case:

1. Anadolu Cam has the opportunity, owing to the structure of the tender, to apply a price policy complicating the activity of Marmara Cam without incurring a significant cost and without being required to sell below the cost.

2. That Anadolu Cam is in dominant position is even acknowledged by the representatives of the undertaking.

3. The only competitor of Anadolu Cam in the tender is Marmara Cam.

4. Evidence indicating the goal was found during the on-the-spot inspection made at Anadolu Cam. Moreover, this intent is also acknowledged in the defence of Anadolu Cam.

23. Within the framework of such statements, the Competition Board decided that the pricing policy of Anadolu Cam in Tekel tender be considered as an abuse of dominant position by having committed actions with a view to complicating the market activity of Marmara Cam. It should be kept in mind that intent played a crucial role in concuding abuse in this case.

2.3. Predatory Pricing

2.3.1. Coca Cola – Frito Lay 2000

24. These two separate cases highlight the approach of the Board to predatory pricing. In *Coca Cola*, the Board mentions four elements to take into account in general while deciding the existence of predatory price as economic superiority (dominant position), extremely low price, intent and recoupment. Recoupment was discarded by the Board because even if predatory price is unsuccessful, it causes transition from producer's welfare to consumer's welfare meaning inefficient use of resources. Therefore, it was agreed that intent could be used within the structural features of the sector besides commercial superiority and low price.

25. Previously, in *Frito Lay* the Board's following remarks focus on intent:

> "During the process of price-cost analysis concerning with the predatory price, the concept of average variable cost constitutes the main movement point. A price under the average variable cost creates doubt toward the existence of the predatory price. If this doubt is supported with the intention of hardening activities of competitors or driving them out of the market, this case rules the existence of the predatory price also in reference law application sources[4]…

26. It may be expressed that there are two exceptions to evaluate the sales under cost as the predatory price, these are promotion activities and following the competitors. In a pricing policy carrying out within the framework of a certain promotion activity and for a temporary period the sales prices under the average variable cost may be accepted."

27. Moreover, the Board in *Coca Cola* cites widely the literature and the case law of the US and EU concerning predatory price and as a result accepts that even if the prices change between variable cost and total cost, the practice can be predatory price if there is predatory intent. In this case, no document proving

evidence of predatory pricing could be found and the motive behind the pricing strategy was tried to be found within the context of the structural features of the sector and the economic features of the period when the predatory prices were alleged to be applied and as a result no intent was proved.

2.4. Exclusivity Clauses

2.4.1. Karbogaz

28. Another case deserves to be mentioned is against Karbogaz Carbon Dioxide Industries Joint-Stock Company (Karbogaz) that concluded long term exclusive contracts with its clients.

29. In this case, the Board tried to establish whether Karbogaz, the dominant firm in the market of liquid carbon dioxide, had abused its dominant position via long term exclusive supply contracts with direct users.

30. Although no definition of abuse is given in the Act, the Board defined "abuse" as "…every kind of activities which is related to the existence of the undertaking and prevent the continuity or the improvement of the competition and thus cause weakening the competition through influencing to market's structure by different methods from conditions in normal operation of competition …" in the light of European competition law. The Act, as mentioned above, does not prohibit dominance but its abuse. This distinction recognises as legitimate the increase of the market share of a firm via internal efficiencies and as a result the undertakings are accepted to have the opportunity to outperform their rivals via their internal efficiencies and dynamics. The crucial point is the market power as a result of internal dynamics and efficiency. If the undertaking cannot keep internal efficiency, it is expected that the rivals would limit its power on the condition that no entry barrier, structural or behavioural, existed. The abuse is an objective concept and therefore, no intent to restrict competition is absolutely needed. A conduct can be prohibited if its effect restricts competition. It is accepted that dominant undertakings have special responsibilities unlike those that are not dominant. Thus, within this special responsibility dominant undertakings are expected to know the effects of its conduct in the relevant market and control its conduct accordingly.

31. Based on this theoretical basis, the Board analysed whether Karbogaz abused its dominant position: That Karbogaz strived to prolong the duration of the exclusive contracts in the face of a new entrant is regarded as a policy of preserving its position and excluding the rival strategically against the new rival. This policy is basically dependent on long term exclusive contracts and the result is elimination of freedom of clients to work with alternative suppliers and foreclosure of the market to competition for these clients. The conduct to prolong the duration of the contracts to 3-5 years was regarded as aiming to sustain the market power, achieved by its own internal dynamics, through uncompetitive methods. The effect of the long term exclusive contracts is entry of limited number of undertakings into the relevant market and unwillingness of potential entrants. The basic reason for existence of two entrants in the relevant market and their survival is their activities in other business fields. It was hard to enter or remain in the market if they involved in only liquid carbon dioxide. Such exclusive agreements were regarded as creating entry barriers in a market where no structural or legal entry barriers and complicating the actual or potential rivals and enabling the preservation of dominant position of Karbogaz. It was Karbogaz's special responsibility not to restrict competitive conditions that were already restricted in the market by conduct that were not the result of its internal efficiency although Karbogaz gained its market power by its internal efficiency to a great extent. Thus, Karbogaz should know about the fact that its market strategy, which was essentially based on the exclusive supply contracts made with the clients to protect its market position, would have created negative effect in the market and this negative effect would not originate from its own dynamics and Karbogaz should have acted according to this. As a result, when the effects and the supposed intentions behind them are taken into consideration Karbogaz violated the provision of "preventing,

directly or indirectly, other enterprises in its area of commercial activities or practices which aim to impede the activities of the competitors in the market" in subparagraph (a) of the Article 6 of the Act.

32. The Board in this case again emphasised the special responsibility of dominant undertakings and took into account foreclosure effect of the exclusive agreements. Intent in this case is taken into consideration while alleging abuse, however, it can be said that it is not an essential component of the analysis. Rather, effect of the contracts has constitutive feature in determining abuse. That Karbogaz lost some market share although it prolonged the duration of the contracts was not enough for relief because existing level of effects of the contracts was sufficient to condemn the conduct.

2.4.2 Frito Lay 2004

33. The decision discusses whether a dominant undertaking's exclusive agreements with retail outlets for sale of only its products complicate the rival's activity and constitute abuse or not. Agreements with exclusivity clauses that require a sales point to sell only the products of a supplier to the exclusion of the products of rival suppliers normally benefit from the block exemption of the Communiqué concerning vertical agreements (the Communiqué). Block exemption communiqués legalise such otherwise anti-competitive unlawful agreements on the condition that beneficial effects on competition outweigh anti-competitive impacts and consider them as lawful. The beneficial effects must ensure new developments and improvements, or economic or technical development in the production or distribution of goods and in the provision of services; benefit consumers; avoid elimination of competition in a significant part of the relevant market and avoid limitation of competition more than what is compulsory for achieving the beneficial goals. These conditions are known as conditions for exemption. The Communiqué is applicable to agreements of any undertaking regardless of its market power. However, the Communiqué foresees that benefit of block exemption can be withdrawn in case exemption conditions are proved to be lacking. Moreover, the benefit of block exemption does not avoid application of the Article prohibiting abuse of dominant position. As a result, it is accepted that exclusivity may be condemned as abusive because it prevents rival suppliers to deal with certain customers. The Board again reiterates the special responsibility of a dominant undertaking to know about the effects of its conduct in the relevant market and control their conduct accordingly and warns dominant undertakings to cease their relationships including exclusivity if they reach a level that complicates the activity of the actual or potential competitors or cover an important part of the relevant market. The Board says that abusive intent is not absolutely required to condemn a conduct or a transaction by a dominant undertaking because it is an objective concept and therefore it is sufficient to find abuse if the effect of a conduct restricts competition. Intent, on the other hand can be taken into account while imposing fine.

34. The Board further gives the elements of the analysis as internal dynamics, just cause (objective justification) and proportionality. The Board seeks for whether the conduct is derived from internal efficiency of the undertaking or it has a just cause. If the conduct is just and can be connected to internal dynamics, then the conduct might be deemed lawful even the competitive conditions are distorted against the competitors. Besides, another factor to be considered is the principle of proportionality meaning there must be proportionality between just cause and the conduct. Moreover, if the conduct does not lead to any efficiency gain for the consumers but merely drives the competitor out of the sales point, then the conduct might not have any connection from internal efficiency and might be named as abuse.

35. It is useful to distinguish complication of competitors' activities as a result of competition that is expected to be in the market and as a result of conduct of dominant undertaking that is not competitive. Otherwise the prohibitions would punish only the dominant undertakings. Utmost care must be taken to eliminate the risk that many conduct of the dominant undertaking that complicates competitors might be condemned as abusive as part of their special responsibility. Therefore, concept of complication must be construed narrowly in line with economic reasons and only the conduct that diminishes or totally abolishes

the power of the competitors to compete must be seen under the concept of complication. Within the concept of complication, a substantial part of the market must be foreclosed and the competitive process must be disrupted as a result of the conduct.

36. The conduct of Frito Lay, the dominant undertaking in salty snack market, in the form of discounts, products for free and cash in return for exclusivity was proved to be realised in limited time periods and areas and therefore produced limited effect with no power to drive the competitor out of the market. Therefore no abuse was found in the end.

3. Conclusion

37. Competition law is a field of law where it is not easy to draw clear-cut conclusions beforehand as to what constitutes competition on the merits. Reading of the decisions of the Turkish Competition Board gives some principles as to conduct on the merits and off merits, however it is not always easy to draw clear cut conclusions in advance without sensitive analysis on a case by case basis. The nature of the market, the content and purpose of the conduct in question, the effects in the market are all relevant to an extent. The intent might play an important role for cases involving predatory or selective prices whereas intent might not be required in other cases such as those involving foreclosure allegations because abuse is an objective concept. The dominant undertakings should know that their conduct should come from their superior competitive capabilities to avoid competition investigations and any conduct should be accountable in terms of internal dynamics.

NOTES

1. Eurofix-Bauco v. Hilti (1988) OJ L65/19 [The European Commission]
Case T-30/89, Hilti v. Commission (Hilti) [1991] ECR II-1439 [CFI]
Case C-53/92 P, Hilti v. Commission (Hilti) [1994] ECR I-666 [ECJ].

2. Cewal (1993) OJ L34/20 [The European Commission]
Cases T-24-26&28/93, Compagnie Maritime Belge Transports SA and Others v. Commission (Cewal) [1996] ECR II-1201 [CFI]
Case C-395&6/96 P, Compagnie Maritime Belge Transports SA and Compagnie Maritime Belge SA v. Commission (Cewal) [2000] ECR I-1365 [ECJ].

3. Irish Sugar (1997) OJ L258/1 [The European Commission]
Case T-228/97, Irish Sugar plc v. Commission (Irish Sugar) [1999] ECR II-2969 [CFI]
Case C-497/99 P., Irish Sugar plc v. Commission (Irish Sugar) [2001] ECR I-5333 [ECJ].

4. “Reference law application resources” refers to European competition law applications