BAKER & McKENZIE
RESPONSE TO DG COMPETITION’S
ARTICLE 82 CONSULTATION

1. Introduction


2. Summary and General Remarks

2.1 An effects based analysis grounded on economic principles - we welcome the proposal by DG Competition to adopt an effects based approach grounded on foreclosure analysis. While we comment on how the Paper should be clarified and expanded, we agree with the broad thrust of the Paper in applying economic principles to Article 82.

2.2 Firm statement of enforcement policy - the utility of Article 82 guidelines will depend on the extent to which the Commission adopts them as a statement of enforcement policy. It is positive that the Paper has already received judicial acknowledgement in AG Kokott’s opinion in British Airways which, for all its caveats, appears to interpret the EC court’s case law in some respects as aligning with core concepts of the Paper.1 The Commission cannot pre-empt the EC courts. However, a strong statement that the Commission believes that its guidelines reflect sound economics will have persuasive force on national and, perhaps, EC courts in developing the law. We recommend that the Commission give a strong, positive statement, that its guidelines reflect economic best practice, that it will encourage their adoption by member states, and that the guidelines will form the basis of its enforcement policy under Article 82.

2.3 Rethinking of the traditional dominance thresholds - the dominance thresholds set out by case law, broadly followed by the Paper, are out of date and have no place in an effects led analysis of Article 82. This part of the Paper should be rethought. If market share presumptions are retained, 70% rather than 50% is the appropriate threshold.

2.4 Omission of discrimination seriously undermines the efficacy of the guidelines - a section on discrimination is essential if the Paper is to have practical use. Many rebate programmes have both potentially exclusionary and discriminatory effects, in particular exclusivity, growth and individualised target rebates (British Airways). The Commission’s statement at para. 140 (that absent horizontal foreclosure, anticompetitive effects of discrimination are unlikely) should be given more prominence and stated to be the Commission’s working assumption as to the legality of discriminatory pricing practices.

2.5 Absent clear safe harbour tests, the guidelines will fail to assist business in self-assessing lawful conduct and have a chilling effect on pro-competitive pricing practices - the Paper develops useful analytical steps, but fails to deliver clear safe harbour or de minimis

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1 Case C-95/04 British Airways v Commission (23 February 2006, not yet reported), paras. 28 (warning that a discussion paper does not replace EC precedent), 54 (recognition of an equally efficient competitors test, in finding rollback rebates abusive where “competitors would have to offer [customers of the dominant company] disproportionately higher rebates or premiums, which even for equally efficient competitors is often uneconomic.”) and 77 (apparently rejecting per se approach in favour of a CFI approach which “assessed the likelihood of their hindering competition in a quite concrete way by reference to the circumstances of the case”) (emphasis supplied).
thresholds which allow businesses to screen out clearly non-abusive conduct. There should be a safe harbour that conduct is presumed non-abusive if less than, say, 30-50% of the market is affected. The more complex areas of assessment also need worked examples to show how the tests apply in practice.

2.6 The Paper’s treatment of abuse of collective dominance departs from sound economic principles and should not be addressed in this paper - the case law on collective abuse to date shows that abuse has been held to occur only in cases of intra-group or cartel like activity. Whether collective abuse is possible without structural links or explicit agreement is untested. Indeed, rebate schemes or other price competition engaged in by collectively dominant companies is the antithesis of oligopoly. Such rebates/price competition is intended to disrupt rather than entrench oligopolistic markets. The Commission's posited theory that collective dominant companies should be prohibited from engaging in activities that present a common front to the market is also unworkable. It is plain that close oligopolies will act in parallel out of sound commercial self-interest rather than anti-competitive intent. Moreover, the practical implications of such a rule would be to require the business to identify current or future competitive conduct of competitors in order to differentiate itself or be accused of collective abuse. Such contact/information gathering is plainly undesirable in an oligopoly. We suggest that the section on collective abuse be removed from the guidelines until the case law and economic thinking on collective abuse matures.

3. Chapter 4 Dominance

Relevance of Market Shares (para. 31)

3.1 The market share threshold presumptions at para. 31 do not demonstrate genuine market power. The retention of these presumptions is inconsistent with an effects based approach to Article 82:

(a) the rationale for the 50% threshold must be re-examined. The 50% threshold is predicated upon "old industry" assumptions. That is to say, it assumes the industry in question is heavily capacity constrained. In such an industry it is possible a 50% supplier can reduce production and increase prices knowing that far smaller rival plants cannot scale up production to challenge the price increase. The assumption, if it were ever appropriate, is clearly outdated. Manufacturing is increasingly outsourced. Key economic sectors, software or financial services for example, have little or no capacity constraints. A one-size-fits all evidential assumption cannot, therefore, be appropriate. Market power must be assessed on a case by case basis and we suggest the guidelines reflect this reality;

(b) it is incongruous to set a safe harbour of 25% market share for dominance compared to the safe harbour for vertical restraints of 30%. The Commission's decisional practice demonstrates clearly that the majority of market power investigations are against companies with far higher market shares than 40-50%. It is therefore implausible that companies with just over 50% market share presumptively have the power to distort competition unilaterally;

(c) low thresholds also perpetuate the divergence from US practice, where monopolisation is unlikely below 70% market share.

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2 Discussion Paper, para. 31 ("It is very likely that very high market shares, which have been held for some time, indicate a dominant position. This would be the case where an undertaking holds 50% or more of the market […]. In the case of lower market shares, dominance is more likely to be found in the market share range of 40%-50% […]. However, undertakings with market shares of no more than 25% are not likely to [be dominant].")
3.2 We submit that market shares be no more than a guide to a finding of dominance, which should rest on the market power test of ability to affect competition unilaterally. Any guide range should be confined to those companies with genuinely high shares, 70% or more, over a sustained period.

Innovation Markets

3.3 Innovative markets are particularly vulnerable to the chilling effects of over-regulation. The Paper should provide guidance on how to assess, for example, fast moving markets with short production cycles such as IT, telecoms and other new and evolving markets. Just as envisaged under the R&D and Insurance Block Exemptions, there should be a presumption against enforcement in innovation markets until, at least, such markets have had an opportunity to mature. Based on the R&D Block Exemption the appropriate maturity period should be at least 7 years.³

Temporal Aspects of Dominance (para. 26)

3.4 The Paper provides no guidance as to the temporal aspect of dominance (para. 26). This is a missed opportunity to clarify an essential part of market power analysis which is largely unaddressed by existing case law and practice. A finding of dominance over too short a period results in over-regulation. This has a particularly chilling effect in dynamic and innovation driven markets, where competition policy's role should be to foster, rather than penalise, advances. Dominance should only be established if sustained market power is observed, over at least 3-5 years. Any shorter duration casts doubt on whether barriers to entry are genuinely insuperable in the short term. The Paper should provide further guidance to this effect.

Buyer Power (paras. 41-42)

3.5 Requiring that buyers should sponsor new entry to counteract market power sets the bar too high. Substantial buyers can and do discipline even the most powerful sellers through temporary delisting, cutting access to promotional space, or more favourably placing smaller rivals. The effect of even temporary delisting can be a substantial deterrence to suppliers with high fixed costs and/or production base loading. Once disciplined in this way, a high market share seller is unlikely to be tempted to seek to raise prices again. Moreover, this benefit accrues not just for the powerful buyers in question (contrary to para. 42), but is extended to the entire market through resale/arbitrage.

4. Chapter 5 General Framework for Analysis

4.1 We broadly agree with the effects based approach adopted by the Paper. We set out below areas where we consider further clarification is necessary.

Omission of Discrimination (paras. 3, 53 and 140-141)

4.2 The omission of discrimination deprives the Paper of much practical utility. Most abuses contain both an exclusionary as well as an exploitative or discriminatory element. It is of no comfort to companies that conclude, on the basis of the Paper, that they have not illegally excluded competitors, if they can be penalised for illegal discrimination or exploitation instead.

4.3 In contrast, para. 140 rightly observes that discriminatory conduct between downstream customers, which does not exclude competitors in an upstream market, is unlikely to be anticompetitive. This statement should be made at the outset of Chapter 5, so that companies can understand the interface between discriminatory and exclusionary abuses.

Only Passing Reference to Consumer Welfare (paras. 54-56)

4.4 The Commission initially emphasizes the importance of consumer welfare protection (paras. 54-56). However, from para. 58 of the Paper, consumer harm is not specifically considered, save via the various proxies used in the specific abuse tests. We would recommend that each abuse should, as a further consideration supplementing any abuse specific test, be cross-checked against consumer harm. Once predation or an unmatchable rebate scheme has been identified, therefore, the Commission should confirm that a competitor is likely to be excluded or marginalised and prices likely to rise in the long run. Absent this secondary check the risk of false positives, and hence deterrence of pro-competitive pricing behaviour, increases.

The "As Efficient Competitor Test" Must be Applied Consistently (paras. 64-68)

4.5 The "as efficient competitor test" (the "AEC Test"), while a useful analytical tool, must be consistently applied. For certain abuses, the Commission applies measures of cost above average avoidable cost ("AAC"), namely average total costs ("ATC") for predation and long run incremental costs ("LRIC") for bundled rebates. Abuse tests above AAC fundamentally harm consumers. They force dominant companies to keep prices artificially high and, consequently, both shield weak competitors from competitive discipline and, worse, encourage inefficient entry. The result is that consumers pay higher prices for less competition. Tests other than AAC should either be removed from the Paper or clearly limited only to the most exceptional of circumstances to prevent this consumer subsidy of weak businesses.

Guidance on Cost Allocation (paras. 64-65)

4.6 Costs based tests are complex and require difficult judgments. To provide meaningful guidance, the Paper should consider cost allocation (how to allocate common costs; how to allocate fixed and variable costs; how costs are going to be allocated time wise; and how to allocate cost in different types of industries such as telecoms, airlines and traditional manufacturing). At a minimum, we suggest worked examples be provided.

Defences: Distinction Between Burden of Proof and Evidence Gathering (para. 77)

4.7 We disagree with para. 77 that "[t]he burden of proof for such an objective justification or efficiency defence will be on the dominant company." Article 82 contains no defence to abuse, rather abuse and objective justification are assessed simultaneously. Justified conduct is never abusive. It is well established that the burden is on the regulator to prove violation of Article 82. While companies wishing to claim justification must adduce arguments and evidence to that effect, the burden remains on the Commission to prove that such justifications, once raised by the company, are insufficient.

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4 AG Kokott has already afforded this concept judicial recognition in British Airways.
5 Regulation 1/2003, Article 2 ("In any national or Community proceedings for the application of Articles 81 and 82 of the Treaty, the burden of proving an infringement of Article 81(1) or of Article 82 of the Treaty shall rest on the party or the authority claiming the infringement.")
Defences: Evaluation of Efficiencies (paras. 84-92)

4.8 The Paper's analysis of efficiencies is too abstract. There is no indication of how an efficiency (say, integration of two new products to create a new one) will be measured against loss of competition (say, tying as a result of integration). The practice may result in both absolute foreclosure of a tied market and incalculable consumer gains by creating a new market which redefines the industry. Further guidance, with worked examples, is required.

Defences: Elimination of Competition (paras. 91-92)

4.9 We also believe that the 75% threshold for elimination of competition is too simplistic. First, the market power presumptions are too low (paras. [3.1] above). A more coherent threshold for dominance is around 70%. On that basis, a 75% definition of near monopoly is clearly inappropriate. It also ignores that the threat of expansion of, say, 5 competitors each with 5% market share may well discipline a high share competitor such that efficiency benefits are passed on to consumers. Finally, the chilling effect of a 75% elimination of competition threshold is clear when one considers infrastructure and or innovation cases. Investment in an innovative product, pipeline, port or bridge may well lead to the owner/operator having a monopoly. However, it is plainly desirable that such investments be made and that the owner/operator be incentivised to invest by the ability to raise prices, deny third party access or protect ancillary markets, which would never have existed but for the original investment.

4.10 The dangers of the 75% elimination threshold are well illustrated by the tying example (at [4.8] above). If an innovative integrated product is the first to market and results in an industry shift to adoption of the new product, competition for the old, unbundled products is plainly eliminated. Yet the progress resulting from the integration is highly desirable and results in clear consumer benefits. An efficiencies test which seeks to reward competition through innovation must take these factors into account. It must factor in the evolution of markets, particularly innovative ones, rather than view competition as a steady state process.

5. Chapter 6 Predatory Pricing

5.1 It is a natural part of the competition process that all undertakings, including dominant ones, compete aggressively through reducing prices to customers. Over-intervention is highly damaging to the competitive process. It denies consumers the benefits of competition and deters pro-competitive conduct by companies.\(^6\) Moreover, illegal predation can be hard to distinguish from keen competition. Given the risk of damaging overregulation and false "acquittals", the Paper should make clear that the burden must be on the regulator to show abuse. .

Impact of Predation on the Market

5.2 The Paper should make clear that predation is only anti-competitive if the incidence of the practice is widespread, rather than applied to individual companies only as an exception (by referring back to Section 5).

\(^6\) Paper, para. 94 ("Predatory pricing is in practice often difficult to distinguish from normal price competition. The lowering of prices, the directly visible part of predation, is also an essential element of competition. … This is competition that benefits consumers that a competition authority wants to defend and protect.")
Pricing Below Average Avoidable Cost ("AAC") ( paras. 106-110)

5.3 We agree that AAC provides a better cost benchmark than average variable cost ("AVC") in many cases.\(^7\)

5.4 The Paper should confirm, for the avoidance of doubt, that calculation of AAC should also take account of common costs (i.e. assets and costs that are shared in relation to the manufacture of different goods or the provision of different services), consistent with the Commission's practice in Deutsche Post.

Pricing Above AAC But Below Average Total Cost ("ATC") ( paras. 111-126)

5.5 Pricing above AAC should, in general, be viewed as economically efficient, pro-competitive and ultimately to the benefit of consumers. Undue intervention in relation to above-AAC pricing would result in protection of smaller rivals who would ultimately not have been serious long-term competitors. Competition law should only intervene where the adverse effects of the above-AAC pricing have been established. Demonstrating such adverse effects (and not the subjective intention or planning of the dominant undertaking) should be the legal test for establishing predation in the case of pricing above AAC.

5.6 For the same reason, intent documents cannot be considered probative, without more, of predation. Internal business documents will be worded aggressively to reflect natural and quite desirable business rivalry; however, aggressive language is irrelevant without actual impact. Such wording may be business hyperbole or, often, a mistaken belief in the company's power to predate. It is actions in the market that should dictate abuse. In view of the inherent weakness of such evidence and risk of wrongly deterring pro-competitive pricing, such internal documents should never be probative without genuine, measurable economic effects. A mere rebuttable presumption does not cure the defect:

(a) a dominant company should not be required to defend essentially pro-competitive conduct. This unfairly burdens the company and deters beneficial pricing practices;

(b) the regulator is better placed to obtain information as to the actual effects of the above AAC pricing on the market by seeking information from competitors and customers.

5.7 As to the Commission's test for a predatory plan absent intent documents, we tentatively agree that pricing above AAC should only be considered unlawful if there are no reasonable explanations. We note, however, that above AAC, where the dominant company is covering avoidable costs, that explanation could simply be that the dominant company is reducing price in the face of fierce competition. On the other hand, the Commission then states that "in such a case [no explanation for above AAC pricing] it will not be necessary to show that a foreclosure effect is likely" (para. 116). We consider that a sound competition policy should not dispose of the need to demonstrate adverse effects for fundamentally pro-competitive above-AAC pricing strategy and, accordingly, the regulator should be required to demonstrate that foreclosure effects are likely.

Pricing below long-run average incremental costs ("LRIC")

5.8 We agree with the use of LRIC as the appropriate benchmark in relation to activities protected by a legal monopoly and in relation to sectors that have recently undergone liberalisation. For the avoidance of doubt, it should be made clear that the LRIC calculation should also include

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\(^7\) Paper, para. 108 ("If the dominant company, for instance, had to expand capacity in order to be able to predate, then also the fixed or sunk investments made for this extra capacity will have to be taken into account and will filter into the AAC benchmark.")
an allocation of a proportion of the common costs that are shared in the manufacture of numerous products or the provision of numerous services.

_Above ATC (paras. 127-128)_

5.9 We disagree with the two examples (collective dominance and exceptional circumstances) posited by the Paper as potentially requiring intervention above ATC:

(a) where companies in a collectively dominant situation apply a clear strategy to collectively exclude or discipline a competitor by selectively undercutting the competitor, we consider such conduct, as footnote 79 recognises, is better dealt with under Article 81;

(b) the second example identified by the Paper is hardly an exceptional circumstance ("a single dominant company operates in a market where it has certain non-replicable advantages or where economies of scale are very important and entrants necessarily will have to operate for an initial period at a significant cost disadvantage because entry can practically only take place below the minimum efficient scale"). This is an unacceptably wide carve out from the fundamental principle that above-ATC pricing is not predatory. Many, if not most, dominant undertakings will have certain non-replicable advantages and economies of scale are a natural part of almost all industrial sectors. It is not the purpose of Article 82 to protect an entrant that has made a commercial miscalculation by choosing to enter at an inefficient scale or enter a market where it cannot replicate the dominant undertaking's advantages. Once again, this would result in inefficient competitors, as opposed to the competitive process, being protected by antitrust policy.

5.10 Accordingly, any guidance issued by the Commission should make it clear that an undertaking cannot be considered as engaging in predatory pricing where there is above-ATC pricing.
6. **Chapter 7 Single Branding and Rebates**

6.1 We are pleased that the Paper recognises, at para. 138, that single branding obligations and rebates have efficiency enhancing effects. Such schemes should never be prohibited *per se* and should always be considered on their merits.

*Price Discrimination (para. 140)*

6.2 The Paper correctly recognises that pricing which discriminates between customers is unlikely to be anticompetitive, if it does not also foreclose competitors. We invite the Commission to give this essential statement on the interface between exclusion and discrimination more prominence (para. [4.1] above). The Paper will be of no assistance unless both exclusionary and discriminatory elements are dealt with.

*Presumptions and Burden of Proof Reversal is Inappropriate Given the Recognised Efficiency Gains of Pricing Practices (paras. 149-150, 162-163 and 172-176)*

6.3 Economists conclude that rebates are generally pro-competitive. Dominant firms should not, in general, have to justify their discounts. Excessive intervention risks stifling beneficial behaviour, rather than encouraging it. Presumptions of foreclosure or reversal of the burden of proof in showing efficiencies is therefore inappropriate in respect of rebates. Rather, given the plainly beneficial nature of price competition, regulators should be required to show the clearest basis for intervention (para. [4.7] above). The competition authorities should show that any single branding obligation or rebate scheme both: (a) has actual or likely anticompetitive effects; and (b) those effects outweigh the benefits of lower prices and the efficiency incentives engendered by the conduct.

*Efficiency Enhancing Effects of Percentage Requirements/Individualised Targets (paras. 151 and 158-159)*

6.4 Paras. 151 and 158-159 of the Paper suggest that rebates formulated as a percentage of the buyer’s total requirements, or as an individualised volume target, are, in general, more likely to have an anticompetitive loyalty enhancing effect than rebates formulated as a standardised volume threshold. Yet such individualised targets generate greater efficiencies than standardised volume targets, as they are a more effective way of encouraging and rewarding a buyer’s resale efforts, particularly in cases where monitoring is difficult or costly. Targets or percentage requirements align the supplier's and reseller's incentives to optimise sales of the former's products. Any abuse analysis should expressly recognise the efficiency enhancing features of such rebates. The Paper should set out, perhaps in the form of worked examples, the trade off between foreclosure and pro-competitive incentives on customers.

*Need for Safe Harbours/De Minimis (paras. 145, 148 and 168)*

6.5 The Paper rightly proposes that the first step in assessing whether single branding obligations and rebates are anticompetitive is to determine whether they have a likely or actual foreclosure effect. Yet, in contrast to the Commission's guidelines on almost every other

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9 EAGCP Report, pages 9-12; and RBB Report, paras 1.10 and 1.12-1.13
10 EAGCP Report, pages 13, 22 and 50 (Regulator must show that there is exclusion and no legitimate competitive behaviour); RBB Report, paras. 1.16-1.20 and 5.105-5.106 (Regulator must rule out efficiencies that outweigh any anticompetitive effect).
11 EAGCP Report, pages 36-37; and RBB Report, paragraphs 4.21-4.25, and 4.31.
aspect of competition policy, no affected market share threshold is provided. Rather the question of whether the market is sufficiently affected is left to vague, unquantified statements. A clear safe harbour is vital to allow business to screen out at an early stage plainly non-abusive practices, so as to focus on those which may be more problematic. A safe harbour, if less than 50%, should certainly be more than 30% of the market, by analogy with the Verticals and Technology Transfer Block Exemptions.

Use of ATC Rather Than AAC (paras 154, 156, 168, and 171)

6.6 We strongly disagree with the use of ATC rather than AAC (the predatory measure used in Chapter 6 of the Paper) to assess rebates. The Paper states ATC is appropriate because the dominant firm, in theory, is able to operate the rebate system without a profit sacrifice potentially indefinitely (para 154). However, this reasoning fails to take into account that AAC, across the actual (or expected) duration of the rebate period, will take into account fixed costs incurred by the dominant company to engage in the predatory practice (such as plant upgrades, de-bottlenecking). As all capital assets need to be renewed over time, an indefinite AAC test tends to ATC in any event. The Commission therefore does not need to resort to the use of inconsistent cost measures in order to anticipate that a dominant company may use predatory rebates indefinitely. The AAC test is a more appropriate measure of predatory rebate practices. Use of ATC is not only unnecessary, but risks deterring pro-competitive above AAC pricing and gives a hand up to less efficient competitors.

Abuse Above ATC Where “Non-replicable Advantages” (para. 165)

6.7 Para. 165 states that pricing above ATC may exceptionally be found to be abusive if the dominant firm has certain “non-replicable advantages”. The meaning of “non-replicable advantages” is unclear. If it is intended to relate to facilities owned by the state or former state monopolies, the Commission should make this clear. As noted above (para. [5.10]) scale economies should never be considered “non-replicable.”

Roll-back Rebates: Test (paras. 152-165)

6.8 The Paper examines the contestable demand of an average customer (those units which a small competitor can supply) and considers whether the small competitor can match the dominant company's rebate across those contestable units. If the dominant company's rebate is substantial and the contestable demand small, then the competitor may be forced to sell below cost to match the dominant company's rebate. This is because the dominant company can profitably spread the rebate over a large number of units, while the small competitor must offer the same rebate over a far smaller number (the contestable demand units).

6.9 The key to the assessment is how to calculate contestable demand. An error has far reaching results. If contestable demand is erroneously thought to be small, the rebate scheme will almost certainly be illegal. The Paper's thinking on this calculation is confusing and inconsistent. It appears to posit three tests for the contestable demand of an average customer:

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12 Paper, para. 145 notes that the "tied market share" is important, paras. 149-162 purport to create presumptions of foreclosure if a single branding obligation affects “if not most, at least a substantial part of market demand” suggesting that "substantial" is less that 50%, but no more than that. Confusingly, para. 148 then refers to foreclosure in respect of a "modest part of market demand" and para. 168 to "important enough" rebate arrangements.

13 RBB Report, paragraphs 3.67-3.68

14 RBB Report, paragraphs 3.138-3.145 and 4.161
(a) the number of units equivalent to the percentage of the small competitor's market share (para. 155);

(b) a number of units equivalent to the percentage of the market a new entrant would have to capture to enter at minimum efficient scale (para. 157);

(c) an adjustment to (a) and (b) based on: (i) the possibility that the competitor might concentrate sales on a substantial part of the requirements of a few targeted customers rather than selling an equal amount to all customers (as (a) and (b) theorise); (ii) that a new entrant's entry scale would be greater than the minimum efficient scale; or (iii) that competitors are not capacity constrained and able to supply a larger number of units than their market share suggests (para. 157).

6.10 While the premise of these tests is the same foreclosure concerns, we believe the tests are poorly formulated.

(a) Test (a) posits far too strict a test:

(i) test (a) is impossible to satisfy in low margin industries. For example, if margins are thin (say 10%), and if the dominant firm’s list price is 100, a competitor would have to have a market share exceeding 50% to match a 5% rebate (required share = 5% x 100/(100-90) = 50%); and

(ii) it assumes that each competitor will spread its sales evenly across all customers. This is, of course, implausible. Smaller rivals are highly unlikely to target all the dominant company's customers simultaneously, but rather to target individual customers. Small rivals will not seek to gain a presence simultaneously in all customers' outlets market-wide. They will target individual customers to gain a foothold in the market through which to gradually increase sales. This is particularly the case in commodity markets or at an intermediate stage in the supply chain where the smaller rival merely needs, say, one wholesale distributor to access a market. The Commission should make clear, if test (a) is retained at all, that it applies only in exceptional circumstances where competitors have to be present, to an equal degree, in all outlets in the market to have a viable business.

(b) Test (b) leads to equally perverse results. Where minimum efficient scale is small (for example, there are no particular scale economies and a 1% share is sufficient for an entrant to be competitive), the rollback rebate is immediately abusive. This is the case, even if there are numerous existing competitors who operate at a far larger scale and are quite capable of matching the dominant company's rebate.

(c) Test (c) proposes a mix of tests, which while more plausible (for example, accepting that competitors will target a few customers rather than all of the dominant supplier's customer base simultaneously), are not examined in any detail.

6.11 The correct test for rollback rebates is:

(i) to calculate the contestable share of the average customer's purchases; defined as that share of the customer's demand which is not assured to the dominant supplier because, say, its brand is a must stock item or rivals’ capacity constraints prevent the customer sourcing all its needs elsewhere. This should be determined by analysis of capacity constraints and purchasing behaviour, but also surveying customers as to their propensity to switch substantial quantities away from the dominant company and whether
customers would be concerned (and, if so, to what degree) by supply shortages if they did not source from the dominant company. What would they consider the minimum stock of dominant company products?

(ii) determine if there are any reasons why some or all of the competitors would not target the entirety of the contestable units of each customer; and if not, determine whether each competitor can match the dominant company’s rebates across the contestable range and remain above AAC;

(iii) cross-check to determine whether other features of the market make exclusion unlikely, for example, evidence that the dominant company is losing share or competitors have counter measures (such as competition on quality, ancillary services); and

(iv) exclusion of one competitor should not result, per se, in a finding of abuse. Consistent with the Paper’s approach to refusal to supply, elimination of one of many competitors or deterring entry when there are plentiful existing competitors, should not be considered abusive.

6.12 In passing, we note that it is unclear why the Paper states, in para. 155, that when the shares of customers’ requirements purchased from equally efficient rivals are smaller than the required share of such rivals, “in such a situation a rival would have to more than double its sales to these customers to overcome the foreclosure effect”.

Uncertainty and Loyalty Enhancing Effect (para. 160)

6.13 We disagree that uncertainty as to the level of a target threshold and/or the level of the rebate is loyalty inducing. It assumes that buyers are unsophisticated about incentives. The uncertainty of future payment terms is a widespread, daily business risk, which buyers can be expected to factor into their purchasing assessment. In practice, if a buyer is offered no guarantee of a rebate, its incentive to exclude rivals is diminished. The buyer is more likely to purchase for a certain, but smaller, rebate from a smaller rival, than to gamble on the dominant company’s vague promises of a higher amount.\footnote{RBB Report, para 5.95}

7. Chapter 8 Tying and Bundling

Presumptions of Abuse Subject to Rebuttal

7.1 We welcome the Paper’s recognition, in para. 178, that tying and bundling are often pro-competitive. It is inappropriate to prohibit dominant firms from engaging in tying practices or offering bundled rebates, per se. The presumptions of abuse and reversal of the burden of showing efficiency is inappropriate. If tying is fundamentally pro-competitive and efficient, the burden should be on the regulator to demonstrate clearly that it is anticompetitive (para. [4.77] above).

Safe Harbours/De Minimis (paras. 188, 196 and 198)

7.2 Again, to provide useful guidance, consistent with Commission practice, the Paper should provide firm affected market share safe harbours/de minimis thresholds to allow meaningful self assessment for businesses.\footnote{No hard guidance is provided as to the appropriate share. Para. 188 refers to a “sufficient part of the market being tied,” para 196 asks “whether the market as a whole can be considered to be foreclosed” and para 198...} The appropriate safe harbour is that foreclosure is
considered unlikely where the tying or bundling affects less than 30-50% of market demand. This is foreshadowed cryptically in para. 198, but requires explicit adoption.

**Failure to Provide Guidance on Product Integration (paras. 187 and 205)**

7.3 Clear guidance is required as to when integration of separate products is considered abusive. Such innovations are common and key to competition and economic advances. The statements at paras. 187 and 205, that integration must lead to an industry wide shift in demand, effectively making the standalone products redundant, sets the test unattainably high. Integration is fundamentally pro-competitive and should not be condemned, save in exceptional circumstances, for example, where integration is a sham or patently designed only to exclude rivals in a tied product.

**Use of LRIC Rather Than AAC (para. 190)**

7.4 In relation to bundling discounts, the Paper uses LRIC. This contrasts with the use of AAC in relation to predation. The Paper’s reasoning for choosing LRIC rather than AAC is that this captures the extra costs of the dominant company’s activities in markets in which it is not dominant. As above, we consider that a cost measure above AAC would effectively require the dominant firm to give a hand up to less efficient competitors and is therefore undesirable. We therefore consider that AAC should be the relevant cost standard for assessing bundling discounts, unless there are particular circumstances which mean that AAC is not an appropriate cost measure to use (for instance, because the industry under investigation has high fixed costs and low variable costs).

**Bundling Exceptionally Exclusionary Above LRIC (para. 190)**

7.5 Para. 190 imports the exceptional circumstances referred to at paras. 67 and 129 as being cause to find abuse above LRIC. We refer to our comments at para. [5.10(b)] as to why these circumstances are hardly exceptional and should be removed if the guidance is to be of any utility. In particular, regulators should be cautious not to strip away advantages (such as first mover advantage or learning curve effects) which the dominant firm has obtained as a result of successful innovation or investment, as this may have the effect of discouraging future innovation or investment. Any such exceptional circumstances should be very clearly defined.

**Multi-product Rebates (para. 193)**

7.6 The Paper also applies the bundled pricing test to assess foreclosure of multi-product rebates. The Commission should make clear that there will be no foreclosure in relation to a particular product in the multi-product bundle, if customers are not obliged to purchase that product to qualify for the rebate, either explicitly or in practice. Where the dominant firm offers a rebate if customers purchase a combined quantity of products A, B, and C, product C is not foreclosed, if customers can qualify for the rebate by meeting the target through purchases of products A and B only, and the dominant company cannot predict with any certainty how purchasers will meet these targets. This point is particularly important for portfolio companies with hundreds of product lines that habitually offer multi-product rebates, as the test in para. 193 of the Paper is set unattainably high. The guidelines should make clear that tying foreclosure is only a possibility if the dominant company can predict that a high

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states that tying “may pose less of a risk” if “only a third” of customers are affected. These statements seems to suggest a safe harbour where 33% or less of a market is affected by tying.

17 RBB Report, paragraph 3.145
19 As the RBB Report, para. 3.113
percentage of customers will buy substantial quantities of dominant product A, such a
multiproduct rebate across all of A, B and C potentially has foreclosing effects on B and C.

8. Chapter 9 Refusal to Supply

8.1 We welcome the Commission's recognition (para. 207) that undertakings, including dominant
undertakings, must generally be entitled to determine whom they can deal with. This reflects
the fundamental principle of freedom to contract and protects incentives to invest and
innovate, essential to a properly functioning market. Regulators should act with considerable
decorision before interfering with property rights. Indeed, such a deferential approach is in
line with Article 295 EC, which provides that "[t]his Treaty shall in no way prejudice the
rules in Member States governing the system of property ownership". Moreover, the right to
one's property is recognised as a fundamental right by the case-law of the European Courts
and by the European Convention on Human Rights.

8.2 Accordingly, an obligation to supply should indeed be imposed on dominant undertakings
"only after a very close scrutiny of the factual and economic context" (para. 214) and that
"[f]or a refusal to supply to be abusive, it must … have a likely anticompetitive effect on the
market which is detrimental to consumer welfare".

Termination of an Existing Supply Relationship (paras. 217-222)

8.3 The presumption that continuing existing supply relationships must be pro-competitive is self-
evidently incorrect (contrary to para. 217). Just as there may be pro-competitive reasons for
supplying in the first place, equally the decision to take supply in-house may be just as
beneficial. For example, a supplier may find its brand damaged by poor installation or
support of its products or may choose to simplify its distribution channels and reduce costs by
offering an internet only direct supply business model. For that reason, there can be no such
presumption against the dominant undertaking.

8.4 In the Paper, there is no requirement of "indispensability" in order to demonstrate that a
refusal to supply an existing customer is abusive, unlike the position in relation to a refusal to
start supplying an input. We see no reason to distinguish between a refusal to supply in
relation to an existing customer and a refusal to start supplying an input. There may be
legitimate commercial reasons why an undertaking may wish to cease supplying an existing
customer. It is illogical that Article 82 could be used to require the continuation of an
existing supply relationship where the same provision would not have required the dominant
undertaking to commence supplying to that customer in the first place. Accordingly,
indispensability should also be a requirement in relation to a refusal to supply an existing
customer.

8.5 The Paper appears to provide for fewer possible objective justifications in relation to a refusal
to supply an existing customer when compared with a refusal to start supplying an input. For
example, in the case of a refusal to supply an existing customer, the Paper is silent on whether
the dominant undertaking would be able to rely, by way of objective justification for the
refusal to grant access, on capacity constraints, substantial increases in costs as a result of
granting access, or the undertaking being denied access no longer being able to use the
facility in a proper manner. These objective justifications should be available in the case of a
refusal to supply an existing customer and any guidance issued by the Commission should
reflect this.

Refusal to Start Supplying an Input (paras. 226-236)

8.6 That a supplier should benefit from its own labours in terms of choice of supply is
fundamental to investment incentives. We are disappointed that the Commission has done
little more than restate existing case law and perpetuate the divergence between the US and EC on this issue. The Paper should recognise at the outset that the presumption should be that suppliers should not be required to part with their property. Forced supply is an exceptional and damaging remedy and should be recognised as such.

8.7 In relation to the indispensability criterion, the Paper provides that a facility should only be viewed as indispensable "when duplication of the existing facility is impossible or extremely difficult, either because it is physically or legally impossible to duplicate, or because a second facility is not economically viable in the sense that it would not generate to cover its costs". We assume that the latter point (namely, a second facility not being economically viable) refers to the market in general not being able to cover the costs of a second facility, as opposed to each individual smaller rival not being able to cover the costs of a second facility.

8.8 Finally, guidelines should reflect the fact that a product is less likely to be indispensable in a sector that experiences rapid innovation. Undue interference from a regulator or a court imposing an obligation to supply is simply likely to dampen the incentive to innovate on the part of smaller rivals in such a sector.

Refusal to License Intellectual Property Rights (paras. 237-242)

8.9 Only in genuinely "exceptional" circumstances should a refusal to license an intellectual property right ("IPR") be considered abusive. International conventions and domestic statutes recognise the need to encourage innovation and research and development and have accordingly conferred monopoly protection on the holder of the IPR for a certain period of time. Antitrust policy should only interfere with these monopoly rights in exceptional circumstances.

8.10 We appreciate that certain commentators see no difference, as a matter of principle, between interfering with IPRs and interfering with other property rights (for example, granting access to an infrastructure, such as a port). However, from a policy perspective, there is an even greater need to ensure protection for IPRs for a number of reasons:

(a) first, it is important to encourage innovation. Indeed, research and development have been recognised as a key element of the Lisbon Strategy's objective to make the EU "the most competitive and dynamic knowledge-driven economy by 2010";

(b) antitrust policy should reflect the fact that investment in IPRs (particularly in such sectors as pharmaceutical products) will inevitably have involved numerous failed attempts to innovate successfully;

(c) IPRs are generally more prone to free-riding than other property rights and thereby merit a greater degree of protection; and

(d) antitrust policy should ensure that there is no undue interference during the limited exclusivity period granted to the rights holder.

8.11 Refusal to license IPR should only be considered abusive where the undertaking requesting a licence intends to produce new goods or services that are not offered by the IPR owner and for which there is a potential customer demand. Clearly, the new goods or services should be sufficiently differentiated from those already offered by the IPR owner in order to justify the interference in the IPRs. Exceptional circumstances should be a closed category reserved to this stifling of new products.

Refusal to Supply Information for Interoperability (paras. 239-242)
8.12 In our view, interoperability issues should not be addressed in any manner different from the legal test applicable to refusal to license IPRs. Interoperability details are in many cases also protected by IPRs and may constitute protected trade secrets, as noted by the Paper. The Software Directive provides a legislative fix to program interfaces which should not be second guessed by competition law.

8.13 However, to the extent that any lower standard of information should apply to interoperability, we would ask that the Commission provide more guidance on what the relevant legal test is rather than simply indicating that a lower standard of intervention applies in relation to interoperability information when compared to IPRs.

EWB/SWB/SZM/TMK
31 March 2006
Baker & McKenzie