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Common Market Competition Policy as a Strategic Planning Issue for Transnational Firms

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Introduction

Managers in charge of international business decisions must recognize competitive conditions to make production, distribution, and marketing decisions. They must be cognizant of competitors' strategies as well as institutional arrangements which affect competition. As the international business environment has expanded, government regulations designed to control unfair or restrictive business practices have proliferated. Today, nearly all major developed countries with market economies prohibit the abuses of monopoly power and proscribe certain enterprise activities which restrain competition.[1] Furthermore, governments have become less reluctant to apply their antitrust law extraterritorially. The ability of multinational firms to compete in international markets will increasingly depend upon their recognition and adherence to statutes which regulate business operations.

This paper discusses the historical development of European Economic Community (EEC) competition policy with regard to U.S. firms competing in the Common Market. The study points out the business practices of American multinationals that have been determined to be incompatible with the EEC treaty. Further, the Community's settlement of its antitrust case with IBM, and the effects of the agreement are analyzed.

The Extraterritorial Application of EEC Competition Rules

In 1958 the Benelux countries, France, Italy, and Germany signed the Treaty of Rome and formed the European Economic Community.[2] The Treaty states in Article 3(F) that the Community must institute a system to ensure that competition in the Common Market is not distorted.

Articles 85 and 86 of the Treaty provide the competition law to deal with public and private enterprise activity.

Article 85, paragraph one, of the EEC Treaty prohibits concerted practices, agreements, and decisions of enterprises, if such practices affect trade between EEC member states and have the object of preventing, restricting or distorting competition within the EEC.[3] Article 85(1) points out that price fixing, market sharing, tying agreements and placing dissimilar conditions to equivalent transactions with other trading partners may violate the Treaty.

Paragraph three of Article 85 allows for exemptions from the prohibitions of paragraph one if the activities contribute to the improvement of production or distribution of goods or promote technical or economic progress within the EEC. Thus, Article 85 does not proscribe any activity per se, and, in theory, any restraint of trade may be deemed acceptable if economic or technological improvements are likely to be forthcoming.

Article 86 prohibits the abuse of a dominant market position by one or more enterprises if trade is affected in a substantial part of the Common Market.[4] The provision does not disallow monopolies or the acquisition of monopoly power, only the abuse of a dominant position is proscribed. The Article signals the EEC's approval of building large-scale firms of community size to compete with foreign multinationals. However, the Article points out a non-exhaustive list of possible abuses: (1) directly imposing unfair purchase or selling prices; (2) limiting production, markets or technical developments; (3) applying dissimilar or discriminatory conditions to equivalent transactions; or

(4) concluding contracts which contain supplementary obligations that have no connection with the subject of such contracts.

The supranational administrative body primarily responsible for the implementation of competition policy is the EEC Commission. The Commission has fourteen members which represent all nationalities in the Community. The Commission has the power, granted under Regulation 17, to investigate business practices, invoke the prohibitions of Articles 85(1) and 86, and grant exemptions from prohibition under Article 85(3).[5] The Commission is advised by the Competition Directorate-General (DG IV) which consists of approximately fifty officials.

In 1969, the EEC extended for the first time a ban on enterprise activities to companies with headquarters in non-member countries. The extraterritorial application of Article 85 occurred in the Aniline Dyes Cartel (69/243) decision which established the "unity of the group theory."[6] Eleven aniline dye manufacturers, including three in Switzerland and one in the United Kingdom, were fined a total of 540,000 units of account for participating in a restrictive practice involving uniform and simultaneous price increases throughout the Common Market. The Commission reasoned that when a parent and a subsidiary form a single economic unit then the action of a subsidiary can be imputed to the parent company, and, consequently, EEC rules of competition are applicable to all restrictions of competition which affect trade in the Common Market.

The advent of EEC extraterritorial jurisdiction has resulted in an increase in the application of EEC competition provisions to U.S. firms. In 1970, Continental Can Company of New York, through its European subsidiary Europemballage, signed an agreement to purchase the Dutch firm Thomassen.[7] Continental purchased 91 percent of Thomassen in April of 1970. The Commission immediately opened an investigation of the acquisition and in December of 1971 decided Continental Can had abused its dominant market position in the light metal container industry by its purchase of Thomassen. The Commission reasoned that the acquisition had practically eliminated competition in certain packaging products in the EEC. Although the Court of Justice annulled the Commission's decision in 1972 for not sufficiently showing the facts on which the decision was based, the precedent of attempting to regulate the behavior of U.S. firms in the Common Market was established.[8]

Since the Continental Can case, a number of American multinationals have been involved in EEC investigations concerning their European marketing and production practices. In 1975, United Brands Company (UBC) was fined one million units of account for price discrimination and refusal to supply distributors.[9] UBC, the world's largest seller of bananas, was found guilty of fragmenting European markets and charging customers different prices according to the member state, although there was no objective reason for such discrimination. The importance of the decision lies in the fact that the Commission investigated the firm's entire marketing policy to determine that UBC indulged in business practices at variance with the goals of integrated markets and undistorted competition in the Common Market.

The Commission found in 1973 that General Motors Continental infringed Article 86 by charging a price that was abusive for the issue of Belgian automobile inspection certificates.[10] A fine of 100,000 units of account was levied against the firm for the infringement. In

1972, Commercial Solvents Corporation of New York was fined 200,000 units for abuse of a dominant position in the nitropropane market, and for the first time in any Community competition-law case the Commission fined the company 1000 units for each day's delay in paying the fine.[11] The Commission held that Commercial Solvents abused its dominant market position by refusing to sell nitropropane to an Italian firm, ZOJA, and, thus, appreciably restricted competition in the EEC.

Although the above-mentioned American firms were fined for practices which infringed on EEC competition laws, other U.S. multinationals have received favorable rulings from the Commission and Court of Justice. Several agreements for joint research and development between U.S. enterprises and Common Market firms have been authorized.

The Commission maintains that efforts made in pure and applied research determine the competitiveness of enterprises and enhance the possibility of development in the economy.[12] Also, they recognize the research hastens the pace of technological innovation. Consequently, the Commission has tried to remove obstacles to the cooperation of enterprises in research and development throughout the 10-nation group. Article 85, paragraph three, of the Rome Treaty empowers the Commission to exempt business activities from the ban on restrictive practices if a contribution to technical or economic progress is likely to result.

A rather remarkable exemption was granted by the Commission in Henkel-Colgate (72/41).[13] The Henkel-Colgate decision is highly indicative of the balancing process utilized in the EEC to determine the acceptability of concerted practices. Henkel of Dusseldorf, and Colgate-Palmolive of New York entered into an agreement to coordinate their development of laundry soaps and detergents. Although Henkel and Colgate controlled 37 percent of a highly oligopolistic market, the Commission approved the agreement because they believed consumers would receive a fair share of the benefits from the cooperation through a greater supply of improved products. The Commission contended that "technical progress" from the joint efforts was predictable, and competition between Henkel-Colgate and its two other large competitors would be promoted.

In a similar case, an exemption from prohibition was granted by the Commission on a specialization agreement between DeLaval Turbine International in Trenton, New Jersey and Stork Corporation, located in Amsterdam.[14] DeLaval and Stork formed a joint venture in the Netherlands for the purpose of combining their production and marketing activities throughout Europe. The firms agreed to cooperate in the development, manufacture, maintenance and sale of compressors used in heat recovery equipment in large-scale plants. The Commission pointed out in its findings that the agreement should benefit users by allowing a jointly-owned plant to operate near capacity, thus reducing the proportion of total costs represented by fixed costs and, ultimately, lowering prices.

The important implication from the exemptions granted under Article 85(3) of the EEC Treaty is that American firms with specific technical expertise may be able to efficiently penetrate European markets by entering into joint cooperation agreements with Common Market firms. Also, specialization agreements between U.S. and European firms which rationalize the production or distribution process have been viewed favorably by the Commission.[15]

The cases cited suggest that supranational governmental actions designed to promote competition have a significant effect on the planning and operation of U.S. firms competing in the EEC. Regulation, legislation, and litigation affect the businesses multinationals enter, the risk associated with attaining corporate goals, and research and development priorities. The Common Market's settlement on August 1, 1984 of its long-standing investigation of the business practices of IBM is likely to produce the most profound effects for multinationals to date.

Background of the IBM Case

The EEC Directorate of Competition began an investigation of the marketing practices of International Business Machines of Armonk, New York, (IBM), in 1974 after receiving complaints from five of IBM's competitors in the Common Market.[16] All five companies were subsidiaries of U.S.-based firms and included Memorex Corp., Amdahl Corp., National Advanced Systems, Manguson Corp., and Four-Phase Systems, Inc. The firms had long complained that IBM dragged its feet in servicing and updating programs run on non-IBM hardware. Specifically, IBM was accused of delays in updating, debugging, and making engineering corrections of the software. In addition to such charges, Amdahl Corp. accused IBM of generating fear, uncertainty, and doubt - known as "fud" in industry circles - in the software market. Allegedly, between the time a new IBM software product is announced and shipped, IBM salesmen create "fud" in customers by not making public the operating principles of the interface between software and computer hardware.[17] Thus, the Commission conducted an investigation between 1974 and 1980 of the marketing practices of IBM and its subsidiaries to determine if the practices amounted to an abuse of a dominant market position within the meaning of Article 86 of the EEC Treaty.

The EEC's case, filed in December of 1980, strongly resembled the U.S. Justice Department's 13-year antitrust investigation and civil suit against IBM. However, the U.S. dropped its case in January of 1982 after six years of trial, saying the evidence was "flimsy" and the case was "without merit."[18] During this time, IBM won or settled 16 private antitrust suits, including a Supreme Court decision involving Memorex Corp., one of the U.S. companies which complained to the Common Market.

The Common Market pressed on in its case, despite the considerable economic might which IBM wielded in the negotiations. The company publicly and privately informed the European Community that they annually bought close to $2 billion of goods and services from 50,000 European supplies; in 1983 invested $1 billion in land, buildings, and equipment; had 87,000 European employees; and operated 15 manufacturing plants and 9 research centers.[19] These facts are indicative of IBM's European economic power, but the $1 billion which the company paid in European taxes in 1983 was probably more significant in the settlement negotiations.[20]

Besides taking on a firm of extensive economic importance in the European Community, the EEC had to contend with U.S. government intervention on behalf of IBM. Only a few days after the June 8, 1982 announcement of the dismissal of the U.S. antitrust case against IBM, William Baxter, chief of the Justice Department's antitrust division, personally appealed to officials of the EEC Commission attending a Paris meeting of the OECD to curb the European case against the computer company. Also, the U.S. invoked special diplomatic procedures and for the first time sent an official observer to European Commission anti-trust hearings. Sherman Unger, the general counsel of the Commerce Department, was dispatched to work with the Europeans to head off problems.

The U.S. contingent maintained throughout the proceedings that a ruling against IBM would reduce the firm's profits from innovation, negatively affect U.S. trade, and have extraterritorial effects. The dismissal of the U.S. case against IBM and the intervention in the EEC led Judge David Edelstein, who presided over the U.S. case, to raise questions about a possible conflict of interest on Mr. Baxter's part. A letter to Mr. Baxter, made public by Edelstein, stated:

> The U.S. government is now bootstrapping your action [dropping the IBM case] into its attempt to pressure the EEC to drop its charges against IBM . . . I must seriously question whether you have kept your faith with either the administration or with your professional responsibilities. Needless to say, I believe your dismissal of the IBM case [in the U.S.] did major damage to our judicial process. I also believe it was deliberately timed so as to benefit a single U.S. company in its international activities.[21]

The effect of Baxter and Unger's "participation" on the EEC's persistence in the case is indeterminable, but the perception existed among Community officials that U.S. representatives were motivated by the belief that "what's good for IBM is good for the U.S."[22]

At stake for IBM was its European business, which contributed about 30% ($12 billion) of its 1983 revenue of $40.18 billion. The remedy which IBM feared the most would force the company to disclose details of interfaces at the same time it announced a new product. Consequently, a key element in IBM's legal defense was the contention that early disclosure could eliminate the company's lead time on new products around the world and reduce the incentive to innovate. Further, IBM representatives at the Commission argued that IBM should not have to disclose valuable proprietary information when judge after judge in the U.S. had ruled that the company didn't have to disclose technical details before shipment. Finally, IBM lawyers maintained that the Commission breached established principles of international law, namely the principles of comity or non-interference in internal affairs of the United States.[23] The comity principle maintains that a state has a duty to consider its exercise of enforcement jurisdiction in the face of potential conflict with the law or policy of another state with a substantial interest in the matter. IBM's contention was that since the case was not settled in the U.S. in 1980, the Community should not have issued a statement of objections indicating their intention to make a decision on the legality of IBM practices in the EEC.

Particulars of the IBM Case

In the statement of objectives issued December 19, 1980 by the Director General for Competition, the Commission informed IBM that a procedure pursuant to Regulation 17 had been initiated and that a decision regarding infringements of Article 86 of the EEC Treaty was forthcoming.[24] The marketing practices of IBM were investigated for infringements under Article 86 because the statute prohibits the abusive exploitation by one or more firms of a dominant position within the Common Market. Specifically, the Article proscribes activities which limit product or technical developments, or "tying contracts," i.e., when a product is sold only on the condition that the buyer purchase certain additional products or services from the seller.

The Commission did not set forth the criteria it used for establishing its jurisdiction over IBM's activities in the 15 page settlement issued in early August. However, IBM has 15 European manufacturing plants, which produce ninety percent of the computers and data processing equipment the company sells in the EEC. Also, the firm controls almost two-thirds of Europe's market for "mainframe" computers, and is the foremost supplier in every country. Clearly, the extensive European operations of IBM provided the foundation for the Common Market's claim to jurisdiction in the case.

In order for the Commission to impose a fine or to make an order for termination of an infringement under Article 86, it had to establish that IBM held a dominant position in a specific geographic and product market and that an abusive practice had taken place. It must be pointed out that, historically, the Commission has been virtually indifferent to how dominance was acquired. Instead, the main emphasis has been on supervising the use of market power toward suppliers and purchasers once dominance had been achieved.

The issue of whether a firm has a dominant market position is concerned with structural competition. The Commission must determine that an enterprise holds a dominant position in a specific market before the question of abusive behavior is considered. The Court of Justice established in its Continental Can (6/72) decision that a full market power analysis is required to establish market dominance.[25] No exact percentage of market share has been established as a threshold for automatically indicating a dominant position. Thus, the Commission considers a firm's control over raw materials and capital; its command over technological expertise; as well as the likelihood for the development of competitors.[26]

The second determination the Commission undertook in the IBM matter involved behavioral aspects of competition under Article 86. This area concerned the abusive use of economic power by the company. Obviously, many enterprise activities may ultimately be found to violate EEC competition rules. However, at the time of the IBM investigation, the abuses which had been prohibited under Article 86 were:

1) the imposition of unfair terms and conditions upon members of an association which controlled music performance rights;

2) a merger which substantially reduced competition;

3) a refusal to supply goods to a longstanding customer;

4) the excessive pricing of automobile inspection certificates;

5) discriminatory pricing; and

6) the imposition of exclusive purchase privileges.

This list suggests that the definition of what constitutes an abusive practice has primarily been determined on a case-by-case basis. The conclusion that can be reached from this approach is that abuses occur where the Commission finds them to exist, and that the process is meant to be a deterrent to firms with market power in their relations with customers and competitors.

The Commission's case against IBM was founded upon the premise that the firm occupied a dominant market position in the supply of central processing units and basic software for the IBM 360 and 370 type computer systems and, thus, independently controlled the operation and maintenance of such units.[27] The Commission estimated that IBM had 40%

of the total computer market (mainframes and microcomputers) and 38% of the data processing market in Europe. Furthermore, the Commission adhered to the criterion established by the Court of Justice in the Continental Can (6/72) decision, namely that dominance exists when a firm has the power to act independently without considering competitors, purchasers, or suppliers. IBM's market share was a smaller percentage than the market shares of firms considered dominant in many EEC decisions taken under Article 86, but IBM's sales revenues in 1983 were seven times greater than its nearest competitor and actually totaled more than the sales of the nine next largest companies combined.

Data Processing Revenues In Western Europe
1983
($ millions)

1.	IBM (U.S.)	10,634
2.	Bull (France)	1,537
3.	Siemens (W. Germany)	1,380
4.	Olivetti (Italy)	1,160
5.	Digital Equipment (U.S.)	1,053
6.	ICL (U.K.)	984
7.	Nixdrof (W. Germany)	926
8.	Burroughs (U.S.)	860
9.	NCR (U.S.)	841
10.	Hewlett-Packard (U.S.)	775

Source: International Data Corporation

Based upon this information, the Commission established that IBM market power was great enough to meet the minimal requirement of dominance, i.e., the ability to affect trade between member states. The most important implication from the Commission's determination of dominance in this case is it showed that the question of market dominance can be settled before competition is eliminated. Thus, the touchstone to dominance in the IBM case was the power to prevent or interfere with effective competition between member states.

The EEC Commission determined through its investigation that IBM had abused its dominant position under Article 86 of the EEC Treaty in four ways:

1) by failing to supply other manufacturers, in sufficient time, with the technical information needed to permit competitive products to be used with System/370 ("interface information");

2) by not offering System/370 central processing units ("CPU's") without a capacity of main memory included in the price ("memory bundling");

3) by not offering System/370 CPU's without the basic software included in the price ("software bundling"); and

4) by discriminating between users of IBM software, in that IBM refused to supply certain software installation services ("Installation Productivity Options" = IPOs) to users of non-IBM central processing units.[28]

These practices infringed on EEC competition laws because they limited choice among purchasers and restricted opportunities for competitors who offer products designed to compete with as well as be compatible with IBM computer systems. The abuses fall into three categories under Article 86: tying arrangements (bundling); limiting production or technological developments; and discriminatory practices.

IBM's marketing policy of supplying main memory or basic software with central processing units was considered "bundling" by the Commission because the components were supplied without a separate price. The practice was considered an abuse of a dominant market position because IBM was perceived as protecting its position against manufacturers which produce processing elements designed to be plug-compatible with IBM's System/370 computers. In the Commission's view, "bundling" precluded European plug-compatible manufacturers from selling their own memory devices, interfered with technical developments, and had the potential of reducing the number of European firms in the computer industry. As pointed out, IBM engaged in both "software bundling" and "memory bundling."

An abusive practice which aided the Commission in its determination of IBM's market dominance was the recognition of the company's ability to "freeze" most of the European computer market. The situation occurs when IBM announces a new product but doesn't disclose the technical details, known as interface information. The information describes the physical interconnection and electronic interaction between various components of a computer system which plug together. In order for competitors' products to communicate with IBM machines, a set of rules and formats used by IBM computers, referred to as Systems Network Architecture (SNA), must be known.

When IBM introduced its System/360 computer in 1964, the principles of operation were released well in advance of product shipment. However, as IBM gained dominance in the market the practice of releasing interface information ceased, and IBM began releasing details only when it shipped a product to a customer.[29] Beginning with the introduction of the System/370 in 1971, announcement of a new product has preceded the actual shipment by as much as 18 months.

IBM's refusal to provide technical information creates fear, uncertainty, and doubt ("fud") among European customers. Potential buyers are reluctant to purchase IBM plug-compatible equipment because, with a new IBM product coming, they aren't sure that other equipment will stay compatible. Thus, the Commission decided that IBM's failure to release interface information was an abusive practice due to the detrimental effect on the incentive for IBM competitors to undertake innovation.

The Commission also contended that IBM had unfairly discriminated against EEC computer purchasers who used or desired to use IBM software with non-IBM computer systems. The complaints were submitted to the Commission by users of IBM products or competing products, not by the five firms which made the original objections. IBM software customers claimed that IBM delayed service or refused to supply software unless such equipment was used with an IBM central processing unit. Specifically, they alleged that IBM refused to supply a service known as an Installation Productivity Option (IPO) to users of central processing units produced by manufacturers other than IBM.

IBM's dilatoriness in providing and servicing its software used on non-IBM mainframes impaired competition in the EEC because computer purchasers were apprehensive about buying non-IBM products without the assurance of IBM's full and prompt support and service for its software. Thus, the Commission considered the practice an abusive use of IBM's market power, as it likely impeded the ability of non-IBM computer manufacturers to penetrate and compete effectively in the Common Market.[30]

The August 1984 settlement of the EEC-IBM case was reached after protracted Commission hearings and negotiations with IBM. After a hearing in February 1982, the Commission sent IBM a statement of the remedies dealing with the issues of memory bundling and interface disclosure. IBM suggested discussions take place with Commission officials to resolve the remaining concerns in the case. Informal discussions started in April 1983 in parallel with the formal proceedings. A second hearing in June 1983 resulted from the proceedings. The June hearing produced a preliminary draft decision which was then submitted to the Advisory Committee of national experts in June 1984. A final solution acceptable to the Commission was announced on August 2, 1984.

The Settlement and Effects of the Undertaking

The agreement between the Common Market and IBM outlines four points to which IBM must adhere. The agreement is scheduled to last at least until January of 1990.

The most important point requires that IBM provide, within four months after announcing a new computer, sufficient interface information to enable competing companies in the EEC to attach both hardware and software products of their design to the System/370. Another point in the agreement mandates IBM to disclose adequate and timely technical details of the Systems Network Architecture for the System/370. A speed-up in the publication of such information will better enable competitors to hook up their products to communicate with IBM machines. Further, IBM must undertake to offer its System/370 CPUs in the EEC, either without main memory or with only the capacity necessary for testing. Finally, IBM is to continue its efforts to match its Systems Network Architecture to the communications standard used by other European companies, called Open Systems Interconnection (OSI).[31]

The EEC is of the opinion that the agreement will have the effect of substantially improving the position of both users and competitors in the markets for System/370 products in the EEC. The earlier availability of interface information allows competitors the opportunity of putting their products on the market simultaneously with an IBM introduction. Consequently, the Commission expects the structure of competition in the Common Market to be strengthened and made more effective. The clear statement regarding IBM's conduct also introduces an element of certainty to customers which had been missing. Potential buyers will have more assurance that equipment purchased from other manufacturers will be compatible with IBM products. Thus, much of the fear, uncertainty, and doubt generated by IBM's announcement of new products will be eliminated. Additionally, users will now be given the possibility of a choice between different hardware and software suppliers at an earlier time.

Finally, as a result of IBM's agreement to offer customers the chance to buy mainframe computers without purchasing data-storage memory, customers will have the opportunity to purchase main memory at a lower price from an IBM rival. As IBM abandons the practice of bundling substantial capacities of main memory, users will enjoy choices and competitors' opportunities which have not existed previously.

Conclusion

The European Economic Community's August 1984 settlement of its competition case against International Business Machines, the world's largest computer manufacturer, brought to an end the longest and most complex competition action in EEC history. It marks the first time any government entity has persuaded IBM to meet a specific schedule for technical disclosures after a product announcement. Also, it appears to be the first agreement to establish formal procedures by which IBM's business practices can be reviewed by a government body.

The agreement between IBM and the EEC may have widespread ramifications for the computer industry in Europe as well as dominant companies in other industries. Although the compromise settlement only indicates what changes IBM must make in its European marketing practices, the guidelines can be expected to affect the conduct of multinational enterprises competing in the Common Market. Further, it is clear that the Commission is confident in its ability to proficiently analyze and decide complex competition issues involving firms with worldwide economic power.

ENDNOTES

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