ABUSE OF DOMINANT POSITION (TOBACCO): THE AAMS CASE

Subject: Abuse of dominant position
Distribution arrangements
Monopoly
Relevant market
Fines

Industry: Tobacco; cigarettes
(Some implications for other industries)

Parties: Amministrazione Autonoma dei Monopoli di Stato (AAMS)
Commission of the European Communities
Rothmans International Europe BV (intervener)
JT International BV (intervener)

Source: Judgment of the Court of First Instance, dated 22 November 2001 in Case T-139/98 (Amministrazione Autonoma dei Monopoli di Stato v Commission of the European Communities)

(Note. This case illustrates the difference, in the competition law of the European Communities, between "monopoly" and "abuse of a dominant position". The state tobacco monopoly in Italy is underpinned by Italian law; it contravenes the Community's rules on competition only when it enjoys a dominant position in a given geographical and product market and abuses that position. The present case is interesting for its careful discussion of the nature of the abuses. As to the level of the fine imposed by the Commission, the applicant, AAMS, failed to secure a reduction and the intervener, JV International, an increase.)

Background

1. The present action seeks annulment of Commission Decision 98/538/EC of 17 June 1998 ... (hereinafter the contested decision). Amministrazione Autonoma dei Monopoli di Stato (AAMS) is a body forming part of the financial administration of the Italian State which, in particular, engages in the production, import, export and wholesale distribution of manufactured tobaccos. AAMS's activities and the way it is organised are set out in, and regulated by, Italian Royal Decree-Law No 2258 of 8 December 1927.

[Paras 2 and 3 note that the Commission's Decision arose from complaints by certain companies, including the interveners in the present case.]

4. The Commission found that Article 45 of Law No 907 of 17 July 1942 (GURI No 199 of 28 May 1942) gave AAMS the exclusive right to produce manufactured tobacco on national territory. It found that, at the time when the contested decision was adopted, AAMS was producing not only the cigarette brands which it owned but also brands owned by Philip Morris. It also noted that

over several decades, AAMS had concluded licensing agreements with Philip Morris and that in 1995 AAMS manufactured some 54 million kilograms of cigarettes, of which 40 million kilograms were its own brand and 14 million the branded of Philip Morris (recital 2 of the preamble to the contested decision).

5. The Commission found that the importation into Italy of cigarettes from other Member States and their wholesale distribution were liberalised by [the Italian Law of 1975] and that, consequently, imports were allowed through distribution warehouses other than those of AAMS. It observed that, despite that liberalisation, all Community cigarettes continued to be imported into Italy by AAMS, which also handled their wholesale distribution on the basis of agreements concluded by it with foreign manufacturers (hereinafter foreign firms) wishing to sell their cigarettes in Italy.

[Para 6 describes the way in which Italian law regulates the distribution of articles subject to monopoly, including cigarettes]

7. The Commission made clear that the inspectorates, the warehouses and the warehouse outlets were part of AAMS, that private individuals were responsible for the management of the magazzini and that AAMS was not present in the market for retail sales of cigarettes. It added that retail sales of all cigarettes in Italy were subject to a monopoly, that the management of tobacco outlets was regulated by decree and, in particular, by instructions given by AAMS and that, since 1 January 1993, foreign firms had been able to entrust the wholesale distribution of their cigarettes to commercial traders with 'bonded warehouses used to market other products liable to excise duty.

8. In order to determine whether AAMS held a dominant position within the meaning of Article 86 of the Treaty, the Commission identified three markets for products and services, characterised by a high degree of interdependence, so that any action taken in one of them could have an appreciable effect on the others. First, there was the market for cigarettes produced in Italy or in other Member States for distribution and sale on Italian territory (hereinafter the cigarette market). Second, there was the market for services relating to the distribution and wholesale of the abovementioned cigarettes (hereinafter the wholesale distribution market). Third, there was the market for services relating to the retailing of the cigarettes (hereinafter 'the retail distribution market).

9. The Commission went on to hold that, from a geographic point of view, those markets were coterminous with Italian territory for the following reasons:
(a) the preferences of Italian smokers were different from those of smokers in other Member States;
(b) retail prices for cigarettes differed considerably from those in other Member States;
(c) in order to meet the requirements of the prevailing Italian regulations, all foreign manufacturers wishing to sell their products in Italy were required to label their cigarette packages with appropriate warnings (such as "Tobacco seriously damages your health") in Italian;
(d) there were no parallel imports of cigarettes into Italy.

10. On the basis of those various factors, the Commission concluded that the relevant markets for the purposes of the instant case were: the Italian market for cigarettes, the Italian wholesale distribution market and the Italian retail distribution market.

11. The Commission went on to assess AAMS's position on those markets. First, as regards the Italian cigarette market, it found that it consisted of a duopoly made up of Philip Morris and AAMS (which together held some 94% of the market), with other firms having only a marginal share of the market.

12. Second, the Commission found that AAMS held a dominant position on the Italian wholesale distribution market. Despite the fact that the import and wholesale distribution of cigarettes had been liberalised, manufacturers preferred to continue to use the AAMS network to distribute their own products in Italy. According to the Commission, foreign firms had considerable financial difficulty in setting up a sufficiently extensive independent wholesale distribution network. The Commission found, in that connection, that foreign firms had systematically chosen to use AAMS for the distribution of their cigarettes in Italy. The Commission also described it as an unavoidable trading partner for foreign firms, since it had a de facto monopoly. Furthermore, it was not possible for those undertakings to entrust wholesale distribution of their cigarettes to traders with bonded warehouses, since the latter would have encountered insurmountable financial obstacles. First, Italian regulations required manufactured tobaccos to be kept on separate premises from other goods subject to excise duty and that involved the parties concerned in substantial investment. Second, cigarette retailers were very different from the customers for other excise goods, so that it would have been necessary to set up a new transport and distribution structure, which would not have brought about any operational synergies with the existing distribution structure. Third, the market share held by foreign manufacturers (excluding Philip Morris, which was tied to AAMS by licensing agreements) was extremely small (about 7%) and hence did not provide a sufficient financial incentive for firms wishing to compete against AAMS in the wholesale distribution of tobacco. Further, it would not have been in the interests of retailers to obtain supplies from a different wholesaler if the latter could supply them only with a small proportion of the cigarettes they required.

13. In the third place, the Commission found that AAMS was not present on the market for retail sales of cigarettes.

14. The Commission found that AAMS had abused its dominant position on the market for the wholesale distribution of cigarettes. It identified two kinds of conduct on the part of AAMS:
- the conclusion of standard distribution agreements with certain cigarette manufacturers, under which the latter made AAMS responsible for the introduction and wholesale distribution on Italian territory of cigarettes which they manufactured in another Member State;
- certain unilateral actions on the part of AAMS concerning cigarettes manufactured in another Member State and subsequently brought into Italy.

[In paras 15 to 21, the Court describes the Commission's objections to various features of the distribution agreement and, in particular, to he clause relating to the time-limit for the introduction of new cigarette brands onto the market; the clause relating to the maximum quantities of new cigarette brands allowed onto the market; the clause relating to the maximum monthly quantities of cigarettes allowed on the market; the clause relating to increases in the monthly maximum quantities of cigarettes allowed on the market; and clauses relating to the packaging of cigarettes and to inspections.]

Abusive practices

22. The Commission found that AAMS had on several occasions refused to accede to requests from foreign firms under Article 2.5 of the distribution agreement, asking it to increase the maximum quantities of imported cigarettes allowed on the market, and that the effect of that conduct had been to prevent the firms from placing on the Italian market the volume of cigarettes that they judged opportune and hence to weaken their competitiveness.

23. The Commission also found that AAMS inspectors who supervised the activities of the magazzini took action which was required neither by the legislation in force nor by any term of the agreement and which was aimed at promoting domestic cigarettes and limiting sales of imported cigarettes. The restrictive effect of such conduct was particularly severe in the cases where AAMS had required magazzini to comply with sales quotas applicable both to AAMS cigarettes and to foreign cigarettes. Further, AAMS inspectors took action with regard to retailers which was required neither by the legislation in force nor by any contractual provision and which was aimed at promoting AAMS cigarettes and limiting sales of imported cigarettes (recitals 48 to 53 in the preamble to the contested decision).

24. On the basis of those findings, the Commission adopted the contested decision, the operative part of which reads as follows:

Article 1
Taking advantage of its dominant position on the Italian market for the wholesale distribution of cigarettes, [AAMS] has engaged in improper behaviour in order to protect its position on the Italian market for cigarettes, in breach of Article 86 of the EC Treaty, through the use of clauses compulsorily inserted in distribution contracts as set out in Article 2, and through unilateral practices as set out in Article 3.

Article 2
The compulsory clauses improperly inserted by AAMS in the distribution contracts are as follows:
(a) the clause relating to the time limit for the introduction of new cigarette brands onto the market (third paragraph of Article 1);
(b) the clause relating to the maximum quantities of cigarettes allowed on the market (Appendix B, fifth and sixth paragraph);
(c) the clause relating to the maximum monthly quantities of cigarettes allowed on the market (Appendix B, second paragraph);
(d) the clause relating to increases in the monthly quantities of cigarettes allowed on the market (fifth and sixth paragraph of Article 2);

(e) the clause relating to the printing of Monital on the cigarettes (Article 4);
(f) the clause relating to inspection and analysis of the cigarettes (Article 5).
Article 3
The improper unilateral practices pursued by AAMS are as follows:
(a) refusal to authorise increases in the monthly quantities of foreign cigarette imports requested by foreign undertakings in conformity with the distribution contracts;
(b) behaviour with regard to magazzini and retailers, designed to promote national cigarettes and to limit sales of foreign cigarettes.

Article 4
AAMS shall forthwith put an end to the infringements referred to in Articles 2 and 3, in so far as it has not already done so. In particular, AAMS shall amend the clauses of the distribution contracts referred to in Article 2 which are still in force, in such a way as to eliminate the abuses found by this Decision to have occurred. The new distribution contracts shall be submitted to the Commission.

Article 5
AAMS shall refrain from continuing or repeating the behaviour referred to in Articles 2 and 3 and from all activities having an equivalent effect.
To that end, AAMS shall, for a period of three years from the date of notification of this Decision, forward to the Commission within two months of the end of each calendar year, a report on the preceding year describing the quantities of foreign cigarettes distributed by AAMS as well as any refusal (total or partial) to distribute such cigarettes.

Article 6
A fine of ECU 6 000 000 is hereby imposed on AAMS in respect of the abuses referred to in Articles 2 and 3...

[Paras 25 to 37 set out the procedure followed after the Commission had issued its Decision; the forms of order sought by the parties; and the parties' arguments on the geographical market, on which the Court found as follows.]

38. First of all, the contested decision defines the relevant product and services markets as the markets for cigarettes manufactured in Italy or in other Member States and for services relating to wholesale distribution and retail sale of those cigarettes. The applicant does not dispute the validity of those definitions.

39. Turning next to the relevant geographical market, it is settled case-law that that market must be defined so as to determine whether the undertaking concerned is in a dominant position in the Community or a substantial part of it. The definition of the geographical market, as that of the product market, accordingly calls for an economic assessment. The geographical market can thus be defined as the territory in which all traders operate under the same conditions of competition in so far as concerns specifically the relevant products. It is not at all necessary for the objective conditions of competition between traders to be perfectly homogeneous. It is sufficient if they are the same or sufficiently homogeneous (Case 27/76, *United Brands v Commission*, paragraphs 44 and 53; Case T-83/91, *Tetra Pak v Commission*, paragraph 91). Furthermore, the market may be confined to a single Member State (Case 322/81, *Michelin v Commission*, paragraph 28).

40. According to recital 28 in the preamble to the contested decision, from a geographic point of view, the three markets for the products and services concerned are coterminous with Italian territory. It is apparent both from the contested decision and from the documents before the Court that AAMS supplied the services provided for by the distribution agreement solely in Italy and that it was present neither as a manufacturer nor as a distributor of cigarettes on the markets of the other Member States. Furthermore, AAMS does not dispute that, at the time when the contested decision was adopted, it was the only trader present on the Italian market for the wholesale distribution of cigarettes and that it had for many years enjoyed a de facto monopoly on that market. Those facts are sufficient on their own to support the Commission's analysis in the contested decision concerning the definition of the geographical market and to rebut AAMS's arguments in that regard.

41. But in addition, the definition of the geographical market employed in the contested decision is supported by various other undisputed facts which are apparent from the decision and which illustrate the special nature of the market. Those facts include in particular:
- the existence, in Italy, of legislation governing all operations concerning cigarettes and, in particular, the production, import, storage, labelling, wholesale distribution and retail sale of cigarettes;
- considerable differences in retail sale prices between Italy and other Member States;
- the lack of parallel imports of cigarettes into Italy;
- the fact that Italian consumers have particular preferences;
- the fact that AAMS brands of cigarettes had a very large market share in Italy, while they were virtually non-existent in the other Member States;
- the fact that Philip Morris cigarette brands had a higher market share in Italy than in the other Member States.

42. The Court finds, in the light of the foregoing, that the Commission could rightly conclude that the relevant markets defined in the contested decision are coterminous with Italian territory. As to the remainder, it should be pointed out that, as the Commission argues, the fact that Italian legislation regarding tobacco labelling has been imposed by a Community directive in no way precludes that legislation from being taken into consideration as a determining factor in the definition of the relevant geographical market.

43. It follows that the first part of the plea must be rejected.

The second part of the plea: AAMS's dominant position on the Italian market for the wholesale distribution of cigarettes

[Paras 44 to 50 set out the arguments of the parties; the Court found as follows]

51. It is settled case-law that very large market shares are in themselves and save in exceptional circumstances, evidence of the existence of a dominant position. An undertaking which has a very large market share and holds it for some time, by means of the volume of production and the scale of the supply which it stands

for - without holders of much smaller market shares being able to meet rapidly the demand from those who would like to break away from the undertaking which has the largest market share - is by virtue of that share in a position of strength which makes it an unavoidable trading partner and which, because of this alone, secures for it, at the very least during relatively long periods, that freedom of action which is the special feature of a dominant position (*Hoffman-La Roche*, paragraph 41). Moreover, a dominant position is a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers (*United Brands*, paragraph 65).

52. In the present case, AAMS does not dispute either that its share of the Italian market for the wholesale distribution of cigarettes was 100% or that it preserved that share in its entirety, despite the fact that at law foreign firms were able either to set up their own distribution network or to entrust the wholesale distribution of their cigarettes to traders operating bonded warehouses. Further, AAMS's argument alleging that the creation by foreign firms of their own distribution networks could be justified from an economic point of view cannot be accepted. The financial difficulties that foreign firms (other than Philip Morris), whose total share of the Italian cigarette market is less than 10%, would have encountered when setting up an independent distribution network and AAMS's ability to decline the requests of those firms for amendments to be made to the distribution agreement are factors which may properly be taken into account in a finding of a dominant position. Furthermore, AAMS did not deny at the hearing that retailers are in any event obliged de facto to obtain their supplies from AAMS's warehouse outlets.

53. It follows that the Commission did not make a manifest error of assessment when it found that AAMS held a dominant position on the Italian market for the wholesale distribution of cigarettes.

54. Consequently, the second part of the plea must be rejected.

[Para 55 briefly dismisses the third part of the plea, alleging errors in assessing the restrictive effects of certain clauses of the distribution agreement. Paras 56 to 72, on the clauses relating to the maximum quantities of new cigarette brands, to the maximum monthly quantities of cigarettes allowed on the market and to increases in the monthly quantities of cigarettes allowed on the market set out the arguments of the parties; the Court found as follows.]

73. At the outset, it must be pointed out that AAMS has objected only in general terms to the Commission's analysis of the three clauses mentioned above, save for its arguments relating to the payment of an additional fee prescribed by Article 2.5 of the distribution agreement.

74. In those circumstances, it is necessary to consider whether the applicant has established that the Commission has made manifest errors of assessment in

finding that the inclusion in the agreement of the three clauses in question constituted an abuse of a dominant position.

75. First, AAMS's argument concerning its refusal to negotiate specific clauses with the various foreign firms is not relevant. In the contested decision the Commission did not object to the use of a standard distribution agreement. It merely complained that AAMS had insisted on the inclusion in the agreement of the six specific clauses outlined in Article 2 of the contested decision.

76. Second, as regards AAMS's arguments concerning the application to the present case of the Court's reasoning in *Bronner*, the Court would point out that that judgment is not relevant here. The Commission does not accuse AAMS of refusing to grant certain foreign firms access to its distribution network but of making access to the network conditional upon the firms accepting unfair terms in the distribution agreement.

77. Nor can AAMS's arguments relating to its storage and distribution capacity be accepted. First, AAMS does not make any mention in its pleadings of having encountered real difficulties in that regard. Second, AAMS does not dispute that it distributed 102 million kilograms of cigarettes in 1983, that 90 million kilograms of cigarettes were lawfully sold in Italy in 1995 and that it did not reduce its storage capacity in the meantime. Finally AAMS did not produce, before the present action was commenced, any figures concerning its actual storage capacity or any concrete examples of difficulties with storage. It is quite apparent from the documents before the Court that, during the administrative procedure, AAMS did not avail itself of the opportunity to adduce any firm evidence in that regard...

78. AAMS argues that the obligation laid down in Article 2.5 of the standard distribution agreement to pay an additional fee where the number of cigarettes placed on the market is increased is prompted by the need to avoid certain financial risks. Suffice it to say, at this stage, that AAMS merely reproduces the arguments that it put forward during the administrative procedure without adducing any proof at all that the Commission made a manifest error of assessment at the time when the contested decision was adopted.

79. In any event, while it is the case that the fact that an undertaking has a dominant position on a market does not deprive it of its entitlement to protect its own commercial interests when they are attacked and while such an undertaking must be granted the right to take such reasonable steps as it deems appropriate to protect its interests, AAMS has not proved to the requisite legal standard that the clauses mentioned above were necessary to protect its commercial interests and to avoid both the risk of its distribution network becoming overloaded and the financial risk of cigarettes not ordered by retailers remaining in storage for lengthy periods.

80. In the light of all the foregoing factors, the Court holds that the Commission was fully entitled to find that AAMS's insistence on including the clauses in

question in the distribution agreement amounted to an abuse of a dominant position within the meaning of Article 86 of the Treaty.

[Paras 81 and 82 set out the arguments of the parties on the clause relating to the inspection of cigarettes; in para 83, the Court noted that AAMS and the Commission disagreed as to which provisions of Italian legislation were relevant in this case and found that the inspections were disproportionate and needless.]

84. It follows from the foregoing that AAMS has not adduced any persuasive evidence capable of establishing that the Commission's analysis of the clause referred to in Article 2(f) of the contested decision is vitiated by a manifest error of assessment.

85. It follows that the third part of the plea must be rejected in its entirety.

The fourth part of the plea: alleged error of assessment as regards improper unilateral practices

[Paras 86 to 91 set out the arguments of the parties; the Court found as follows.]

92. In the contested decision the Commission states that AAMS, taking advantage of its dominant position on the Italian market for the wholesale distribution of cigarettes, adopted various improper courses of conduct, which were intended to protect and strengthen its position on the Italian cigarette market.

93. First, AAMS's arguments relating to its refusal to approve increases in the maximum monthly quantities of cigarettes allowed on the market cannot be accepted. AAMS does not deny that it refused on several occasions, particularly in 1995 and 1996, to allow foreign firms to increase the maximum amount of cigarettes allowed on the market, as they had asked to do under Article 2.5 of the distribution agreement. It merely tries to play down the significance of those unjustified refusals by pointing out that the Commission found only a few cases over a limited period of time.

94. Nor can AAMS's arguments concerning the conduct of its inspectors towards the magazzini and retailers be accepted. The Court holds that the Commission has shown to the requisite legal standard that the effect of AAMS's conduct was to prevent foreign firms from placing on the Italian market the quantities of cigarettes that they judged to be appropriate and that it weakened their competitiveness.

95. In recital 18 in the preamble to the contested decision, the Commission listed eight examples of actions taken by AAMS inspectors with regard to the magazzini, which it alleges demonstrate that AAMS intended to favour national cigarettes and restrict sales of imported cigarettes. It is appropriate to point out that AAMS raises objections to the relevance of the facts set out in the first three examples described in recital 18 but does not dispute the facts recounted in the five other examples featuring in that recital. It is quite apparent from the last five examples that the AAMS inspectors sent the magazzini letters on several

occasions requiring them, in particular, to observe sales quotas applying to national and imported cigarettes. The following paragraph can be found in one of those letters: "It goes without saying that an increase in sales of foreign products must go hand in hand with a proportional increase in the sales of domestic products. Exceptional sales of non-domestic products will in any case have to be offset within the next two months ...". The Court finds that AAMS has not shown, to the requisite legal standard, that the conduct of its inspectors was vindicated by a concern to ensure that the service was efficient and regular or that it was required by the legislation in force or by contractual terms. As a result, the Commission has adequately proved that the conduct of AAMS's inspectors amounted to abuse within the meaning of Article 86 of the Treaty. Furthermore, the contested decision contains an adequate statement of reasons in that regard in recitals 48 to 50.

96. The Commission also held in the contested decision that AAMS's inspectors had adopted a course of conduct towards retailers intended to promote sales of AAMS's cigarettes and to limit those of imported cigarettes. The conduct in question is described in recital 29 in the preamble to the contested decision and consisted, in particular, in stressing to the retailers the need to sell a minimum quantity of domestic cigarettes, something which AAMS does not dispute.

97. However, AAMS argues that in its relations with retailers it was acting in its capacity as a public authority and that those relations cannot be examined in the context of a procedure under Regulation 17. The Court asked AAMS to provide further details about the regulatory powers exercised by its inspectors in the course of the four operations referred to in recital 19 to the contested decision and to explain in what respect the inspectors' conduct was consonant with the objectives of the legislation applying in the cigarette sector.

98. In its reply, AAMS restated that its inspectors were carrying out public duties and had statutory supervisory powers over distributors and retailers in the cigarette sector under [Italian Law]. It added that its inspectors were obliged to monitor the activities of the distributors and retailers of monopoly goods under [Italian Law] to prevent fraud. According to AAMS, "if retailers receive abnormally large supplies, that may result from, or be symptomatic of, factors such as prohibited advertising of the products or the illegal provision or supply of goods to third parties". It argues that, in any event, even if the actions in question were not consonant with the objectives of the provisions concerned, they are merely liable to be declared an abuse of powers.

99. It is appropriate to point out that the actions referred to in recital 19 to the contested decision were taken in order to favour the sale of domestic cigarettes and that AAMS's arguments concerning the need to prevent fraud and unlawful advertising are merely speculative and unpersuasive. Consequently, the Court holds that AAMS has not established that the Commission made a manifest error in its appraisal of the actions in question.

100. In those circumstances, the fourth part of the plea must be rejected.

The alternative claims seeking a reduction in the fine imposed

[Paras 101 to 103 set out the parties' arguments; the Court found as follows.]

104. First of all, as regards the applicant's arguments concerning the circumstances in which it would be appropriate to set aside the fine or to reduce the amount thereof, the Court has not upheld AAMS's claim for annulment of the contested decision and so there are no grounds to set aside that part of the decision relating to the fine or to reduce the amount of the fine on that basis.

105. Furthermore, AAMS cannot validly rely on the fact that the contested decision refers only to certain events which took place in 1995 and 1996 and that the infringement must, therefore, be regarded as of medium duration, rather than of long duration. Even if the Commission has found only a few examples of AAMS refusing to approve increases in the maximum monthly quantities of cigarettes imported between 1995 and 1996, that conduct must not be considered in isolation, but globally as part of a series of actions taking place between 1990 and 1996. The assessment made by the Commission of the duration of the infringement is not vitiated by any error, since it is apparent from recitals 16 to 19 in the preamble to the contested decision that the actions which AAMS is alleged to have taken as regards cigarettes in Italy occurred over a seven-year period, namely from 1990 to 1996. In those circumstances, the conclusion must be drawn that the Commission has adequately demonstrated that the infringement of which AAMS stands accused was of long duration.

106. The fourth paragraph of Article 37 of the EC Statute of the Court of Justice provides that an application to intervene is to be limited to supporting the form of order sought by one of the parties. JT International BV intervened in the present action in support of the form of order sought by the Commission. Its claim for an increase in the fine must be rejected as inadmissible, given that the Commission did not seek such an increase.

107. It follows from the foregoing that the claims of AAMS and JT International BV concerning the legality and the amount of the fine must be rejected in their entirety.

[Paragraphs 108 and 109 concern costs.]

Court's ruling

The Court of First Instance hereby:
1. Dismisses the action;
2. Orders AAMS to pay the costs of the Commission and of the interveners and to bear its own costs. ■

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