DG COMPETITION DISCUSSION PAPER
ARTICLE 82 – EXCLUSIONARY ABUSES
CBI RESPONSE – 31 March 2006

GENERAL COMMENTS

The CBI welcomes DG Competition’s efforts to modernise the application of Art 82 to exclusionary abuses. In particular we strongly support the direction followed in the paper of an effects based approach. We are also pleased to see a move away from formalistic rules and acceptance of the concept of efficiencies.

We would wish to see DG Competition continuing the project and producing Art 82 guidelines that describe an enforcement policy that reflects the economic objectives of competition law. In this way any intervention should be better aligned with the needs of business and predictability improved. The eventual guidelines will be of great value to companies and their advisers if they describe DG Competition’s policy on enforcement as well as containing worked examples and safe harbours.

Also we should like to reiterate some key general points made in our paper of 12 October 2005:

- Enforcement policy should not inhibit dominant companies from competing vigorously on the merits. A presumption of dominance at a 50% market share has a chilling effect and the move away from any such presumption is welcome. There should be no explicit or implied obligation on companies to adhere to standards of “gentlemanly competition”.

- Enforcement should be directed at market entry barriers so that new forms of competition are not unfairly prohibited.

- In the interests of increasing competitiveness in the EU, major capital investments need to be encouraged and not discouraged.

- Intellectual property rights are a major source of competitive advantage in the knowledge economy. EU companies should not be at a disadvantage against global rivals when exercising IPR. Compulsory licensing has a strong chilling effect on innovation and on higher risk investments and therefore should only be imposed in exceptional circumstances.
When looking at exploitative abuses, DG Competition should as far as possible allow self-correcting forces in the market to operate before intervening. We note that the current draft does not contain an assessment of excessive pricing or price discrimination. As and when later versions are produced it will be important that rules in these areas do not discourage dynamic competition. Also we propose that they be subject to a full opportunity for comment and consultation.

In addition, we are very pleased to see the announcement of a workshop with stakeholders to discuss the issues raised by the Discussion Paper and the eventual proposals regarding exploitative abuses. This workshop will be greatly appreciated by business.

SPECIFIC COMMENTS

1. Market definition – paras. 11-19

1.1 We support the statement that any single method of market definition is likely to be inadequate and that a variety of methods need to be adopted to check the robustness of the market definition (para.13) adopted in any particular case. For example, the packaging of services with products in response to customer demand means that tests based on product pricing (the SSNIP test) are likely to be too simplistic for many markets.

1.2 The analysis of the geographic and product markets needs to take a broad view of global competition and technology developments. These have accelerated in the last few years making a static view of markets obsolete. Temporal aspects of market definition need to receive a higher profile, particularly where the matter in question relates to new technology.

2. Dominance – paras. 20-42

2.1 We regard the analysis of dominance as a fundamental requirement of Art 82. This has to logically precede any finding of abuse. We oppose any approach based on first examining the alleged abuse by its impact on consumer welfare and then working backwards to a finding of dominance. This would be taking an effects based approach of Art 82 beyond legitimate limits and would risk losing an essential check on regulatory discretion. In addition such an approach would be impracticable and particularly unpredictable. For example, in an Art 82 case before a national court, the evidential burden would be unmanageable if only a consumer welfare test was applied, without the initial screening process of establishing dominance which the law requires.

2.2 We agree with the statement that for dominance to exist the undertaking must have substantial power (para.23) and that the analysis of this should consider a number of relevant factors such as market positions of suppliers, barriers to entry and expansion and the market position of buyers (para.28). Further discussion and clarification of these key factors would be welcome.
2.3 We also agree with the statement that the existence of a dominant position may derive from several factors which, taken separately, are not necessarily determinative (para. 28). In fact, we believe it is overly restrictive for the Commission’s assessment of market power to be constrained in the way outlined. In our view, market power is entirely context specific and will depend on a range of variables, with their weighting varying according to the economic situation. We urge DG Competition to move clearly away from a market share orientation and to ensure that a wider array of evidence is considered in all cases.

2.4 We believe that a high relative market share over time (para.29) is only one factor that has to be weighed, together with other relevant factors, in order to determine dominance.

2.5 We support the statement (in para.26) that an undertaking’s economic strength cannot be measured by its profitability at a particular point in time. We believe this is more universally valid than the opening statement that higher than normal profits may be an indication of a lack of competitive constraints. We suggest therefore that this paragraph should have been reordered.

2.6 We believe strongly that there should be a move away from a formalistic calculation that a certain market share equates to dominance (para.31). We consider such an approach does not reflect the full analysis of dominance that is required and is likely to produce a chilling effect on undertakings with large market shares and those who fear that they might be held to have a substantial share of a narrowly-defined market.

2.7 We propose that in para.31 the wording is amended to explain that it is only exceptionally that undertakings with market shares below 40% can be considered to be dominant. Also that para.31 should be amended to make clear that it is always necessary to extend the dominance analysis beyond market shares.

2.8 We agree that there is a need to show a “link between the position of economic strength held by the undertaking and the competitive process, i.e. the way in which the undertaking and the other players act and inter-act on the market.” (para.23). We therefore believe that a key factor that should be repeated in the discussion of single dominance is an assessment of whether the leading undertaking is required by pressure from its rivals to reduce its prices and/or to improve the quality of its products. Where the leading undertaking in the relevant market cannot act independently of its rivals it should not be considered to be dominant.

2.9 Similarly, we agree with the statement that in “markets where for all or most part of demand there are proper substitutes” and the “competitors are not capacity constrained”, it “is unlikely that a dominant position [should be] found, even at high market shares. (para.146 & fn 92). This type of situation exists in many “bidding markets” where rivals of the leading firm are able to compete for all or most opportunities and thus can constrain the pricing of the leading firm even if they only win a minority of the bids.

2.10 We propose that there should be a clearer explanation of the position of IPR (in para. 40). We strongly support the statement that IPR does not as such confer dominance on the holder. But the following sentence indicates that the nature and strength of IPR can result in barriers to expansion and entry, with the implication that this could contribute to a finding of dominance. It is most important to have clear guidance in this area so that IPR owners are free to achieve the legitimate commercial rewards that flow from successful innovation.
3. Collective dominance – paras 20,43-50,74-76,98,211

General Comments

3.1 In our opinion, it is particularly important not to discourage vigorous competition in oligopolistic markets, including those where the main players may be held to be collectively dominant. Although collective dominance based purely on market structure may be very important in merger review cases, the concept of abuse needs great care when assessing these cases under Art 82 if vigorous competition is not to be discouraged.

3.2 Elements of fact and conduct which are evidence of the existence of collective dominance (e.g. parallel behaviour, adopting a common policy on the market without actual collusion) cannot of themselves be evidence of abuse since the existence of a dominant position is not prohibited.

3.3 We believe that the Commission should limit the application of Art 82 involving collective dominance to situations in which there are “ownership or other links in law” that lead “the undertakings concerned to co-ordinate.” (para.45). According to the Discussion Paper, the case law to date only has applied Art 82 “where there were strong structural links between the undertakings holding the dominant position.” (para.76). Going beyond the case law to reach independent actions taken by undertakings in “oligopolistic markets” present significant issues regarding both the counselling of such undertakings as well as the formulation of suitable remedies.

Specific Comments

3.4 We agree that "in the case of collective dominance the undertakings concerned must, from an economic point of view, present themselves or together on a particular market as a collective entity" (para.20 and para.44) but merely having the ability to adopt, or the fact of having adopted a common strategy is not equivalent to acting as a collective entity. We propose para.47 should be adjusted to reflect this, including by deletion of the fifth sentence, reading: “In other words, they may be able to adopt a common strategy that allows them to present themselves or act together as a collective entity.”

3.5 In para.74, "tacit following of a common policy on the market" and the mere "manifestation of a collective dominant position" are in our view only evidence of a collective dominant position and not evidence of abuse.

3.6 Para.74 suggests that an abuse does not necessarily have to be the action of all of the undertakings in question. Although this is the finding of the CFI in Irish Sugar - Case T-228/97, we submit that case was exceptional, a virtual single entity case. If collectively dominant companies are defined as those which present themselves as a collective entity on the market, separate action by one alone will tend to disprove dominance.
3.7 The example given in para.75, where the dominant undertakings had different tasks, each defending separate areas of the market, only some of which were under attack from new entry, appears extreme and should, we suggest, be prosecuted under Art 81, not as an abuse. In any event, it is hard to see whether the draft is suggesting that all of the undertakings referred to in para.75 are guilty of abuse, which would be bizarre since some have done nothing, or only the one taking action, which would be unfair.

3.8 Clearly if there is actual collusion to defend the market against new entry, the appropriate basis for a prosecution is Art 81 which can properly address all of the parties to the collusion. "Recycling" what is properly a violation of Art 81 as an abuse of a collective dominant position is not allowed - see Italian Flat Glass Case T-68/89 para.60).

3.9 We agree with the statement in para.76 that the case law so far has dealt with exclusionary abuses only in situations where there were strong structural links between the undertakings concerned (para.76) and feel it should explained that abuse is highly unlikely except where such structural links (or express collusion) exist.

3.10 In para.98, we suggest "very unlikely" rather than "less likely" is the appropriate way to describe the near impossibility of collective dominant companies predating.

3.11 As regards single branding and rebates, we would welcome a clear statement that use of such policies independently by an undertaking in a collective dominant position is not an abuse since such price competitive mechanisms are important for effective competition between collectively dominant players. This would, of course, be without prejudice to the illegality of any express collusion regarding such matters.

It would, we note, be impossible for one of a group of collectively dominant players independently to make the calculations and assessments required by Section 7 of the Paper. It would also be impossible to provide reliable advice to a company if its independently-adopted rebate system might become unlawful merely if de facto other companies adopted similar systems, perhaps at a later date. So any lack of clarity regarding the legality of unilateral rebate policies by individual undertakings in a collectively dominant position would be bound to discourage them from pricing competitively through rebates.

3.12 As regards refusal to supply, we agree with para.211 that refusing access to an input which is collectively owned by a group of companies who are collectively dominant should be subject to the same rules as if the input were owned by a single dominant firm. But, absent express collusion, we strongly disagree that refusing access to individually owned inputs could also be abusive.

Such a policy would be entirely impracticable. How could each individual owner know whether they were required to supply or whether they could leave it to one of the competitors to do so? Indeed, how could the law identify which of the individually owned inputs needs to be opened to access? Would one company's refusal, initially an abuse, become lawful simply because its competitor grants access, a curious outcome? The current language in the Paper would appear likely to encourage discussion, the opposite of the intended effect."
4. The central concern and proof of foreclosure – paras. 54–60

4.1 We welcome the clear and forthright statement in para. 54 of the essential objective of Art 82 and its emphasis that it is competition and not competitors as such that is to be protected. Similarly, we see the statement in para. 55, that Art. 82 will be enforced only against conduct that “produces actual or likely anti-competitive effects in the market,” to be an extremely important principle that should guide all enforcement activity in this area.

4.2 In contrast, we consider that the statements in para. 60 do not provide helpful guidance. It is not obvious when alleged exclusionary conduct is “clearly” not competition on the merits and where there are “clearly” no efficiencies. Also, if conduct does not have “clear” exclusionary effects there should be no requirement for the dominant company to make a positive case that its conduct “creates” efficiencies, since no such presumption is required by law. Accordingly, we propose that para. 60 be deleted.

4.3 Moreover, there is no parallelism between Art 82 and Art 81 that could justify using the criteria of Art 81(3) as a yardstick for efficiencies. Art 82 is dealing with unilateral behaviour which in most cases is pro-competitive. The question whether a certain behaviour produces efficiencies cannot be separated from the question whether there is an abuse. Allowing pro-competitive behaviour only if the dominant company can provide sufficient evidence that such behaviour is indispensable and does not eliminate competition is likely to stifle competition and will result in largely regulated competition in markets where there is a dominant company.

4.4 We do not agree that a presumption of abuse should arise and that the alleged dominant company should have the burden of proving no abuse. In our view, the legal burden of proving an infringement of Art. 82 must always rest on the authority or party alleging the infringement, in line with the legal framework of Art 82 (which differs from Art 81) and the express wording of Art. 2 of Regulation 1/2003. There is a need to distinguish between the legal burden of proof and the evidentiary burden. Only the latter may shift to the dominant company once the party or authority alleging infringement has proved its existence to the required legal standard.

5. Price versus non-price based exclusionary conduct – paras 61-68

5.1 The DG Comp paper advocates the “as efficient competitor” test as a way to establish the principle that dominant firms should be free to compete vigorously on the merits, and should not be obliged to accommodate rivals just to assist competitors. This is a welcome statement that potentially advances enforcement policy beyond some of the formalistic approaches that can be found in the less satisfactory case law. However, as shown in the examples below we believe the discussion paper does not follow through this useful principle in a number of respects.
5.2 The paper proposes a confusing array of different price-cost tests that might be applied to dominant firm price competition:

5.2.1 The concept of *avoidable costs* is one that bears a clear relationship to the identification of strategic pricing behaviour by dominant firms. Consistent with the reasoning behind the *Akzo* judgment, a dominant firm that charges a price that fails to cover the avoidable cost of supplying the goods in question is making a deliberate decision to lose money.

There can be circumstances where such below-cost pricing has a legitimate business purpose and these are correctly recognised in para.95. Also we accept that the avoidable cost test provides a useful benchmark for identifying acts of “profit sacrifice” by dominant firms that, if shown to exist, merit some explanation. We also recognise that the concept of avoidable costs is a flexible one, such that for example the costs which are avoidable in the very short term may be more limited than those that can be avoided in the longer term.

5.2.2 In contrast, we consider the use of an *average total cost (ATC)* test bears no relationship to any viable economic test for dominant firm behaviour. At a purely practical level, ATC is not even a concept that can be calculated by businesses with any degree of accuracy, as it depends on the allocation of fixed and/or common costs using essentially arbitrary cost allocation rules.

More substantively, for a dominant firm that has low avoidable cost but high ATC, it may be impossible to define a response to entry or competition that meets the “requirement” to cover ATC, and attempts to do so are very likely to rule out a range of short term pricing responses based on efficiency. Use of an ATC test for pricing abuses will give completely different compliance messages from use of a more economically robust avoidable cost test, and will probably have no consistent implications for economic efficiency.

5.2.3 The suggested use of *long run average incremental cost (LAIC)* is subject to similar criticisms. It proposes that a firm which has made large sunk cost investments in fixed costs should be obliged to recover a “fair” allocation of those costs on every sale in order to avoid accusations of exclusionary price abuse. We consider such a mechanistic rule has no place in an economic effect-based approach to Art. 82 enforcement, and will surely deny dominant firms their efficient response to competition and discourage investment.

We appreciate that LAIC has been used as a benchmark for the purposes of managing competition in liberalising industries such as telecommunications, but it is important to draw a clear distinction between the public policy objective of managing competition in such sectors, and the application of competition law principles in the rest of the economy.

5.2.4 The discussion paper also refers to *marginal cost (MC)*. However, MC does not play any role that cannot be fulfilled by the much more operational concept of avoidable costs.
5.3 In view of the above, we would favour exclusive focus on an avoidable cost test, and the removal of confusing thresholds based on ATC, LAIC and MC from the guidelines.

5.4 At various critical points, the discussion paper reverts to a dirigiste approach that appears to succumb to the temptation to manage competition and protect competitors, rather than the stated aim of setting a framework within which vigorous competition can take place.

5.5 At para. 67, for example, the discussion paper states that “it may sometimes be necessary in the consumer’s interest to also protect competitors that are not (yet) as efficient as the dominant company,” and suggests a distorted application of the as efficient competitor test in which dominant firm advantages that arise from economies of scale, first mover advantages and learning curve effects are for some reason disallowed.

5.6 Furthermore, such an approach would prevent dominant companies competing effectively against less efficient rivals since it would appear expressly to prevent a dominant company passing on the price benefits of economies of scale which it in fact enjoys.

5.7 Such attempts to create a “level playing field” and/or to protect competitors on infant industry grounds clearly signal an industrial policy objective that we believe has no role in a properly functioning competition law. Even if such interventions are well-meaning in the specific cases at hand (which we would doubt in any case), DG Competition must appreciate the much broader chilling effects that such statements have on the broader set of incentives facing business. If the guidelines signal to business that DG Competition can be relied upon to intervene to protect competitors in this way, the danger is that this creates a complainant-led culture within which the vigour of the competitive process is dimmed, and the fruits of vigorous competition are denied.

6. Possible defences: objective justifications and efficiencies – paras 77–92

6.1 We welcome an analysis and explanation of the objective justifications, for example efficiencies, that are available. We believe will be helpful to business and its advisers.

6.2 As we indicate above, there is a need to distinguish between the legal burden of proof and the evidentiary burden. Only the latter may shift to the dominant company once the party or authority alleging the infringement has proved its existence to the required legal standard.

7. Meeting competition defence – paras. 81-83 and para. 132

7.1 We consider the general rules laid down in these paragraphs to be unduly restrictive of normal commercial activity and if followed strictly will have the effect of damping competition.
The question raised by these paragraphs is how is a company, who may be dominant according to the Commission’s assessment, to react to a new entrant who is offering lower prices? DG Competition quite rightly wishes such a company to compete vigorously. However, this statement may unintentionally rule out legitimate responses to competition in some circumstances, for example where investments can allow a dominant firm to improve its efficiency still further.

We consider that the concept of profit sacrifice and the application of an avoidable cost test ought to be sufficient to define the legitimate responses to meeting or beating competition. We suggest more clarification is needed, together with examples, of how the requirement of the conduct being “indispensable” can be met.

It would be helpful to know also how the company could meet the proportionality test. This is said to involve a weighing of the interest of the dominant company to minimise its losses and the interest of its competitors to enter or expand. The principle behind this appears to involve the protection of competitors rather than promoting the process of competition. As this test has to be carried by the company concerned it is likely to lead to gentlemanly competition and a higher price umbrella under which competitors can shelter.

Once again, we can see no valid basis for preventing dominant firms from responding to competition provided that response generates revenues that cover the avoidable costs of the output concerned.

Also we observe in para.81, that objective justification is said not to be possible if the dominant company is not able to show that its conduct is only a response to low pricing by others. This is to impose an obligation on the company to prove a negative which we suggest is an impossible burden for any company to discharge, as well as wrongly reversing the burden of proof of abuse.

If guidelines are to be produced, we believe this section should be redrafted to provide positive guidance on how companies can compete on price. Ideally, the finance director and the legal adviser of the company concerned should be able to read the guidelines and readily understand what course of action is permissible.

8. Efficiency defence – paras.84-92

While we welcome the principle of an efficiency defence we are concerned that the conditions listed in para.84 are unduly restrictive and inappropriate in the context of Art.82. What we would propose is that the efficiencies should be set out in terms of economic analysis instead of in a formalistic way.

We consider that the condition that the conduct concerned is indispensable is too absolute. It does not reflect the proportionality and balance which are essential to the analysis and could prohibit behaviour which is on balance to the benefit of the consumer.
8.3 This paragraph also imposes the entire burden of demonstrating efficiencies on the dominant company. However it cannot be ignored that the overriding burden of proving the abuse rests with the party making the allegation. This in our view requires DG Competition, as part of a balanced approach of assessing the existence of an abuse, to consider itself what efficiencies could apply, even if they are not raised by the undertaking concerned. In effect, our view is that it is conceptually flawed to treat efficiencies as a “defence” rather than as an integral part of the necessary abuse analysis.

8.4 Efficiencies are not less likely depending on the market share or overall market position of the dominant company involved. Efficiencies should therefore be considered irrespective of market shares. Otherwise competition by dominant companies would be prohibited just because of the market position involved. This would be equivalent to prohibiting certain market positions as opposed to the abuse of such position which is clearly not the objective of Art 82.

8.5 In relation to para.85, we consider it is unduly restrictive for the dominant company to have to show that the conduct in question is undertaken to contribute to achieving the stated improvements. It should be sufficient to show that these improvements will arise from the conduct in question.

8.6 In relation to para.86, we believe it should be sufficient to show that the efficiencies achieved outweigh any negative effects on competition and harm to consumers without the conduct in question having to be indispensable to achieving these efficiencies.

8.7 In relation to para.87, we believe it should be incumbent on the Commission to identify the likely adverse effects on competition and harm to consumers from the conduct in question. In addition it needs to demonstrate that there is a high likelihood of such adverse effects/harm arising, before considering whether such effects/harm are outweighed by efficiencies.


9.1 We welcome the acknowledgement that in practice it is often difficult to distinguish predatory pricing from normal price competition (para.94). For this reason it is essential that any guidelines provide the maximum clarity to the distinction between legitimate and vigorous price competition on the one hand and predatory pricing on the other. Uncertainty in this area is likely to dampen competition and harm consumer welfare.

We refer to our comments above concerning the various price-cost tests which are particularly relevant here.

9.2 We agree with the explanation of predatory pricing in the first sentence of para.96. However we believe that references to foregoing profits (as opposed to incurring losses) in the short run (in paras.93, 95 and 96) should be omitted since this should not be regarded as an example of predatory pricing conduct.

9.3 Our view is that predatory pricing requires a finding of loss-making on the relevant market, together with the likelihood of recoupment, and does not exist if there is some remaining profit on that market. Some sacrifice of profit in response to a competitor’s pricing is more likely to be characteristic of normal price competition. The analysis of predatory pricing should instead be focused on pricing below cost and the appropriate measurement of cost.
10. Pricing below average avoidable cost (AAC) – paras.106-110

10.1 The paper explains that there is a rebuttable presumption of abuse where the dominant company prices below AAC. However it is open to the company to rebut the presumption in exceptional circumstances. It is also said in para.131 that pricing below AAC may be justified where there is an issue of start-up costs or strong learning effects. It should in addition be a requirement to show that the pricing in question is having the effect of excluding competition from the market.

10.2 To provide more helpful guidance we would propose a fuller explanation of the exceptional circumstances which can be recognised and also how start-up costs are viewed by the Commission. For example, some flexibility was introduced to the Akzo test by the Wanadoo case where customer acquisition costs were regarded by the Commission as start-up costs.

11. Direct evidence of a predatory strategy – paras.113-114

11.1 We do not agree with the statement that if there is direct evidence of a predatory strategy, other elements do not need to be shown. In many circumstances of competition between few players in a market, the desire to beat rivals can be indistinguishable from the desire to win the race, and we would be very sceptical of the ability of “intent” evidence to draw this distinction.

It appears to be argued that if predatory intent can be demonstrated there is a presumption that the outcome follows. We strongly believe that infringement of Art 82 requires more than evidence of intent and the statement is in conflict with Art 2 of Regulation 1/2003.

12. Indirect evidence of a predatory strategy – paras.115-123

12.1 Our conclusion from following the statements in these paragraphs is that it will be very difficult for a business person to distinguish a predatory strategy from normal vigorous competition. It is standard sales practice to selectively target certain customers, particularly those of a rival, and to analyse the strengths and weaknesses of a competitor.

12.2 It seems to us that, in order to assess, on the basis of indirect evidence, whether a pricing behaviour only makes commercial sense as part of a predatory strategy, it would be necessary as part of that assessment to consider whether a foreclosure effect is likely.

12.3 What are needed are some clear bright lines, with some examples, to show exactly what constitutes predatory pricing. Without these, we believe it would be better to omit these paragraphs.
13. Recoupment – paras. 121 and 122

13.1 We agree with the statement, in para. 121, that the issue of whether losses can be recouped should be investigated. We also agree that the question to be asked is whether it is reasonable to assume that the dominant company can recoup its losses (para. 122). It is then suggested this assumption can be tested by investigating the entry barriers to the market, the (strengthened) position of the company and foreseeable changes to the future structure of the market.

13.2 However we believe it is a step too far for the Commission then to presume the possibility of recoupment because dominance is already established. This would ignore the other necessary steps in the analysis, such as foreseeable changes. It would also remove an essential check from the system which is necessary given the damage to economic efficiency that can be caused by false convictions in this area. Accordingly we strongly disagree with the statement that recoupment can be presumed in some circumstances.

13.3 As an example, the existence of barriers to entry (which would be examined as part of the dominance analysis) is necessary for the dominant firm to recoup its losses but is not sufficient to establish that recoupment would occur. The recoupment assessment should take into account a number of factors including: the magnitude of the likely losses, the level of increased prices following foreclosure and the period of time during which those prices would need to be charged, the time value of money, and the prospects for innovation affecting the ability to recoup as well as the prospects for entry prior to recoupment of the losses on a NPV basis.

14. Pricing below long-run average incremental costs (LAIC) – paras. 124 – 126

14.1 It is stated that LAIC, rather than AAC, is the appropriate benchmark in cases concerning sectors which have been liberalised or which are undergoing liberalisation such as telecoms. In our view, while LAIC may be an appropriate benchmark for assessing wholesale pricing in respect of network elements, we doubt that it is the appropriate benchmark for assessing retail pricing, even in sectors which have been, or are being, liberalised. It is our firm view that LAIC is a singular concept that belongs to sector regulation and should not be imported as a general standard in competition law.

15. Pricing above Average Total Cost (ATC) – paras. 127-129

15.1 It is stated in para. 129, that where the dominant company has certain non-replicable advantages or where economies of scale are very important and entrants would have to operate at a cost disadvantage because of this, there are certain circumstances in which pricing by the dominant company, even if above its own ATC, could be abusive. In our view, pricing above ATC should never be considered predatory and any guideline to the contrary could seriously discourage competitive pricing.

15.2 We also refer to our comments above (in 5.4) on para. 67 of the Discussion Paper.
16. Meeting competition defence – para. 132

16.1 Where the alleged predation involves a price above AAC, it seems to us that the onus should be on the Commission to show that the company’s pricing is abusive and not a legitimate meeting of competition, rather than the reverse of the company having to show that its pricing is “suitable, indispensable and proportionate”. In assessing whether there is abuse it is for the Commission to take all relevant factors into account rather than the company having the burden of rebutting the Commission’s presumptions.

17. Single branding and rebates – paras.134 – 176

General comments

17.1 While we accept that this is a challenging topic, because of the unsatisfactory case law, we nevertheless feel that the resulting guidance is very complex and difficult to follow. If we consider the objective of providing clear guidance which can readily be followed by a finance director and a legal adviser, then we believe this test is not met.

17.2 In particular there is no clear indication of when a potentially dominant company is on safe ground. There are some positive statements but these are more than cancelled out by caveats which reserve considerable discretion to the Commission. This large margin of flexibility can only create a large measure of uncertainty for business.

17.3 One important step towards providing increased certainty to potentially dominant firms would be to make clear that a dominant firm is free to respond to customer initiated requests for offers to supply all or most of its needs for a specified period of time. Even though a successful offer by a dominant firm will result in partial or complete exclusivity for the period of the contract, customers will benefit if dominant firms are able to compete aggressively for such opportunities. Para.134 discussing competition “for individual orders” could easily be amended to cover the related concept of competition “for the contract.”

17.4 The starting point for assessing discounts should be that they are generally pro-competitive, increase consumer welfare and release increments of demand which would not otherwise be addressed. Accordingly, discounts should generally only be considered abusive where they meet the predation test.

Specific comments

17.5 Foreclosure effects

We support the statement that rebates will be assessed in light of their likely and actual foreclosure effects (para.144). We also welcome the acknowledgement that standardised volume thresholds are less likely or unlikely to be abusive for both aggregate and incremental rebates. (paras.159 & 169)
17.6 Incremental discounts - para.168

In our view, the proposed test fails to compare like with like, as it compares incremental revenue with ATC, thereby failing to correctly address the question of fixed costs. Either the test should compare incremental costs and incremental revenue or average revenue and ATC. We suggest that the correct test should be whether the resulting price for the incremental purchases is predatory, by comparing it to the incremental cost of the incremental sale.

17.7 Aggregate discounts

In our view the test proposed is not only very complex but also unworkable. In particular, we believe the example set out (154 - Box) is incorrect. As the average unit cost of all sales decrease with the increase in volumes sold, average total fixed costs per unit would fall as sales increase. We suggest the correct test for the example given should be whether average variable cost (AVC) rather than average total cost (ATC) exceeds 50.

17.8 Benchmark

We support the proposed assessment which would generally only find rebates abusive if resulting prices are below a certain threshold. However, in our view the proposed ATC benchmark (154,165,168) is incorrect. We propose that the only relevant test for rebates should be whether they are predatory (as proposed by DG Competition in para.168), and that the same test applicable to predation should apply to rebates.

18. Tying and bundling – paras.177- 206

18.1 We support the clear statements (in para.178) that these are common practices that often have no anti-competitive consequences and that integrating two or more components into one product is a fundamental part of many economic activities. It is right that firms must have every encouragement to innovate.

18.2 Since technological change has been accelerating and restructuring taking place in a large number of markets, we consider that any foreclosure effects of tying and bundling will generally be transitory in those markets. They are increasingly likely to be eroded by changes in the market and by innovation. We accept that in other cases, where significant foreclosure effects are unlikely to be transitory, intervention may be warranted.

18.3 As many retail markets are affected by new technologies, with good examples provided in the audio-visual sector, competition authorities will need to distinguish between bundling practices which are driven by consumer demand and those driven by supplier efficiency. Where it is the consumer’s desire that drives bundling the Commission should be less concerned about supply side issues.

18.4 We believe therefore that these practices should not have a high priority for enforcement action and that any action should be directed primarily at contractual tying. Accordingly we would highlight the very strict limitations imposed on the use of efficiencies which is likely to discourage companies from pro-competitive conduct that would increase consumer welfare.
18.6 We are also concerned that the Commission’s approach to assessing whether a purported tie involves two distinct products may lead to erroneous findings of abuse and may deter product innovation. The mere fact of separate consumer demand for both the tying and the tied product is not a reliable indicator of two separate markets, in the absence of any information about whether there is consumer demand for the tying product without the tied product. If there is no such demand, the two markets cannot be considered to be distinct.

Similarly, the vagueness of the guidance on what constitutes market foreclosure, with no indications of the scale of foreclosure that would trigger sanctions (and the implication that any foreclosure at all, or even a small degree, could lead to a finding of illegality) will likely discourage firms from engaging in conduct that would benefit customers and consumers.

18.7 The admitted difficulties in this area are evident in the proposed approach of considering the long run incremental costs (LRIC) of a dominant company when an alleged tied product is included in the bundle (paras. 190 & 191). This may be a practical approach in the simplest case of the bundling of two clearly recognisable products but will be extremely difficult to apply when looking at technical bundling. For example, the elimination of a duplicate power source in the alleged tied product is likely to require a very complex cost analysis.

18.8 We consider the correct test should generally be whether the price of the bundle as a whole is predatory (ref. para. 195), using the same test applied to predation. In our view, the test proposed for assessment of mixed bundling (190) is incorrect. This is because it requires assessment of revenue of each element of the bundle where there is no known price for each individual element of the bundle. Although it is assumed the test can be taken by comparing a bundle AB price to stand-alone prices for A and B, there is, however, no reason to believe that such stand-alone prices relevant to the specific sale would exist.

18.9 We are also concerned at the introduction of yet another different benchmark (LRIC), whereas we consider that the correct test should be the same as for predation.

18.10 Since many mixed bundling situations will involve concerns regarding a different relevant market than the market in which the undertaking has been found to be dominant, it should be made clear both that proof of recoupment and proof of the creation of substantial market power in the relevant market are required elements of showing abuse through discounts offered via mixed bundling.

18.11 If guidelines are to be produced in future we believe it would be helpful to include some examples of what would not be considered to be abuses.

18.12 Also we suggest that the analysis of the degree of market coverage of the tied sales (in para. 198) could be used to develop a safe harbour which would be much welcomed. We would support a safe harbour being based on a third of the market. A safe harbour provides greatly welcome predictability for business and encourages vigorous competition.
18.13 We strongly support the statement that it is open to a dominant company to invoke efficiencies (ref. para.5.5.3) as we believe these will arise in most cases. However, as noted above we consider that many firms may be deterred from engaging in pro-competitive behaviour if efficiencies do not become part of an overall analysis of the effects of a certain practice on competition.

19. Refusal to supply – paras.207-265

General comments

19.1 There is a great deal of uncertainty flowing from recent cases and we would welcome some statements of direction from DG Competition to clarify its policy. However as the present Microsoft case may make this difficult we believe it is important for business to state its views.

19.2 Firstly, we do welcome the positive statements in this section (paras.207 & 210) that dominant companies are generally entitled to determine whom to supply and not to supply. Also that for a refusal to supply to be abusive it must have a likely anti-competitive effect on the market which is detrimental to consumer welfare.

19.3 We also strongly support the statements (in paras.213, 235 & 238) that enforcement policy must take into account the possible long-run effect on investment incentives. As is pointed out, the essential facility or an intellectual property right (IPR) can often be the result of substantial investments entailing significant risks. In order to maintain incentives to invest and innovate there must not be undue restrictions on exploiting the value of the investments. This argument has even more force in relation to IPR where the holder is granted an exclusive right of exploitation as a matter of law.

19.4 However, despite these positive statements we feel that the balance of this whole section is tilted away from the principles of a market economy towards regulation and control. This is seen through a number of caveats and presumptions. The overall guidance is that a company has to recognise there are considerable regulatory risks to its investment strategy.

19.5 Although there is limited support in the case law for forcing a firm to share its assets with its competitors, we consider that from a policy viewpoint any such action should be extremely rare. It runs completely counter to the underlying principles of a market which is driven by the interplay of competitive forces. It sends the wrong signal that companies which make substantial investments to secure a competitive advantage may have that removed by regulatory action. It is therefore necessary to have a clear limiting principle to identify those cases where due to exceptional circumstances, compulsory licensing may be considered.

19.6 At a time when the EU needs to enhance its competitiveness, companies need to be encouraged to invest and should not have to face the risk of losing the benefits of their investment.
19.7 We believe there is great merit in the opinion of Advocate General Jacobs in the Bronner case that,

“In the long-term it is generally pro-competitive and in the interests of consumers to allow a company to retain for its own use facilities which it has developed for the purpose of its business…(I)f access were allowed too easily there would be no incentive for a competitor to develop competing facilities. Thus while competition was increased in the short term it would be reduced in the long term.”

**Specific comments**

19.8 In keeping with our previous comments, we do not consider it justifiable to create a rebuttable presumption (in para.217) that continuing previous supply relationships is pro-competitive. We consider it is for those alleging the termination is an abuse to prove it. Similar comments apply to the reversal of the burden of proof in para.224. It should not be for the company concerned to show that consumers are better off with the supply relationship terminated.

19.9 In our view, termination should be a clear-cut matter of fact and the concept of a virtual termination, through delay and unfair practices, is unnecessary. We find it conceptually difficult to characterise a margin squeeze as a termination.

19.10 In the case of margin squeeze, “indispensability” of the input is a condition for an abuse to arise when margin squeeze is analysed as a constructive refusal to supply. On the other hand, when it is analysed as a constructive termination, no such condition is required (contrast section.9.2.2 and para.218 under section 9.2.1). There does not appear to be any sound reason for not requiring “indispensability” in all cases and we feel further clarification is needed.

19.11 We propose that when identifying a distinct market which can be a potential market, or even a hypothetical market (in para.227) it should be made clear that the Commission’s published guidelines on market definition need to be followed.

19.12 Given that this is a very controversial area where the law is uncertain, we are concerned that any guidance should not have the effect of encouraging unjustifiable allegations of abuse. We propose that the statement in para.233 should be reviewed in that light because it suggests an abuse where the market does not even exist. We believe a much more cautious interpretation is warranted.

19.13 A further reason for exercising extreme caution in regulating in this area is shown by para.235 where it is suggested that a dominant firm could be allowed to exclude others for a certain period of time in order to ensure an adequate return on its investment. While this statement appears uncontroversial, the implication is that the competition authority will have to take on the role of a “central planner” and make complex judgements on costs and investment returns, which are likely to need monitoring over time. We question whether from a policy viewpoint this is an appropriate role.

19.14 We strongly support the statements in paras.238 and 239 that there is no general obligation on the IPR holder to license the IPR and that the refusal to license does not in itself constitute an abuse. These are entirely in line with the statutory exclusivity that is granted to the IPR holder as an incentive to innovate and which has been at the core of the market economy for centuries. Conceptually it is extremely difficult to reconcile these statements with the essential facilities doctrine.
19.15 Moreover, we are concerned by the assertion that a dominant firm’s refusal to license its IPR may be abusive if the IPR is required by competitors, who do not intend to produce new goods or services but merely goods or services that are “follow-on innovations” or even (by implication) products in the very same market as those being offered by the dominant firm. We consider that this goes beyond existing case law and constitutes an important erosion of the incentive for innovation that the IPR is intended to provide in the first place. It also undermines, rather than reinforcing, legal predictability, since it broadens the range of circumstances under which a refusal to supply may be considered to be abusive.

19.16 We understand the statements in the following paras.240 to 242 to represent the Commission’s position in the Microsoft case but as this case is currently subject to judicial review they cannot be regarded as settled law and we suggest they should be qualified.

20. **After-markets – paras 243 – 265**

20.1 We support the aim of addressing the treatment of after-markets as this is a subject that is of particular significance to undertakings providing capital equipment and products that use consumables. However, some of the cases involving after-markets have disturbing implications for companies’ pricing and business practices, as they advance the concept that a small company (SME) can dominate a market in the proprietary spare parts for its primary products. We believe it is important for DG Competition to set a direction that avoids an overly narrow market definition that is unrealistic and does not stand up to robust economic analysis.

20.2 We agree that after-markets, or secondary markets, normally should be viewed as constrained by, and therefore part of, the related primary market (para.246). We also agree that customers who buy the primary product may be protected by competition in the primary market from the negative effects of high after-market prices. (paras 255, 258-259).

20.3 We disagree with the approach of looking separately at “customers who have already bought the primary product” to determine whether to find a separate, single-brand after-market (para.254). First, such customers were “future customers” when they initially purchased the product and could have protected themselves at that time. Second, many “existing customers” make new purchases and can use primary market competition for new purchases to address any changes in after-market policies that affect them as “existing customers”.

20.4 The focus on changes in approach that affect existing customers, is likely to harm consumers and reduce competition because it will deter undertakings from adopting open approaches to their after-markets by exposing them to Art 82 liability if they later change their after-market approach. Since the situations in which customers may be exposed to “installed-base opportunism” are very limited (para.262), we believe it is sufficient to rely on contractual provisions negotiated when purchasing the product to protect customers. This is preferable to relying on a misguided application of Art 82 to a single-brand after-market of an undertaking that lacks substantial market power in the primary equipment market.

CBI 31 March 2006