RESPONSE TO:

DG COMPETITION DISCUSSION PAPER
ON THE APPLICATION OF ARTICLE 82 OF THE TREATY TO
EXCLUSIONARY PRACTICES

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19 April 2006
## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. SUMMARY AND GENERAL RECOMMENDATIONS</td>
<td>3</td>
</tr>
<tr>
<td>2. OBJECTIVE JUSTIFICATIONS AND EFFICIENCIES (¶¶ 77-92)</td>
<td>5</td>
</tr>
<tr>
<td>3. PREDATORY PRICING (¶¶ 93-133)</td>
<td>5</td>
</tr>
<tr>
<td>4. SINGLE BRANDING AND REBATES (¶¶ 134-176)</td>
<td>7</td>
</tr>
<tr>
<td>5. TYING AND BUNDLING (¶¶ 177-206)</td>
<td>9</td>
</tr>
<tr>
<td>6. TERMINATING AN EXISTING COURSE OF DEALING (¶¶ 217-224)</td>
<td>10</td>
</tr>
</tbody>
</table>
Response to DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses

This paper comments on the Discussion Paper on the application of Article 82 of the EC Treaty to exclusionary abuses published by the Commission in December 2005 (the “Discussion Paper”).

McDermott Will & Emery welcomes the opportunity to comment on the Discussion Paper and commends the Commission’s efforts to engage interested parties on the development of Article 82 policy. We support the Commission’s efforts to clarify existing Community jurisprudence and to recognise that a more economic approach to the application of Article 82 is necessary. On the whole, the Discussion Paper contains a number of welcome clarifications. At the same time, however, we would encourage the Commission to develop the proposals contained in the Discussion Paper further, with a view to providing more practical guidance to businesses.

These comments are based on the extensive experience of McDermott Will & Emery in advising and representing businesses in relation to Article 82 issues at EU and national level in Europe, and our extensive counselling and litigation experience in the USA under Section 2 of the Sherman Act.

1. **Summary and General Recommendations**

1.1 We have commented on issues in the Discussion Paper that we consider would most benefit from further development. These issues include: (i) objective justifications and efficiencies; (ii) predatory pricing; (iii) single branding and rebates; (iv) tying and bundling; and (v) refusal to deal (termination of an existing supply relationship). The main points are as follows:

- **Objective justification and efficiencies.** Clarification of objective justification and efficiencies under Article 82 is welcome. However, the Paper raises difficult legal issues by placing the burden of proof to show objective reasons or efficiencies on the dominant firm, mirroring its approach under Article 81. To the extent that the Commission confirms that the burden of proof rests with the dominant firm, it will need to develop and provide guidance on the types of evidence needed to establish the specific legal conditions for claims of objective justification and efficiencies.

- **Predatory pricing.** The confirmation of established case law on predatory pricing in the Discussion Paper is welcome. We believe, however, that the Commission should give further consideration as to whether predatory pricing analysis should include the element of recoupment. A recoupment requirement
may reduce the risk of that legitimate price-cutting conduct will be considered predatory and may also promote administrative and judicial efficiency.

- **Single branding and rebates.** We welcome the economic analysis the Commission has advanced in the area of single branding and rebates, and the broadening of the scope of the available defences. We are concerned however that the guidance contained in the Discussion Paper does not provide businesses with sufficient clarity in order to form discounting and single branding policies that are fully compliant with Article 82, *ex ante*.

- **Tying and bundling.** We welcome the Paper’s observations, and believe that they may help businesses to distinguish tying or bundling practices that are legitimate from those that would raise competition concerns. We also welcome the implicit recognition of coercion as a condition of tying and bundling abuses. At the same time, however, we believe that the Commission’s effort to clarify its approach to tying and bundling under Article 82 is not complete. Rather, in its present form, we believe that the Paper creates legal uncertainty in certain important areas.

- **Refusal to deal.** We do not consider it appropriate to treat the termination of existing contracts strictly or differently from first-time contracts at resale or distribution level. Generally, there are pro-competitive reasons for a non-renewal or a termination. Competition problems typically arise only if the termination implements a strategy to foreclose competitors from the market in which the dominant firm is active. Furthermore, forward-integration generally brings about efficiencies that have positive effects on consumer welfare and thus warrants a presumption of legality.

1.2 In addition, so that businesses have a user-friendly framework from which to conduct their operations, we would encourage the Commission to provide, either in the Discussion Paper or in subsequent Guidance:

- a clear and systematic identification of exclusionary conduct which is treated as *per se* abusive and exclusionary conduct for which there is a rebuttable presumption of an abuse of dominance;

- examples of specific situations to illustrate the theoretical principles and analytic assessment underpinning the observations contained in the Discussion Paper; and

- general and specific identification of factors (and type of evidence) considered relevant for assessing whether an alleged abuse is objectively justified or gives rise to efficiencies.
1.3 We understand that the Discussion Paper intends both to maintain an overall consistency with existing case law and to develop Article 82 policy so that it is more aligned with economic thinking. Nevertheless, we consider that more discussion of prior cases in the light of the Commission’s forward-looking approach to Article 82 would provide additional guidance and legal certainty.

2. **Objective Justifications and Efficiencies (¶¶ 77-92)**

2.1 The expressed recognition in the Discussion Paper of objective justification and potential efficiencies under Article 82 is welcome. Clarification of this area is particularly important. A review of case law shows that efficiency claims by the dominant are rarely supported by sufficient evidence and are thus rarely successful. However, the Commission’s Discussion Paper does not provide more detailed information as to level of proof actually required, or how the burden is shared among the parties.

2.2 The Discussion Paper advocates an approach to objective justification and efficiencies that mirrors the “exemption” process under Article 81(3). This approach, however, is not necessarily appropriate in an Article 82 context. For example, to establish an efficiency defence, the Discussion Paper states that the conduct must not substantially eliminate competition. (¶ 84) However, a firm seeking an efficiencies defence under Article 82 would already have been found to be dominant and its conduct found to have an actual or likely foreclosure effect on competition. The Discussion Paper does not offer guidance on how a firm seeking to invoke an efficiencies defence can actually establish it in an Article 82 context.

2.3 Apart from this basic analytical difficulty, the Discussion Paper does little to explain the allocation of the burden of proof among the parties with respect to establishing anticompetitive effects and efficiencies. The Discussion Paper cites recital 5 and Article 2 of Council Regulation 1/2003 to support the proposition that a dominant firm bears the burden of demonstrating that the conditions for defences are satisfied. It is not, however, clear that recital 5 and Article 2 would actually place the burden of establishing an objective justification or efficiencies on the dominant firm.

2.4 The Discussion Paper also leaves unclear the question of the type and level of evidence that must be advanced to establish a defence. A concrete example of this difficulty arises in the area of tying and bundling, where the Paper states that, to be justified, the practice must be “indispensable.” The question of “indispensability”, however, leaves unanswered the more salient question of whether the tie-in’s or bundle’s pro-competitive effects outweigh its anticompetitive effects. By failing to address these issues, the Discussion Paper leaves unclear the issue of how a firm proves that its conduct is justified or defensible.

2.5 Finally, current case law demonstrates that efficiency claims by dominant undertakings have, in the Commission’s view, normally not been well supported by sufficient evidence. As a result, claims based on efficiencies are rarely successful. Case-law
indicates that undertakings tend to claim general efficiencies without producing adequate evidence to prove the efficiencies claimed. We therefore believe the Discussion Paper would benefit by clarifying (i) the standard of proof applicable to objective justifications and efficiencies; (ii) how such standard is met.

3. **Predatory Pricing (¶¶ 93-133)**

3.1 The confirmation of established case law on predatory pricing in the Discussion Paper is helpful. We also welcome the Discussion Paper’s recognition of the strategic context of predatory pricing. We believe, however, that the Commission has missed an opportunity to incorporate a recoupment requirement in predatory pricing analysis.

3.2 The Discussion Paper relies foremost on a cost-based analysis to demonstrate predatory pricing, and considers recoupment only as a defence that can be advanced by an alleged predator. Whatever the cost/price allegation, the Discussion Paper takes the position that recoupment need not be proven to establish predatory pricing in violation of Article 82. Rather, the Discussion Paper states that the ability to recoup can be assumed where a firm is dominant. In other words, because a dominant firm is involved, the existence of high entry barriers and the ability to recoup is presumed. A finding of dominance is not, however, necessarily a substitute for a finding that recoupment is possible, particularly since the determination of dominance is often based on historical market conditions, not forward-looking market conditions.

3.3 In addition, we are of the view, based on our extensive experience in counselling firms in the USA, that the absence of a recoupment condition can be problematic for at least two other reasons. First, not requiring recoupment increases the risk of over-enforcement, which would likely have a chilling effect on price-competition. Chilling legitimate price competition is unlikely to serve the interest of consumer welfare. This concern is reflected in US and Australian antitrust jurisprudence which sets the position that recoupment is an important “screen” against over-enforcement of the antitrust laws, which could otherwise deter legitimate price-cutting.1

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1 In the US, the emphasis on recoupment in predatory pricing cases was settled by the Supreme Court in *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). There it was held that “predatory” pricing is legal unless there is a “reasonable prospect” of the alleged predator recouping its losses. In other words, “[w]ithout [recoupment], predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. … [U]nsuccessful predation is in general a boon to consumers.” (Ibid., at 224.) 3.4 The Australian courts require recoupment in predatory pricing cases for similar reasons. In *Boral* (1999) 166 A.L.R. 410, Heerey J. stated that section 46 of the Trade and Practices Act 1974 (which prohibits predatory pricing), exists to protect competition and consumers, not competitors. Thus neither price cutting (to whatever level) nor ruthless competition, nor conduct designed to injure competitors is necessarily unlawful. The High Court upheld Heerey J’s judgment, stating that recoupment must be treated as a fundamental element in determining a claim of predatory pricing. (*Boral* (2003) 195 A.L.R. 609, para [292]).
3.4 Second, incorporating a recoupment test to establish predatory pricing can lead to administrative and judicial efficiency. On the one hand, recoupment is a good indicator of market power and, on the other, a purely cost-based analysis can be more complicated than an analysis of market structures as recoupment allows. For instance, if market power is about the ability to raise price levels profitably for a sustained period, then the ability of the predatory undertaking to recoup losses (which is a function of entry barriers) should be a factor in determining predation, since it is only in this way that the undertaking secures higher profits than it would have obtained if not for the predatory behaviour.

3.5 In addition, a recoupment requirement can eliminate the need for a complicated price/cost analysis. Citing the US Supreme Court, a US appeals court stated that it is often “much easier to determine from the structure of the market that recoupment is improbably than it is to find the cost a particular producer experiences.”\(^2\) For this reason, the court elaborated, explaining that recoupment should be considered before cost and price, stating that “[o]nly if market structure makes recoupment feasible need a court inquire into the relationship between price and cost.”\(^3\)

4. **Single Branding and Rebates** (¶¶ 134-176)

4.1 The Discussion Paper makes significant progress on the treatment of rebates by taking an effects-approach analysis and broadening the scope of the available defences. We welcome the Commission’s efforts in doing so. We do, however, have the following specific concerns.

- **Rebates are generally pro-competitive.** By definition, a rebate is a mechanism by which customers are offered lower prices. As Commissioner Neelie Kroes recently stated, “low prices and rebates are, normally, to be welcomed….”\(^4\) The Discussion Paper does not, however, offer significant discussion of, or weight to the pro-competitive aspects of discounts/rebates. This creates the incorrect perception that rebates are typically anticompetitive.

- **Consumer harm requirement.** The Discussion Paper, throughout its discussion of single branding and rebates, emphasises that harm can be measured by foreclosure. We consider that this oversimplifies the analysis: foreclosure does not necessarily equate to consumer harm in this particular context. In order for single branding obligations or rebates to be deemed anticompetitive, an actual or

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\(^3\) See Id.

\(^4\) See Neelie Kroes, “Preliminary Thoughts on Policy Review of Article 82” 23 September 2005 SPEECH/05/537.
likely negative effect on consumer prices, quality and output should also be demonstrable.

• **Single branding/English clauses.** The Discussion Paper proposes change in the Commission’s thinking on exclusive dealing by dominant firms. Historically, exclusive dealing has often been treated as more or less a *per se* violation of Article 82. The Discussion Paper now proposes to essentially apply a rule-of-reason analysis, which involves an assessment of the pervasiveness of the exclusive dealing requirement among customers, evidence of foreclosure effects and possible efficiencies (e.g., customer-specific investments). We welcome this proposal. However, the Discussion Paper states only that single brand obligations to “a good part” of a dominant firm’s buyers, affecting “at least a substantial part of market demand”, will likely result in foreclosure that constitutes an abuse of a dominant position ([¶ 149]). It would be useful if the Commission could give more practical guidance on when foreclosure concerns can be presumed not to exist and in particular offer firms guidance with respect to any of the following issues:

  – Does the likelihood of entry or low barriers to entry prevent the Commission from concluding that the market is likely to be foreclosed?

  – What percentage of customers must be “foreclosed” from competitors before a violations will be found?

  – Is there a limit to the proportion of a given customer’s purchases that a dominant company may require to supply in exchange of a rebate?

• **Individualised rebates on all purchases.** We welcome the Commission’s effort to underpin its rebate policy to economic theory. The Discussion Paper states that if the rebate threshold is set at a level that would anyhow be reached by a customer, there can be no loyalty-enhancing effect ([¶ 152]). We consider this to be an accurate and sound approach to rebate analysis. We likewise agree with the Discussion Paper’s position that the foreclosure effect of a given conditional rebate depends on the level of the rebate and the minimum threshold at which a customer qualifies for the rebate ([¶ 153]).

In proposing to assess whether a rebate has a loyalty-enhancing effect by assessing the foreclosure effect on “commercially viable amounts” supplied by potential rivals of the dominant firm, the Discussion Paper creates a complex test of how such “commercially viable amounts” should be calculated. The test for all-purchase rebates is not sufficiently practical to enable a firm to calculate its rivals’ “commercially viable amounts” at the time when it decides its pricing strategy.
If specific rules are to be maintained for rebate practices, they need to be more approachable, or “user-friendly” from the perspective of a business. It may thus be more helpful to provide guidance by listing factors to be taken into account, including, for example, the length of the reference period and by setting a presumption that a rebate affecting X per cent. of customers raises no competition concerns.

- **Standardised rebates on all purchases.** The Discussion Paper indicates that foreclosure is unlikely in rebate structures where the threshold at which customers qualify is standardised (¶ 159). We consider this observation to be generally correct. We also generally agree that conditional rebates on incremental purchases above a certain threshold which are set in terms of a standardised volume target can have foreclosure effects only if the resulting price for these incremental purchases are at a predatory price.

5. **Tying and Bundling (¶¶ 177-206)**

5.1 The Discussion Paper’s attempt to clarify the Commission’s approach to tying and bundling is welcomed. Unfortunately, we consider that, in its present form, the Paper leaves important gaps of legal uncertainty for businesses and practitioners, as further developed below.

5.2 The Discussion Paper distinguishes between “pure” and “mixed” bundling, as well as “contractual”, “commercial” and “technical” tying (¶ 182). It would be useful to clarify how the characteristics of each variety of bundling and tying affects the Commission’s competitive analysis.\(^5\) This is in particular the case in respect of objective justifications and possible defences that may be invoked by a dominant company.

5.3 The Discussion Paper specifies a four-step test: (i) whether the company concerned has a dominant position on the tying market; (ii) whether the tying and tied goods are distinct products; (iii) whether the tying practice is likely to lead to market distorting

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foreclosure effect; and (iv) whether the tying practice is justified by objective reasons or efficiencies. We generally agree with this test. However, as developed below, the Paper does not provide sufficient clarification as to how certain of these conditions are met – in particular the determination of whether the products are distinct and whether the market is foreclosed.

5.4 While the Discussion Paper lists a number of relevant factors in the assessment of whether two products are distinct, a clear test appears to be lacking. A discussion of the tests defined in prior case law, such as *Hilti*⁶, might have been useful.

5.5 To determine market foreclosure, the Discussion Paper advocates an assessment based on which customers are “tied” in the sense that rivals to the dominant firm cannot compete for their business and whether these customers comprise a “sufficient” part of the market being tied. We believe it would be helpful if the Commission were to define what would comprise a “sufficient” part of the market. This would enable a business better to assess whether its tying practice triggers the rebuttable presumption of an abuse of dominance.

5.6 Instead of defining what is a “sufficient” part of the market, the paper provides a long list of factors that may or may not lead to an assumption of foreclosure. A clarification of how these factors are to be incorporated in the Commission’s above mentioned assessment of foreclosure effects would be welcomed.

6. **Terminating an existing course of dealing (¶¶ 217-224)**

6.1 The Discussion Paper proposes treating the termination by a dominant firm of an existing course of dealing at resale or distribution level strictly. It states that there is a rebuttable presumption that continuing these relationships is pro-competitive. The Commission indicates that a dominant firm must, therefore, be able to point to an objective justification for a termination in order to rebut the presumption. Further, where it terminates a supply relationship because it wants to integrate its business downstream, it must show that consumers are better off with the supply relationship terminated than without.

6.2 We consider this rule limits a dominant firm’s right in principle to terminate or not to renew supply contracts and to restructure its business by vertically-integrating. We do not consider that the termination of existing contracts should be treated differently to first-time contracts. There should be no general duty for a dominant firm to continue to deal with another firm at resale or distribution level. We consider that there is only normally a competition problem if the termination of an existing supply contract implements a strategy to foreclose competitors from the market in which the dominant firm is active, in which case the general rules on exclusionary effects may be applied.

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In addition, forward-integration may bring about efficiencies that have positive effects on consumer welfare and may thus warrant a presumption of legality.

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