

## Submission on DG Competition's Discussion Paper on the application of Article 82 of the Treaty to exclusionary abuses

### 1 Introduction

We welcome the opportunity to comment on the DG Competition's "Discussion Paper on the application of Article 82 of the Treaty to exclusionary abuses" ("Discussion Paper"). We also commend DG Competition's efforts to provide an analytical framework within which national competition authorities (NCAs), national courts and businesses will be able to apply Article 82.

We understand that the Commission is also in the process of reviewing the law and policy relating to exclusionary and exploitative abuses and we welcome this development. In the interest of developing a coherent policy under Article 82, we ask the Commission to consider issuing draft guidance on all categories of abuse.

### 2 Key points

#### 2.1 Positive developments

We welcome and support DG Competition's move away from the formalistic, "per se" approach to the concept of abuse used in the past and to acknowledge that:

*"the purpose of Article 82 is not to protect competitors from dominant firms' genuine competition based on factors such as higher quality, novel products, opportune innovation or otherwise better performance."*<sup>1</sup>

Moreover, we agree with the view expressed by the Discussion Paper that the objective of Article 82 (at least as far as exclusionary abuses are concerned) is the protection of competition on the market as a means of enhancing consumer welfare and ensuring an efficient allocation of resources.<sup>2</sup> Whether the consumer welfare objective is properly implemented in the rest of the Discussion Paper, however, is not entirely clear, as will be explained below, but at least the determination to look at consumer harm is the right way forward.

We note and endorse the acceptance, in principle, of a more effects based approach in the Discussion Paper and that Community competition law on unilateral conduct should not be applied in a mechanistic or formalistic way:

*"By exclusionary abuses are meant behaviours by dominant firms which are likely to have a foreclosure effect on the market, i.e. which are likely to completely or partially deny profitable expansion in or access to a market to actual or potential competitors and which ultimately harm consumers."*<sup>3</sup>

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<sup>1</sup> Discussion Paper, paragraph 54.

<sup>2</sup> Ibid.

<sup>3</sup> Discussion Paper, paragraph 1.

We strongly believe that the law on unilateral conduct should be aligned with its economic purpose and in particular should be assessed in terms of its actual and/or potential economic effects.

## 2.2 Remaining concerns

While moving the law and policy under Article 82 in the right direction, the proposed approach in the Discussion Paper remains too cautious. Whilst DG Competition embraces an effects-based approach in theory, the Discussion Paper's wide definition of foreclosure,<sup>4</sup> frequent use of (rebuttable) presumptions of abuse<sup>5</sup> and the heavy burden of proof on companies to prove defences<sup>6</sup> all run the risk of undermining the very consumer welfare standard it is seeking to promote (and effectively reintroducing the old formalistic approach through the back door). In particular:

- (i) At several points the Discussion Paper indicates that certain conduct<sup>7</sup> will be presumed to be abusive, without examining evidence of the actual or likely effects of the conduct (subject to rebuttal or justification). In practice, such presumptions may not be significantly different from the repudiated "per se" approach. We do not believe that presumptions should be used to avoid a rigorous analysis of the economic advantages and disadvantages of unilateral conduct.
- (ii) We believe that the proposed bifurcated analysis of competitive harm and economic benefits under Article 82 is mistaken. It has long been recognised that Article 82, by contrast with Article 81 EC, does not contain any explicit provision for the exemption of conduct otherwise falling within it.<sup>8</sup> In our view, it is preferable to take into account efficiencies and other countervailing benefits when determining whether certain types of conduct on the part of a dominant firm are abusive. This would also be in keeping with the "integrated" analysis under the Merger Regulation<sup>9</sup> and, since modernisation, under Article 81.<sup>10</sup>
- (iii) Efficiencies are only taken into consideration if they satisfy conditions equivalent to those set out in Article 81(3) EC. We are very concerned that these conditions may sometimes be unduly difficult to satisfy, in particular the "indispensability" requirement and the condition that "competition in respect of a substantial part of the products concerned is not eliminated". Dominant firms may be dominant precisely because there are productive efficiencies to their scale which it would be counter-productive to require them to forego.

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<sup>4</sup> Discussion Paper, paragraph 58.

<sup>5</sup> Discussion Paper, paragraph 162.

<sup>6</sup> Discussion Paper, paragraph 77.

<sup>7</sup> See, for example, Discussion Paper, paragraph 158: "[i]n case the threshold(s) is (are) formulated in terms of percentage of total requirements of the buyer or an individualised volume target, the Commission will normally presume that it (they) is (are) set at such level(s) as to hinder customers to switch to and purchase substantial additional amounts from other suppliers and thus enhance loyalty"; see similarly, paragraphs 169 and 171.

<sup>8</sup> See, for example, Case C-53/03 *Synetairismos Farmakopoion Aitolias & Akarmanias (Syfait) v Glaxosmithkline AEVE*, Opinion of Advocate General Jacobs, 28 October 2004, paragraph 72.

<sup>9</sup> See, for example, Andreas Strohm, "Efficiencies in Merger Control: All you always wanted to know but were afraid to ask", (Sweet & Maxwell, 2006).

<sup>10</sup> See, for example, Luc Gyselen, "The Substantive Legality Test under Article 81-3 EC Treaty - Revisited in Light of the Commission's Modernization Initiative", in: Von Bogdandy, Mavroidis & Mény (Eds.), *European Integration and International Co-ordination, Studies in Transnational Economic Law in Honour of Claus-Dieter Ehlermann* (The Hague/London/New York, 2002), p. 197.

- (iv) DG Competition takes the position that it has the burden of proving the abuse but that defendant has the burden of proving any defences.<sup>11</sup> Although the evidential burden may shift to the defendant,<sup>12</sup> it is settled case law that the Commission always has the legal burden of proving an infringement<sup>13</sup> (and that the absence of any justification is an integral part of the abuse). It follows that the burden of proof that conduct has, on balance, a material adverse effect on consumer welfare rests on the Commission.
- (v) The Discussion Paper goes out of its way to avoid creating safe harbours for dominant companies. For example, even companies whose prices are above the unjustifiably high cost benchmark of average total costs (“ATC”) cannot be sure that they do not run the risk of infringing Article 82.<sup>14</sup> We urge DG Competition to consider the use of screens<sup>15</sup> (and other practically administrable rules) that allows businesses to ensure that their commercial strategies comply with Article 82.
- (vi) Certain methods of assessment for rebates set out in the Discussion Paper (in particular for the assessment of conditional rebates on all purchases) are impracticable and fail to provide adequate guidance to (putative) dominant firms for determining the lawfulness of their behaviour.
- (vii) The use of a very conservative cost benchmark, namely ATC risks protecting inefficient competitors and is incompatible with the overall consumer welfare approach advocated by the Discussion Paper.

Given the foregoing, we suggest that greater weight should be given to the view prevalent among economists, that many instances of single-firm conduct (in particular single branding obligations, rebates and bundling) are generally pro-competitive and much less frequently harmful:

*“It is with respect to this type of conduct that it may be most difficult to differentiate between healthy competition on the merits and harmful exclusionary conduct. It is here where enforcers and courts run a significant risk of deterring hard yet legitimate competition.”<sup>16</sup>*

Whilst the Discussion Paper is admirably clear that the function of Article 82 is to protect and promote efficiency as a matter of principle, the Paper is much less clear on the way in which the different types of abuse should be assessed.

The application of Article 82 should be applied only in more narrowly limited circumstances and should be based on careful analysis in order to minimise the incidence of false positives that would otherwise occur.

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<sup>11</sup> Discussion Paper, paragraph 77.

<sup>12</sup> In support of this distinction between legal and evidential burdens, see Philip Collins, Chairman of the Office of Fair Trading, “Reform of Article 82”, 24 February 2006, British Institute of International and Comparative Law.

<sup>13</sup> See, for example, Joined Cases C- 204/00 P etc. Aalborg Portland A/S V Commission [2004] ECR I-123, paragraph 78.

<sup>14</sup> Discussion Paper, paragraphs 127-129.

<sup>15</sup> See, for example, OFT Economic Discussion Paper submitted by RBB Economics “Selective price cuts and fidelity rebates”, July 2005.

<sup>16</sup> R. Hewitt Pate, former Assistant Attorney General, Antitrust Division, U.S. Department of Justice “The common law approach and improving standards for analysing single firm conduct”, 23 October 2003, Fordham Corporate Law Institute.

### **3 The objective of Article 82 EC**

#### **3.1 Adoption of the consumer welfare standard**

At the level of fundamental principle, we welcome the Discussion Paper's commitment to applying Article 82 with a view to maximising consumer welfare:

*"With regard to exclusionary abuses the objective of Article 82 is the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. ... In applying Article 82, the Commission will adopt an approach that is based on the likely effects on the market."*<sup>17</sup>

Historically it is fair to say that Article 82 has been applied with a number of objectives in mind, including the protection of values other than efficiency such as fairness. Obviously these objectives cannot always be easily reconciled.<sup>18</sup>

We agree, however, with the view expressed in the Discussion Paper that "the purpose of Article 82 is not to protect competitors from dominant firms' genuine competition"<sup>19</sup> and support the notion that, in future, maximising consumer welfare will be the touchstone of any assessment of exclusionary abuses. To that end, we endorse the view expressed by Commissioner Kroes who recently stated:

*"I like aggressive competition – including by dominant companies - and I don't care if it may hurt competitors – as long as it ultimately benefits consumers. That is because the main and ultimate objective of Article 82 is to protect consumers, and this does, of course, require the protection of an undistorted competitive process on the market."*<sup>20</sup>

#### **3.2 Implementation of the consumer welfare standard**

To ensure that the future of Article 82 enforcement is based on the policy of promoting consumer welfare through an effects-based approach, the rules that implement that provision must be consistent with it.

For the reasons explained below, the proposed rules on four key categories of exclusionary abuse, i.e. predatory pricing, discounts, tying and refusal to supply, do not currently achieve that objective. Indeed there is a material risk that the suggested approach will lead the Commission to place undue weight on the assumed gains from long-term improvements in market structure at the expense of the more likely gains from short-term competitive dynamism.

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<sup>17</sup> Discussion Paper, paragraph 5; see paragraph 54. This is in line with the Commission Notice - Guidelines on the application of Article 81(3) of the Treaty, OJ [2004] C 101/08, paragraph 13 and 33 as well as *dicta* in the case law under Article 82, notably the Opinion of Advocate General Jacobs in Case C-7/97 *Oscar Bronner v Mediaprint* [1998] ECR I-7791, paragraph 58: "... the primary purpose of Article [82] is to prevent distortion of competition — and in particular to safeguard the interests of consumers — rather than to protect the position of particular competitors."

<sup>18</sup> For example, the meeting competition defence articulated by DG Competition requires that the dominant firm's response be the minimum required to protect its own commercial interests, although that may necessitate potentially unjustified discrimination between customers of the dominant firm. It is not clear which policy concern takes precedence in this situation.

<sup>19</sup> Discussion Paper, paragraph 54.

<sup>20</sup> Neelie Kroes, "Preliminary Thoughts on Policy Review of Article 82", 23 September 2005, Fordham Corporate Law Institute.

For example, the Discussion Paper asserts that efficiencies are “highly unlikely” to outweigh harm to consumers or rivals if a firm has market position approaching monopoly.<sup>21</sup> Even if a firm has a market share of say, 75%, the efficiencies generated by its conduct may nonetheless outweigh any harm. DG Competition should instead base its assessment on whether the disputed conduct gives rise to a material adverse effect on competition.

## **4 Dominance**

### **4.1 Overview**

Article 82 prohibits “*the abuse of a dominant position in the whole or a substantial part of the common market.*” It does not define dominance, explain whether an undertaking must exercise its market power to cause an abuse, or specify any criteria for determining whether substantial market power exists.

We believe that it is essential that the legal (and indeed economic) requirement of dominance is analysed in a way that provides a sound framework for the identification of possible abusive practices.

### **4.2 Dominance is substantial market power**

We welcome the alignment of the classic legal definition of dominance under Article 82 - “a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition”<sup>22</sup> - with the economic concept of “substantial market power”.<sup>23</sup>

It would be helpful to clarify whether and to what extent this interpretation overlaps or is influenced by the notion of “significant market power” used by the Commission’s *Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services*.<sup>24</sup>

### **4.3 Presumptions of dominance based on market shares**

We are very concerned by the suggestion in paragraph 31 of the Discussion Paper that a market share in excess of 50% is *prima facie* evidence of dominance:

*“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, provided that rivals hold a much smaller share of the market.”*

Whatever inferences could legitimately be drawn from a given share of a relevant market lacking arguable substitutes would not apply to the same share of a market that includes imperfect substitutes or that excludes arguably significant substitutes. The decision to include or exclude another producer in a market definition on an all or nothing basis does tend to include too much or too little.<sup>25</sup> Inferences of market power inevitably require the exercise of judgment, especially when (as is frequently the case) the precise boundaries of markets are unclear.

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<sup>21</sup> Discussion Paper, paragraphs 90-91.

<sup>22</sup> Case 85/76 *Hoffmann-La Roche & Co. AG v Commission* [1979] ECR 461, paragraph 38.

<sup>23</sup> Discussion Paper, paragraph 23.

<sup>24</sup> OJ [2002] C165/6.

<sup>25</sup> See, for example, Sir John Vickers, “Competition economics and policy”, 3 October 2002 (describing the “zero-one fallacy”).

We suggest, therefore, that the Commission should abjure altogether the use of presumptions in making affirmative findings of dominance. This would also be consistent with the enforcement action taken by the Commission in the past - most prohibition decisions that have been taken involve market shares substantially in excess of 50%. In our view, Commissioner Kroes has correctly stated that:

*“... I consider that high market shares are not - on their own - sufficient to conclude that a dominant position exists. Market share presumptions can result in an excessive focus on establishing the exact market shares of the various market participants. A pure market share focus risks failing to take proper account of the degree to which competitors can constrain the behaviour of the allegedly dominant company.”<sup>26</sup>*

Market definition and market shares are second best to direct measurement (and can often be an imperfect basis for inferring market power). Accordingly we suggest that any future guidance should moderate the inferences it purports to draw from market shares alone. As the Discussion Paper correctly recognises, market power will vary with the entry barriers and with the various factors impeding or facilitating workable competition.

#### **4.4 Safe harbours - no finding of dominance**

In our view, market shares are much better suited to establish safe harbours - in the same way that they have been used in respect of various benign agreements under Article 81. When seeking to identify dominance, market shares can be an initial screen. If the firm offering the selective price cut does not have a market share of above say, 40%, that is a powerful indication that it may not have the ability to raise price above competitive levels or to exclude competitive entry and that in general its practices will not harm competition.

On the use of market shares as safe harbours in dominance cases, we note that the Guideline published by the UK Office of Fair Trading (“OFT”) on Assessment of Market Power aptly points out that:

*“The OFT considers that it is unlikely that an undertaking will be individually dominant if its share of the relevant market is below 40 per cent”<sup>27</sup>*

We believe that any future guidance should contain a similar safe harbour and should, at a minimum, rephrase the much weaker statement currently found in the Discussion Paper to the effect that “undertakings with market shares of no more than 25% are not likely to enjoy a (single) dominant position on the market concerned”<sup>28</sup> which has been interpreted by some commentators to suggest that, once a firm’s market share exceeds 25%, a finding of single-firm dominance is possible.

## **5 General analytical framework**

### **5.1 Welcome move towards an effects-based policy**

Paragraph 57 of the Discussion Paper refers to the hallowed definition of abuse by the Court of Justice in *Hoffmann-la Roche v Commission* about exclusionary abuses.<sup>29</sup> At first

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<sup>26</sup> Neelie Kroes, “Preliminary Thoughts on Policy Review of Article 82”, 23 September 2005, Fordham Corporate Law Institute.

<sup>27</sup> OFT Guideline, “Assessment of Market Power”, December 2004, OFT 415, paragraph 2.12.

<sup>28</sup> Discussion Paper, paragraph 31.

<sup>29</sup> Case 85/76 *Hoffmann-La Roche & Co. AG v Commission* [1979] ECR 461, paragraph 91.

sight, that hortatory statement offers little help in determining what substantive elements an authority should adopt to assess an alleged infringement of Article 82. However, paragraph 58 helpfully distils two analytical points of reference from the judicial definition of abuse:-

- (i) There must be conduct that has the capability, by its nature, to foreclose competitors from the market. To establish such capability it is said that looking at the form and nature of the conduct is likely to be sufficient.
- (ii) Having identified the disputed conduct, a likely “market-distorting foreclosure effect” must be established in the specific market context.

This is a welcome repudiation of the view expressed in *Michelin II* that “for the purposes of applying Article 82 EC, establishing the anti-competitive object and the anti-competitive effect are one and the same thing”.<sup>30</sup>

However we suggest that future guidance should go further and reject any (factual) assumption that unilateral conduct can be exclusionary even where the dominant company has lost market shares during the relevant period as “it may legitimately be considered that the market shares of [the dominant firm’s] competitors would have been able to grow more significantly.”<sup>31</sup>

Whether embracing an effects-based approach is also a major step forward in practice depends of course on the definition of “market distorting” and on the burden of proof imposed on the competition authority/plaintiff to establish such distortion. As we will show in the sections that follow, we currently believe that DG Competition has been far too cautious so that there is a serious risk of over-intervention and erroneously condemning and deterring beneficial conduct.

## 5.2 Unnecessary two-stage analysis under Article 82

Article 82 EC does not contain any explicit provision for the “exemption” of conduct otherwise falling within it.<sup>32</sup> However, it is clear that Community competition law provides dominant companies with the possibility of demonstrating a legitimate business reason for their conduct; the European Courts have consistently limited the concept of abuse by reference to the possibility of objective justification.<sup>33</sup>

DG Competition has sought to explain its view of how the doctrine of objective justification (and other defences) work in practice by essentially proposing a two-stage analysis of single-firm conduct:

- The Commission will first assess whether the impugned conduct gives rise to market foreclosure by applying the two-fold test mentioned in section 4.1 above i.e. that the form of the conduct is ‘capable’ of foreclosure and that it is likely to have a market-distorting effect in practice; and then
- The Commission will consider any defences invoked by the allegedly dominant firm. “*Exclusionary conduct may escape the prohibition of Article 82 if the dominant undertaking can provide an objective justification for its behaviour or it can*

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<sup>30</sup> Case T-203/01 *Manufacture française des pneumatiques Michelin v Commission* [2003] ECR II-4071, paragraph 241.

<sup>31</sup> Case T-219/99 *British Airways v Commission* [2003] ECR II - 5917, paragraph 298, on appeal to the Court of Justice in Case C-94/04 P (judgment pending).

<sup>32</sup> See, for example, Case 66/86 *Ahmed Saeed Flugreisen and Silver Line Reisebüro* [1989] ECR 803, paragraph 32.

<sup>33</sup> See, for example, Case 311/84 *Centre belge d'études de marché - Télémarketing v SA Compagnie luxembourgeoise de télédiffusion (CLT) and Information publicité Benelux* [1985] ECR I-03261, paragraph 25.

*demonstrate that its conduct produces efficiencies which outweigh the negative effect on competition.*<sup>34</sup> The Commission's view is that the onus of proof is on the defendant to substantiate any justification/efficiencies.

The two-stage analysis raises a number of difficulties: first, the bifurcation tempts decision makers to define competitive harm in an overly broad manner, presumably in the knowledge that there is an "exemption" exit. That has been one of the problems traditionally associated with the enforcement of Article 81. Second, this bifurcation seems to advocate an unstructured balancing exercise, which in turn assumes that "harm to competition" and "efficiencies" can be measured and compared on a cardinal scale. In our view, this overestimates the powers and precision of competition law, which is a fairly blunt instrument.<sup>35</sup>

We suggest that it would be preferable, in terms of both legal principle<sup>36</sup> and practicality, to consider the party's efficiency claims or legitimate business justifications as part of its overall assessment of the conduct in question. This would be consistent with the Commission's "integrated" approach to efficiencies in merger control.<sup>37</sup>

### **5.3 Inappropriate rules on the standard and burden of proof**

#### **5.3.1 Overly broad definition of foreclosure**

The Discussion Paper adopts a very broad definition of foreclosure which embraces:

*"actual or potential competitors [which] are completely or partially denied profitably access to a market" and seems to occur where "entry or expansion of rivals [are discouraged] or their exit [encouraged]."*<sup>38</sup>

The broad scope given to the concept of foreclosure (to include not only exit and non-entry but also any marginalisation, disadvantaging or restraint upon the expansion of rivals) means that a foreclosure effect is relatively easy to establish. When combined with the frequent use of presumptions of foreclosure effects throughout the Discussion Paper,<sup>39</sup> the Commission is running the risk of undermining the very consumer welfare standard it is seeking to promote (and effectively reintroducing the old formalistic approach through the back door). The fact that certain conduct - for example, the launch of a new, superior product - involves a degree of foreclosure does not mean that the conduct is anti-competitive.

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<sup>34</sup> Discussion Paper, paragraph 77.

<sup>35</sup> On the design of appropriate antitrust rules, see Herbert Hovenkamp, "The Antitrust Enterprise: Principle and Execution", (Harvard University Press, 2006).

<sup>36</sup> See, for example, Case C-53/03 *Synetairismos Farmakopoiou Aitolias & Akarnanias (Syfait) v Glaxosmithkline AEVE*, Opinion of Advocate General Jacobs, 28 October 2004.

<sup>37</sup> Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings OJ [2004] C 31/03, paragraphs 76-88.

<sup>38</sup> Discussion Paper, paragraph 58. It appears that, for DG Competition, the crucial limitation upon an over-broad concept of foreclosure is the (frequently repeated) proposition that it is only the foreclosure of "as efficient" competitors that should engage Article 82. That position is, however, qualified (possibly substantially) by the somewhat note that "it may sometimes be necessary in the consumers' interest to also protect competitors that are not (yet) as efficient as the dominant firm" (ibid, paragraph 167)

<sup>39</sup> Discussion Paper, paragraph 162.

### **5.3.2 Unduly high standard of proof for defences**

Having made it relatively easy to come to a finding of competitive harm, the Discussion Paper then raises the bar for dominant companies to rely on efficiencies by imposing very stringent conditions, equivalent to those set out in Article 81(3) EC (which provides an efficiency defence for anticompetitive agreements).<sup>40</sup>

Not only are these conditions very difficult (and at times impossible) to satisfy, some of them, in particular the “indispensability” requirement and the final condition - “competition in respect of a substantial part of the products concerned is not eliminated” - are also incompatible with the consumer welfare standard advocated in the Discussion Paper.

### **5.3.3 Proving the ‘net’ effect of conduct**

DG Competition erroneously takes the position that it has the burden of proving the abuse but that the defendant company is required to show that the effect of its conduct, on balance, is beneficial (or at least neutral) on consumer welfare.

Although the evidential burden may shift to the defendant, the Commission always has the legal burden of proving an abuse.<sup>41</sup> As a matter of legal principle, therefore, we strongly believe that the onus should be on the Commission to show that countervailing benefits are clearly outweighed by the actual or likely loss of competition. How such benefits and competitive harm should be weighed depends, in our view, on the particular type of conduct in question, the likelihood of anticompetitive effects and the risks of misdiagnosis.

## **5.4 No efficiency defence for super-dominant firms**

The Discussion Paper also appears to rule out the possibility of an efficiency defence for any firm having a market share in excess of 75% - so-called “super-dominant” firms - where the risks of being found to be acting abusively are all the greater. The Commission acknowledges explicitly that “ultimately the protection of rivalry and the competitive process is given priority over possible pro-competitive efficiency gains.”<sup>42</sup>

Yet, it is precisely because of such firms’ super-dominance that consumers are particularly dependent on them for realising productive efficiency gains. Assuming that the conduct in question is “indispensable” to realizing those efficiencies, we suggest that it should not be categorised as abusive, in accordance with the consumer welfare standard that DG Competition is proposing to adhere to.

## **6 Predatory pricing**

### **6.1 The proposed methodology**

The Discussion Paper recognises the need to distinguish between price reductions that form part of the normal competitive process and predation. DG Competition’s proposed

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<sup>40</sup> These conditions are: (i) efficiencies are realised or likely to be realised as a result of the conduct concerned; (ii) the conduct concerned is indispensable to realise the efficiencies - there is no economically practicable and less anticompetitive alternative; (iii) the efficiencies benefit consumers (in a timely fashion); (iv) competition in respect of a substantial part of the products concerned is not eliminated.

<sup>41</sup> See speech by Philip Collins, Chairman of the OFT, “Reform of Article 82”, 24 February 2006, British Institute of International and Comparative Law.

<sup>42</sup> Discussion Paper, paragraph 91.

assessment of predation is naturally influenced by the existing jurisprudence, most notably by the cost-based standards established by the Court of Justice in *AKZO v Commission*:

- prices below average avoidable costs (AAC)<sup>43</sup> infringe in the absence of any legitimate justification;
- prices between AAC and average total costs (ATC) infringe if an exclusionary strategy can be shown; and
- prices above ATC only infringe Article 82 in extraordinary circumstances.

The use of cost-based standards is of course more complicated than this brief summary suggests. There are arguments about how best to measure "avoidable" costs and whether it is an appropriate surrogate for the measure traditionally used by the Community Courts: "average variable cost".

## **6.2 Issues raised by the proposed methodology**

Whilst the standard of predation proposed by DG Competition is mostly unobjectionable, the specific tests that it uses to apply that standard raise significant questions both as to their consistency with fundamental principle and as to their workability.

### **6.2.1 The issue of recoupment**

DG Competition's general description of predation is based upon the conventional concept of a recoupable sacrifice by the dominant firm to achieve exclusion.<sup>44</sup> However, when identifying the evidence that may support a finding of predation, DG Competition treats recoupment as a possible but potentially non-essential element in such evidence. Indeed the Discussion Paper treats proof of dominance as sufficient to establish the likelihood of recoupment.<sup>45</sup>

It is submitted that proof of likely recoupment sets forth a rational and reasoned method for determining whether a particular pricing practice infringes Article 82: robust evidence of profit sacrifice, foreclosure and recoupment help to identify genuine instances of predatory pricing. Indeed our view is shared by a Discussion Paper published by the Office of the Chief Economist.<sup>46</sup>

Condemning a profit sacrifice without furnishing any proof that a dominant firm will be able to exercise increase market power and thus recoup its initial profit sacrifice, for example by raising prices beyond pre-predation levels, is very likely to interfere with the pro-consumer aims of Article 82 than further them.

### **6.2.2 Prices below AAC**

The proposed approach that pricing below AAC should be presumed to be predatory broadly follows the cost-based standard developed from the existing case law. That said, DG Competition's approach gives rise to a number of practical and conceptual difficulties. For example:

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<sup>43</sup> Average variable cost (AVC) was actually the measure of cost used in *Akzo*; the AAC measure is really a variant of the *Akzo* test. Under the AAC test, price is compared to the average of variable costs plus non-sunk, product-specific fixed costs over a set range of output. The salient differences between AVC and AAC is raised below.

<sup>44</sup> Discussion Paper, paragraph 93.

<sup>45</sup> For an explanation of why dominance cannot be equated with likely recoupment, see Office of Chief Economist Discussion Paper "A Three-Step Structured Rule of Reason to Assess Predation under Article 82", section 4.2.2 (arguing that dominance is neither necessary nor sufficient to establish recoupment).

<sup>46</sup> [http://ec.europa.eu/comm/dgs/competition/pred\\_art82.pdf](http://ec.europa.eu/comm/dgs/competition/pred_art82.pdf).

- (i) What costs are to be treated as avoidable? DG Competition should give clearer guidance as to the circumstances in which AAC will equate to average variable costs (AVC), and when it may exceed AVC.<sup>47</sup>
- (ii) Over what period of time is the possibility of avoidance to be considered? In practice the measurement of AAC depends upon the time frame over which avoidance is deemed to be possible.<sup>48</sup> It would be helpful for DG Competition to clarify, for example, how it proposes to decide the period over which the alleged predation is expected to occur.<sup>49</sup>
- (iii) What defences should be available to dominant firms pricing below AAC? This issue is addressed in section 5.3 more generally, but we are concerned that the combination of paragraphs 131 and 133 of the Discussion Paper rule out any defence for pricing below AAC. This appears to be at odds with the guidance published by the Office of Fair Trading which correctly recognises a number of pro-competitive reasons for pricing below AAC, including short-term promotions, new product launches, loss leading, selling off obsolete stock.<sup>50</sup> Beyond those reasons, the defendant should also be allowed to invoke an efficiency defence. The dominant company should have the possibility of showing that by pricing below AAC, its behaviour actually enhances efficiency and increases consumer welfare.

### 6.2.3 Pricing between AAC and ATC

The Discussion Paper correctly states that it is necessary to establish the existence of a predatory strategy when prices fall between AAC and ATC. The Discussion Paper identifies a range of factors, including an actual or likely exclusionary effect, and the scale, duration and continuity of the low pricing, but it is not clear how much importance should be attached to any particular factor. Of course, one might claim that such are the dangers inherent in any antitrust case: it all depends on the facts. However, the consequence of a mistake in framing rules on predatory pricing is not simply to require a dominant firm to forego legitimate business activity it wishes to pursue; any such mistakes also create an unacceptable risk of false positives.

The decisive factor appears to be the characterisation of a dominant firm's selective response to competitive entry.<sup>51</sup> We are concerned that the narrow interpretation of the meeting competition defence in the Discussion Paper,<sup>52</sup> under

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<sup>47</sup> The only specific example that it gives of the latter condition is where the dominant firm invests in excess capacity to allow it to predate (para 108)

<sup>48</sup> DG Competition proposes to use the duration of the alleged predation or, if the alleged predation is still continuing, the period over which it is expected to occur (see Discussion Paper, paragraph 105).

<sup>49</sup> Is it to be assumed to be a period as long as it takes to secure the (assumed) foreclosure effect, in which case it could be so long as to render a substantial proportion of the dominant firm's costs avoidable? Or should a finite period be selected, at least where there is specific evidence that the dominant firm would cease its low pricing strategy at a certain point? If the latter approach is adopted, how reliable is the dominant firm's evidence as to its future intentions?

<sup>50</sup> See OFT Guideline "Assessment of Conduct" (draft), OFT 414a, paragraph 4.12.

<sup>51</sup> Discussion Paper, paragraph 118.

<sup>52</sup> DG Competition requires that the dominant firm's response be proportionate to the competitive challenge and that it should not significantly delay or hamper competitive entry. The proportionality condition is expressed in the most restrictive terms possible, demanding proof that the conduct is the least restrictive option available to the dominant firm and that it is pursued for the absolute minimum period of time (Discussion Paper, paragraphs 81-83).

which any successful response likely falls outside the scope of the defence, suggests that any selective price-cutting below ATC will be unlawful.<sup>53</sup>

#### **6.2.4 Prices above ATC**

Price cuts by a dominant firm which do not entail below-cost sales should not be regarded as being abusive since they benefit consumers and, if competitors are equally or more efficient, they should be able to compete on the same terms. We endorse the view expressed by Advocate General Fennelly that:

*“Community competition law should thus not offer less efficient undertakings a safe haven against vigorous competition even from dominant undertakings.”*<sup>54</sup>

Accordingly we suggest that DG Competition should place much greater emphasis on lawful price-cutting and create a presumption of legality for prices above ATC. Such a safe harbour ensures that Article 82 is not used to protect less efficient firms at the expense of efficient firms. As currently drafted, paragraphs 128-129 of the Discussion Paper seek to embody every economic complexity but “may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends [the competition rules] seek to serve.”<sup>55</sup>

### **6.3 Possible defences: objective justifications and efficiencies**

In addition to our belief that the conditions developed under Article 81(3) are inappropriate for Article 82 and that the burden of proof to show a net effect of a unilateral act should be on the Commission, there exist many pro-competitive reasons to price below-cost.

We strongly believe that DG Competition should re-consider its position on the scope for adducing legitimate commercial reasons for pricing below AAC. This would have the merit of being consistent with economic theory,<sup>56</sup> the guidance published by other competition authorities<sup>57</sup> and, indeed, the views expressed by the Office of the Chief Economist.<sup>58</sup>

## **7 Single branding**<sup>59</sup>

### **7.1 The proposed methodology**

The mode of assessment suggested in the Discussion Paper with respect to single branding is not clear.

On the one hand, the Discussion Paper states:

*“Where the dominant company applies a single branding obligation to a good part of its buyers and this obligation therefore affects, if not most, at least a substantial part of market demand, the Commission is likely to conclude that the obligation has*

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<sup>53</sup> Compare the approach of the OFT to alleged predatory pricing in Decision No. CA98/05/2004, First Edinburgh / Lothian, 29 April 2004.

<sup>54</sup> Cases C-395/95 and 396/95 P *Compagnie Maritime Belge v Commission* [2000] ECR I-1365, paragraph 132.

<sup>55</sup> See, to that effect, *dicta* by now Justice Breyer in *Barry Wright Corp. v ITT Grinnell Corp.* (1983) 724 F.2d 227.

<sup>56</sup> Bolton, Broadley and Riordan *Predatory Pricing: Strategic theory and legal policy* (2000) 88 Georgetown Law Journal 2239.

<sup>57</sup> See OFT Guideline “Assessment of Conduct” (draft), OFT 414a, paragraph 4.12.

<sup>58</sup> See n 43 above.

<sup>59</sup> Sections 7-9 of these comments are based, in part, on Linklaters’ contribution to the comments provided by the International Bar Association.

*a market distorting foreclosure effect and thus constitutes an abuse of a dominant position.”<sup>60</sup>*

That statement appears to indicate a presumption that a general single branding obligation on a ‘good part’ of the market can generally be expected to have foreclosure effects. The Discussion Paper also claims that “*such an obligation may lead to market distorting anti-competitive effects even if only a modest part of market demand is affected by the obligation.*”

On the other hand, the Discussion Paper also makes clear that the Commission “*will also take into account evidence why for particular reasons no market distorting foreclosure will occur.*”

## **7.2 Issues raised by the proposed methodology**

The statement in paragraph 140 of the Discussion Paper “the Commission is likely to conclude” does not make clear whether there is a clear presumption of competitive harm for single branding obligations which cover a good part of a dominant’s customer base or a mere expectation that competitive harm would be generally be found. This point should be clarified.

In any event, we take the view that a presumption of foreclosure and (given the way the Discussion Paper has allocated the burden of proof) of consumer harm is not justified in the case of single branding obligation. There are many instances where single branding obligation does not raise any foreclosure concerns or where any foreclosure concerns are outweighed by efficiency gains, some of which (but by no means all) have been listed in paragraph 149 of the Discussion Paper.

Indeed, frequently, a single branding obligation may be at the behest of the customer, rather than at the dominant firm (for example, a customer may issue tender for all of its requirements for a particular period in order to intensify competition among its suppliers). In such circumstances, the Commission may want to consider a (rebuttable) presumption of legality given that a customer driven single branding obligation is likely (although not always) to be consumer welfare enhancing.

We support the Commission’s intention “to take into account evidence why for particular reasons no market distorting foreclosure effects may result”, in other words, to carry out an effects based analysis.

## **8 Rebates: conditional rebates on all purchases**

### **8.1 Proposed methodology**

The Discussion Paper proposes a new methodology for the assessment of conditional rebates on all purchases. This methodology is based on three pillars:

- (i) The assessment of whether the effective price resulting from the rebate when measured against “commercially viable share” of the market is predatory.
- (ii) The use of AVC as relevant cost benchmark.
- (iii) The use of a series of rebuttable presumptions of foreclosure: where a dominant firm operates a rebate system which fails the commercially viable share test and

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<sup>60</sup> Discussion Paper, paragraph 149.

which applies to a good part of the market, the rebate system is presumed to have a foreclosure effect. This presumption can be rebutted either (a) by indications that the threshold is set too low for a good part of the dominant company's buyers to hinder them to switch and to purchase substantial additional amounts from other suppliers without losing rebate or (b) by indications of a lack of foreclosure effect, such as "aggressive and significant entry and / or expansion by competitors and / or switching of customers .

This new methodology (which is a first step away from the current formalistic per se approach) has to be contrasted with (a) the contestable share approach<sup>61</sup> where the relevant price is measured against the whole share of the contestable part of the market and (b) the predation approach where the relevant price is measured against all sales of the dominant firm.

## **8.2 Issues raised by the proposed methodology**

### **8.2.1 Predictability**

The Commission's approach suffers from lack of predictability and does not provide sufficient guidance for dominant firms when particular rebates and discounts risk to being contrary to Article 82. Apart from the issue of general complexity of the Commission's methodology, the problem is largely due to lack of clarity of the concept of "commercially viable share".

Not only does a dominant firm have to have a good understanding about the market shares of its competitors but it also needs to know whether to consider potential entrants and at what scale a potential rival might enter. For example, assume a dominant firm faces a number of competitors, the smallest of which has a market share of 5%. The dominant firm could then assess its rebates against a "commercially viable share" of 5%. However, even then, it would still face the risk that there could be an entrant (unknown to the dominant firm) attempting entry at a share of 0.1%. As a result, dominant firms are much in the same position as under the current "per se" prohibition of loyalty-inducing rebates.

The Commission needs to give clearer guidance as to the relevant "commercially viable share"; for example, to the extent that there are existing competitors in the market, the dominant firm should generally be able to assume (absent strong evidence of pending entry, for example) that the commercially viable share measured is not smaller than the actual market share of its smallest competitor.

In terms of predictability, the proposed methodology compares poorly with the alternative contestable share approach and the general predation standard.

### **8.2.2 Risk of over-enforcement: scope for assisted entry**

While the Discussion Paper frequently refers to an "as efficient competitor" test, the methodology suggested for conditional rebates on all purchases allows for assisted entry in two ways: first, the Commission is willing to protect and foster entry at a sub-optimal level even if efficient entry is possible in the contestable segment of the market (here the methodology in the Discussion Paper is more interventionist than the contestable share approach) and secondly, the Commission is willing to

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<sup>61</sup> See, for example, OFT Economic Discussion Paper submitted by RBB Economics "Selective price cuts and fidelity rebates", July 2005.

protect and foster entry even if the non-contestability of the market is due to efficiencies, e.g. due to the reputation of the dominant firm's products (here the methodology in the Discussion Paper is more interventionist than the general predation approach).

No doubt, this is done in the hope that less efficient entrants may grow subsequently to an efficient scale (and make some of the currently non-contestable part of the market contestable in the long run). The downside of this approach, however, is that competition law provides an umbrella which may protect long term inefficient competitors and which may harm consumers.

We therefore advocate a less interventionist approach, in line with the aim of consumer welfare.

### **8.2.3 Risk of over-enforcement: the ATC Threshold**

The Discussion Paper compounds the problem of over-enforcement by applying the ATC cost benchmark, rather than the usual cost benchmark for predation, namely average variable cost (AVC) or average avoidable cost (AAC).

According to the Discussion Paper

*“[t]he main reason to take ATC as the cost benchmark is that the leveraging between the ‘non-contestable’ and the ‘contestable’ portion of demand allows the rebate system to operate without a profit sacrifice and thus to operate for a long time.”*

The reasoning of the Commission is not convincing. The correct cost benchmark is a means to ensure that only equally efficient competitors are protected by Article 82. This is a separate and unrelated issue from the question whether predatory rebates (or predation more generally) are rational. Even if it were the case that “predatory” rebates can be expected to occur more frequently than general predation, it is hard to see how the Commission's policy is improved by granting protection not only to equally efficient but also less efficient competitors.

It seems that the correct approach would rather be to introduce a recoupment test for general predation in order to take into account that general predation may frequently not be a rational business strategy (and hence that the competition authority may have got its cost assessment wrong).

Finally, while it may well be true that rebates which lead to effective prices below cost over a particular part of the sales (such as a commercially viable share market) are a more likely to be a rational business strategy than general below cost pricing, it also holds that there are far more efficiency justifications for such rebates. Overall, there is no sound basis for a policy which is more hostile to rebates than general predation.

### **8.2.4 Set of presumptions**

We do not agree with the use of the proposed presumptions in the context of conditional rebates on all purchases.

First, a failure to meet the commercial viable share test does not merit a presumption of foreclosure. For example where the share of the market not covered by the rebate scheme in question (i.e. the total market share minus the

“good part”) is bigger than the commercially viable share, it is not obvious why a potential entrant should be foreclosed at all.

Second, the determination of the commercially viable share is subject to a high degree of uncertainty and, consequently, subject to a significant risk of error (what is the expected scale of entry and is that entrant a relevant competitive constraint on the dominant firm?) that only limited weight should be put on the outcome of the test in isolation of other factors.

Furthermore, the mere fact that the effective price of the rebate if measured across the commercially viable share is below cost does not allow any conclusion as to whether the threshold is set at the correct level to prevent a significant proportion of the dominant firm’s buyer’s to switch.

Finally, the evidential requirement to establish an absence of foreclosure, namely “*aggressive and significant entry and/or expansion by competitors and/or switching of customers*” is far too high.

We suggest that in addition to demonstrating that the effective price of a rebate is below cost (if measured across the relevant sales), the Commission should also have to show that the rebate creates a likely or actual barrier to switching and to establish a likely or actual foreclosure effect (in terms of exit or decline of market shares of competitors).

## **9 Conditional rebates on incremental purchases / Unconditional rebates**

### **9.1 Proposed methodology**

The Discussion Paper proposes to apply “the guidance as developed in the section on predatory pricing” with ATC as the relative cost benchmark, both to conditional rebates on incremental purchases and to unconditional rebates.

### **9.2 Issues raised by the proposed methodology**

We agree in principle with applying the general predation standard to both types of rebates.

However, as with conditional rebates on all rebates, we have grave reservations about the use of ATC as the appropriate benchmark. With respect to conditional rebates for incremental purchases, the reasons are basically the same as the ones outlined for conditional rebates on all purchases set out in the previous section.

With respect to unconditional rebates, the arguments in favour of ATC seem even less convincing. It does not strike us as justifiable to take the absence of uniform pricing in itself as “*evidence to show that there is an intent to predate*”.

### **9.3 Possible defences: objective justifications and efficiencies**

With respect to objective justifications and efficiencies, the concerns which we see in relation to single branding obligations and rebates also cut across other types of abuse (such as the fact that the conditions developed under Article 81(3) are inappropriate for Article 82 and that the burden of proof to show a net effect of a unilateral act should be on the Commission, rather than on the dominant firm).

## 10 Tying and bundling

### 10.1 Proposed methodology

The suggested approach in the Discussion Paper is, of course, subject to the outcome of the appeal against the *Microsoft* decision.<sup>62</sup> That said, DG Competition adopts a relatively orthodox approach to the definition of tying, establishing four requirements.<sup>63</sup>

- (i) There are distinct tying and tied products.
- (ii) The firm concerned is dominant in the market for the tying product.
- (iii) The tying practice is likely to have a market distorting foreclosure effect.
- (iv) There are no efficiency or other justifications for the tying practice.

### 10.2 Issues raised by the proposed methodology

#### 10.2.1 Underlying rationale behind the need for “distinct products”

Paragraphs 185-187 of the Discussion Paper discuss the distinct products requirement. We are concerned that the test described might be applied without sufficient regard to its underlying purpose, which is to distinguish tying which benefits customers from tying whose restrictive effects outweigh the benefits.

Applying the rationale behind the distinct products inquiry, the question to be asked is whether there is consumer demand for the tying product and the tied product to be sold as a bundle, or whether there is material demand for them to be sold separately. If the demand for an “unbundled” product is negligible or non-existent, then consumers are not denied a choice which they want to have.

We believe that any future guidance should explicitly recognise and state that the “distinct products requirement” is not a mechanical exercise but operates as an important proxy for net consumer efficiencies, namely whether the efficiencies of tying outweighs the inherent reduction in choice for the consumer.<sup>64</sup> In that respect the reference to “distinct products” is ambiguous and misleading: the question is not whether two products are in form separate products, but whether there is demand for them to be sold separately.<sup>65</sup>

#### 10.2.2 Market-distorting foreclosure effect - element of “coercion”

Paragraph 188 of the Discussion Paper helpfully insists that an inquiry must be made into whether, and to what extent, “customers are “tied” in the sense that competitors to the dominant company cannot compete for their business.”

We understand that inquiry to mean that any challenged “tie” must be found to restrict consumers’ freedom of choice to select, purchase and/or use third party

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<sup>62</sup> Case T-201/04 *Microsoft v Commission* (judgment pending).

<sup>63</sup> Discussion Paper, paragraph 183.

<sup>64</sup> For an excellent explanation of the policy rationale behind the “distinct products” requirement, see the judgment of the in *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (*Microsoft III*), (explaining the consumer demand test is a “rough proxy for whether a tying arrangement may on balance, be welfare enhancing”, that is to say, whether the efficiencies from tying outweigh any customer restrictions).

<sup>65</sup> Probative evidence on consumer demand for a bundled product may be gathered from how non-dominant firms behave in the market.

products. Merely refusing to give customers a choice to obtain the tying product without the tied product would not be sufficient.

It would be helpful for DG Competition to clarify how the approach proposed in the Discussion Paper (set out in paragraph 183) fits together with the four stage test articulated by the Commission in its Decision against Microsoft (at recital 794) and explain whether the tests are complementary, alternatives or, indeed, identical.<sup>66</sup>

### 10.2.3 Market-distorting foreclosure effect - an unduly hostile approach

We welcome and endorse DG Competition's commitment to "*an overall assessment of the likely foreclosure effect of the tying or bundling practice ..., which will combine an analysis of the practice, its application in the market, and the strength of the dominant position.*"<sup>67</sup> This overarching assessment helps focus the tying test on identifying the circumstances in which tying may be considered detrimental under the terms of Article 82.

However we are concerned that certain aspects of the proposed approach with respect to tying and bundling - which, after all, are normal commercial practices - remain unduly hostile. In particular the Discussion Paper states that:

*"Where the Commission ... finds that the dominant company ties a sufficient part of the market, the Commission is likely to reach the rebuttable conclusion that the tying practice has a market distorting foreclosure effect and thus constitutes an abuse of dominant position."*<sup>68</sup>

We consider that such an approach creates undue risks of error and of deterring welfare-enhancing innovation. The ubiquity of bundling should give DG Competition reason to pause before summarily condemning such behaviour by dominant firms.<sup>69</sup> Indeed, it is difficult to reconcile the above likely conclusion with an earlier statement in the Discussion Paper that:

*"Tying and bundling are common practices that often have no anticompetitive consequences. Both companies with and without market power engage in tying and bundling in order to provide their customers with better products or offerings in cost effective ways ... Such bundling can lead to significant savings in production, distribution and transaction costs and to improved quality. Companies may also engage in tying for reasons related to the quality, reputation and good usage of their machines."*<sup>70</sup>

The foregoing statement correctly suggests that bundling is frequently efficient and sometimes harmful: in other words, there are a large number of benign cases and a relatively small number of harmful cases. This means that all other things equal (and there is no reason to believe that for tying the rates of error or costs for false

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<sup>66</sup> Recital 794 indicated that: "Tying prohibited under the Article 82 of the Treaty requires the presence of the following elements: (i) the tying and the tied products are two separate products; (ii) the undertaking concerned is dominant in the tying market; (iii) the undertaking concerned does not give customers the choice to obtain the tying product without the tied product; and (iv) tying forecloses competition". For an example of the possible tension between the two tests, one can compare (iii) of the *Microsoft* test with the second sentence of paragraph 188 of the Discussion Paper.

<sup>67</sup> Discussion Paper, paragraph 188.

<sup>68</sup> Discussion paper, paragraph 188.

<sup>69</sup> Furthermore, as a matter of general principle, such a presumption is unjustified as the legal burden of proof rests upon the Commission to establish the essential elements of the abuse.

<sup>70</sup> Discussion Paper, paragraph 178.

acquittals and false convictions differ), false convictions are more likely to be a problem than false acquittals. We therefore urge DG Competition to align its approach in line with the theory and evidence that tying and bundling are “*common practices that often have no anticompetitive consequences.*”

### **10.3 Possible defences: objective justifications and efficiencies**

As with single branding and rebates, we believe that the conditions developed under Article 81(3) are inappropriate for Article 82 and that the burden of proof to show a net effect of a unilateral act should be on the Commission, rather than on the dominant firm.

We also consider that the generally benign nature of tying and bundling does not support the very restrictive approach adopted by the Discussion Paper to permitted justifications. Efficiency justifications are particularly common, for example, when the products are tied by technological means: costs savings and quality improvements are important synergies to be taken into account. In particular, we are concerned that the Discussion Paper does not even mention that bundling can enhance consumer welfare where it is used as a metering device.<sup>71</sup>

## **11 Refusal to supply**

### **11.1 Proposed methodology**

Paragraph 207 of the Discussion Paper refers to the settled case law that, in general, a company is entitled to determine whom to supply and to decide not to continue to supply certain trading partners.

We strongly support the proposition that any property owner is entitled to determine how that property should be exploited and forced sharing should only be ordered in “exceptional circumstances”. Indeed we agree with the Opinion of Advocate General Jacobs in *Bronner* that intervention is only justified where the refusal of the requested facility would confer upon the dominant firm a genuine stranglehold on the secondary market.<sup>72</sup>

The Discussion Paper identifies three categories of refusal to supply, namely termination of existing supplies, refusal to commence supply and refusal to license intellectual property rights (“IPRs”). We agree with the view expressed in the Discussion Paper that for *any* refusal to supply to be abusive, it must be shown to:

*“have a likely anticompetitive effect on the market which is detrimental to consumer welfare.”*<sup>73</sup>

This requirement is in keeping with the case law requirement to show that competition from the party requesting access is eliminated by the refusal to supply<sup>74</sup> and the consumer welfare standard established by the Discussion Paper.<sup>75</sup>

In termination of existing supply cases it appears that the test of competitive harm, together with the absence of any justification, is deemed to be sufficient for an abuse in

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<sup>71</sup> Compare, for example, The Report by the EAGCP “An economic approach to Article 82, pp 39-40.

<sup>72</sup> Opinion of Advocate General Jacobs in Case C-7/97 *Oscar Bronner v Mediaprint* [1998] ECR I-7791, paragraph 65.

<sup>73</sup> Discussion Paper, paragraph 210.

<sup>74</sup> Case C-418/01 *IMS Health GmbH & Co. OHG v NDC Health GmbH & Co. KG*. [2004] ECR I-5039, paragraph 38.

<sup>75</sup> Discussion Paper, paragraph 54.

certain situations.<sup>76</sup> By contrast, in the case of refusals to commence supply, the Discussion Paper states that, not only is it necessary to show that competition from the party requesting access is eliminated, but also that the facility refused is “indispensable” to operation on the secondary market in the sense that there is no actual or potential substitute available for that facility.<sup>77</sup>

Finally, with respect to IPRs, the Discussion Paper restates the three conditions derived from the case law<sup>78</sup> to the effect that the dominant firm’s refusal to licence intellectual property must: prevent the emergence of a new product, not offered by the dominant firm, for which there is potential customer demand; be unjustified; and result in the reservation for the dominant firm of a secondary market, constituting a stage of production that is distinct from the primary market on which the abuse is committed, because the property is indispensable to the supply of the new product.

## 11.2 Issues with the proposed methodology

We believe that the imposition of a duty under Article 82 for a dominant company to aid its competitors is a narrow exception to the general principle that a commercial entity, whether dominant or not, is entitled to deal – or not to deal - when and with whom it wishes.

We are concerned by certain statements in the Discussion Paper, as discussed below, which fail to distinguish between short run benefits to competitors and the medium to long-term incentives to innovate. This distinction lies at the very heart of property ownership and protection. It was recognised by Advocate General Jacobs in his opinion in *Bronner*, where he pointed out that if access to a facility (in that case, Bronner’s home newspaper delivery service) were allowed too easily, there would be no incentive for a competitor to develop a competing facility, thereby harming competition and consumer welfare over the longer term.<sup>79</sup>

### 11.2.1 Termination of existing supplies

Paragraph 217 states that existing supply relationships “create a rebuttable presumption that continuing these relationships is pro-competitive.” We are concerned that this presumption may give rise to a serious risk of over-intervention and could even deter dominant firms from entering into supply relationships in the first place. Apart from the need to prove an anti-competitive effect, this presumption would effectively (and impermissibly) require a dominant firm to disprove that its termination was abusive (or alternatively objectively justify its behaviour from the outset). We would prefer any future guidance should omit any such presumption and expressly acknowledge the need for “careful justification” of any incursion on the fundamental right to choose one’s own trading partner.

We were surprised by the Discussion Paper’s omission of the indispensability criterion in termination of existing supply cases. Indispensability of the product in question is a necessary condition of all refusal to supply cases. The Court of

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<sup>76</sup> We note, however, that in some cases this requirement is implemented by deploying a rebuttable presumption in paragraph 222: “if the input owner is itself active in the downstream market and terminates supplies to one of its few competitors, it will normally be presumed that there is a negative effect on competition on the downstream market.” We refer to our general reservations in section 2 above on the risks associated with using such presumptions under Article 82.

<sup>77</sup> Discussion Paper, paragraph 224a.

<sup>78</sup> See Case C-418/01 *IMS Health GmbH & Co. OHG v NDC Health GmbH & Co. KG*. [2004] ECR I-5039.

<sup>79</sup> See Case C-7/97 *Oscar Bronner v Mediaprint* [1998] ECR I-7791, paragraph 57 of his Opinion.

Justice has considered indispensability a necessary precondition of any finding of abuse in a refusal to supply case (whether the input is physical property, intellectual property, or even the provision of a delivery service). This was most recently articulated by the Court in preliminary ruling in *IMS Health*:

*“It is clear from that case-law that, in order for the refusal by an undertaking which owns a copyright to give access to a product or service indispensable for carrying on a particular business to be treated as abusive, it is sufficient that three cumulative conditions be satisfied...”*<sup>80</sup>

Hence, we consider that any future guidance should include the indispensability condition as an essential part of a test used to determine whether a termination of existing supplies is abusive.<sup>81</sup>

In none of the previous cases where supply of a product, service or information was required by the Community Courts has there been a (rebuttable) presumption of foreclosure of the kind put forward by paragraph 222 of the Discussion Paper. In our view, only after careful analysis<sup>82</sup> and adducing strong and compelling evidence should the strict requirements for showing an abusive refusal to supply be met.

#### 11.2.2 Refusal to commence supplies

Whilst paragraphs 228-229 of the Discussion Paper correctly refer to the indispensability condition, we are concerned that Article 82 may be applied too readily to deprive dominant firms of the fruits of their innovative activities.

It is not wholly clear whether the suggested interpretation of indispensability is consistent with the strict standard established in *Bronner*. The Discussion Paper indicates that a facility will be indispensable when:

- (i) *“there are no actual or potential substitutes”* available for that facility; *and*
- (ii) *“when duplication of the existing facility is impossible or extremely difficult, or because a second facility is not economically viable in the sense that it would not generate enough revenue to cover its costs.”*<sup>83</sup>

We are not sure, however, whether the Discussion Paper assumes comparable scale when assessing the requesting party's ability to develop a facility comparable with that of the dominant undertaking (as the judgment of the Court of Justice in *Bronner* requires<sup>84</sup>). It is clear that the fact that the requesting party cannot develop a comparable facility on the basis of its own existing scale is irrelevant.<sup>85</sup>

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<sup>80</sup> Case C-418/01 *IMS Health GmbH & Co. OHG v NDC Health GmbH & Co. KG*. [2004] ECR I-5039, paragraph 38.

<sup>81</sup> For example, in Cases 6/73 and 7/73 *Commercial Solvents v Commission* [1974] ECR 223, the refusal to supply the aminobutanol essential for the production of ethambutol meant that the complainant, Zoja, and any other potential competitor of CSC or Istitutuo was immediately unable to produce industrial ethambutol. In Case 311/84 *Telemarketing* [1985] ECR 3261, the refusal of IPB and RTL not to accept the use of any other phone numbers on advertisements but those of IPB meant that Telemarketing (and any other competitor, who would necessarily use non-IPB numbers) would not be able to compete for the provision of telemarketing services.

<sup>82</sup> See Discussion Paper, paragraph 214.

<sup>83</sup> Discussion Paper, paragraph 229.

<sup>84</sup> Case C-7/97 *Oscar Bronner v Mediaprint* [1998] ECR I-7791, paragraph 46 (referring to paragraph 68 of the Advocate General's Opinion).

<sup>85</sup> It is also worth recalling that, in *Bronner*, the Court expressly said that this requirement would not be satisfied if an alternative to the facility in question is available even if it is less advantageous to third parties than the facility: in other words, indispensable does mean what it says.

We are also concerned that the Discussion Paper introduces a new and unjustified limitation on lawful refusals to deal:

*“the dominant firm should normally be free to seek compensation for successful projects that is sufficient to maintain investment incentives, taking the risk of failed projects into account. To achieve such compensation, it may be necessary for the dominant firm to exclude others from access to the input for a certain period of time.”*<sup>86</sup>

Although DG Competition correctly recognises the economic imperative and legal right for a dominant firm to recover its investment, the temporal limitation on the permissible ‘return on investment’ has never been mentioned in the case law and arguably is inconsistent with the condition of indispensability.<sup>87</sup>

### 11.2.3 Refusal to license IPRs

Refusal to licence an IPR is not normally considered to be contrary to Article 82. Holders of intellectual property rights are entitled to decide how best to exploit their exclusive rights. Otherwise, if access to a product protected by an IPR were allowed too easily, there would be little incentive for a firm to innovate and invest in the first place. It is therefore with very good reason that the refusal to license does not normally constitute an abuse.<sup>88</sup>

Having referred to the conditions in *Magill* and *IMS*, the Discussion Paper correctly draws a distinction between an intention to duplicate the goods or services offered by the rightholder (which would not justify a compulsory licence) and an intention to offer new goods or services, not offered by the rightholder, for which there is potential consumer demand (which could justify a compulsory licence). However DG Competition does not specify what the threshold of novelty should be. In particular, it is unclear whether new products includes variations of the products offered by the dominant firm.

DG Competition’s approach to refusal to license draws as much on the refusal to supply cases that do not concern IPRs as it does upon those that do. Although the Commission maintains that the case law supports its approach, that is hard to reconcile with parts of the Discussion Paper. Paragraphs 240 and 242 of the Discussion Paper, in particular, reject the case law that there is a defined category of exceptional circumstances which must be satisfied before compulsory access to intellectual property or interoperability information can be ordered.

It seems to us that these paragraphs 240 and 242 imply that the only threshold criterion which is to be retained from the case law is the indispensability test (which can be regarded as an analogue of the essential facility determination). It is hard to see what purpose is served by the Court’s articulation of three pre-conditions to the imposition of compulsory access if the three conditions do not regulate analogous cases in which that issue has to be decided. That analysis, if it is indeed the Commission’s position, is at variance with the Opinion of the Advocate General in *Bronner* (which was followed by the Court) that particular care needs to be taken

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<sup>86</sup> Discussion Paper, paragraph 235.

<sup>87</sup> On the dangers of such a temporal condition and the risks of using *ex post* tools to correct *ex ante* problems in this context, see Bill Allan “Article 82: A Commentary on DG Competition’s Discussion Paper” *Competition Policy International*, Vol. 2, No. 1, Spring 2006.

<sup>88</sup> See, for example, Case 238/87 *AB Volvo v Erik Veng (UK) Ltd* [1998] ECR 6211.

not to destroy the incentives to innovation that underlie the existence of property rights.<sup>89</sup>

We therefore suggest that any future guidance should expressly adopt the reasoning of the Court's judgments in *Bronner* and *IMS* and that, in general, the owner of an intellectual property right is entitled to determine how it should be exploited and that a compulsory licence should only be ordered in "exceptional circumstances". This will avoid giving the far-reaching impression that merely eliminating competition can be sufficient to justify a mandatory order to supply.

### **11.3 Possible defences: objective justifications and efficiencies**

The case law has consistently limited the obligation upon dominant undertakings by reference to the possibility of objective justification.<sup>90</sup> In *United Brands v Commission* the Court expressly recognised that a dominant undertaking is entitled to take such steps as are reasonable in order to defend its commercial interests.<sup>91</sup>

We are concerned by DG Competition's excessively narrow approach to possible defences. For example, in order to justify termination of an established supply relationship, DG Competition states that it is necessary for the dominant firm to show that termination makes consumers better off than they would be if the existing supply arrangements were to continue.<sup>92</sup>

In our view, DG Competition's proposed interpretation of defences will have a detrimental effect on distributional efficiency. A narrow approach places an unwarranted "strait jacket" on the ability of dominant firms to dispense with independent distribution and vertically integrate their operations - especially where this change in policy may yield substantial productive efficiencies.

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<sup>89</sup> On the importance of investment incentives, see Discussion Paper, paragraph 213.

<sup>90</sup> See, for example, Case 311/84 *Telemarketing* [1985] ECR 3261, paragraph 25.

<sup>91</sup> Case 27/76 *United Brands v Commission* [1978] ECR 207, paragraph 189.

<sup>92</sup> Discussion Paper, paragraph 224.