White Paper

COMPETITION, COMPETITORS, AND CONSUMER WELFARE:

OBSERVATIONS ON DG COMPETITION’S DISCUSSION PAPER ON ARTICLE 82

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EXECUTIVE SUMMARY

In December 2005, the European Commission’s Directorate General for Competition published a Discussion Paper summarizing its views on the application of Article 82 to exclusionary abuses. DG Competition solicited public comments to be filed by March 31, 2006. The Discussion Paper could lead to the adoption of formal guidelines for the interpretation and application of Article 82. Even if this is not the case, the Paper is significant in its own right as an indication of DG Competition’s current thinking on a number of critically important issues. While the Discussion Paper is welcome for its general support of a more economics-based approach to the application of Article 82, the specifics of the Paper do not go far enough in achieving this important objective and are, in a number of respects, disappointing.

This paper comments on the Discussion Paper from the perspective of CompTIA’s members who consist of a wide cross section of companies in the information technology sector. The key conclusions of the paper include:

Insufficient Focus on Economic Effects and Consumer Welfare

- While the Discussion Paper stresses in principle the importance of economic effects and consumer welfare, the actual analysis contained in the paper more closely resembles the Commission’s traditional competitor-focused approach.

- The analyses of tying, bundling, and refusal to supply all indicate, wrongly, that dominant firms should be required to place the interests of their competitors ahead of consumers.

- The Discussion Paper relies on a variety of legal presumptions, thresholds and procedural rules that collectively create an unjustified bias against successful companies and increase the likelihood of erroneous findings of unlawful conduct.

- The proposed approach is particularly unsuitable for assessing competition and claims of exclusionary abuse in dynamic, high technology markets.

Dominance Defined Too Broadly

- The Discussion Paper proposes a broad concept of dominance that is likely to lead to the protection of competitors at the expense of consumers.

- While the Discussion Paper describes a number of factors that “may” indicate dominance, these factors are also consistent with a finding of no dominance in many circumstances.

- The Discussion Paper relies excessively on percentage of market share to determine dominance. Such an artificial standard is far less useful than assessing whether the firm faces competitive constraints that in fact affect its behaviour.

- Market share should only be used to establish levels below which a finding of dominance cannot be supported or is highly unlikely.

- In other cases, the Commission should employ a full-scale economic analysis to determine if a firm is unconstrained by competitive forces and hence dominant.
Efficiency and Consumer Welfare Deserve More Weight

• The Discussion Paper systematically undervalues efficiency gains and other consumer benefits that often arise from the conduct of dominant firms.

• In effect, the Paper proscribes certain categories of conduct as *per se* unlawful, irrespective of the efficiency gains and benefits to consumers that may result and, indeed, outweigh any harm to competitors. This makes no economic sense.

• The Paper also reaffirms the Commission’s past practice of allocating the burden of proving efficiency gains on the defendant.

• This is inappropriate both as a matter of law and institutional design. It is also likely to increase the prospect of erroneous findings of abusive conduct and thereby discourage pro-competitive conduct. For these reasons, at the very least, the Commission should carry the burden of refuting a firm’s prima facie showing of efficiencies and consumer welfare.

• The Discussion Paper’s proposal to apply excessively high standards of proof in showing efficiency compounds the risks of the Paper’s approach.

• Of particular concern are the Paper’s proposal that a defendant must demonstrate that its conduct is “indispensable” to realizing efficiencies, and the Paper’s presumption that companies with market shares over 75 percent will rarely, if ever, be able to show that their efficiencies outweigh any anti-competitive effects.

The Analysis of Tying Is Also Flawed

• Economists agree that tying very often produces efficiencies that benefit consumers. This is particularly true in the case of technical tying in dynamic markets. In effect, the Discussion paper adopts the opposite presumption—tying is inherently suspicious.

• The Discussion Paper continues to rely on both the consumer demand test and the independent supply test to determine whether two “distinct” products have been tied. It ignores a more important inquiry—is there any demand for the tying product without the alleged tied product?

• The Discussion Paper’s description of market foreclosure is very vague, will leave companies in a state of uncertainty, and in all likelihood discourage pro-competitive conduct by large firms.

• Despite the presumptive efficiencies of tying, the Discussion Paper sets a low standard of proof for the Commission to establish that market foreclosure has taken or could take place.

• By contrast, the Discussion Paper sets high standards of proof to establish the efficiency defence in a tying case, and it allocates the burden of proof to the defendant.
**The Proposals on Refusal to Supply IPRs Are Unjustified and Unwise**

- Intellectual property rights are vital to industrial competitiveness. Uncertainty as to when a company may be required to license its intellectual property rights will deter firms from investing in research and development of innovative products.

- The Discussion Paper opens the door to increased use of compulsory licensing and departs from key principles developed by the ECJ in a substantial body of recent case law.

- The Discussion Paper contemplates that dominant companies can be required to license technology to competitors in the same market, which would undermine the value of its IPRs.

- The Discussion Paper’s proposal to afford trade secrets less protection under Article 82 than other forms of intellectual property, when they are needed to achieve interoperability, has no basis in law, economics, or market realities.

- The Paper’s suggestion that a company’s investment in IPRs should be discounted in deciding whether to issue a compulsory license, if the company would have made the investment in any event, is an unworkable standard. It has no basis in ECJ case law and will require regulators to engage in highly speculative analysis for which they are ill suited.

**INTRODUCTION**

In its 2000 Lisbon Agenda, the European Union announced the ambitious goal of becoming the most competitive and dynamic knowledge-driven economy in the world by 2010. EU leaders recognized that achieving this goal would require public policies that promote deeper investments in research and development and structural reforms aimed at improving competitiveness and spurring innovation. EU competition law can be a powerful catalyst for the achievement of these goals.

Many economists and competition lawyers, however, are concerned that EU competition policy, far from furthering these goals, often acts instead to impede them. The rigid formalism of EU competition law, it has been said, leads competition authorities to neglect market realities, place the interests of competitors over consumers, and foster a climate that does not fully reward innovation. The result, many believe, has been to deter firms in Europe from competing aggressively, to the ultimate detriment of consumers.

In response to these criticisms, the European Commission has recently sought to assure industry and the public that EU competition policy is moving toward a more empirically grounded, economics-based approach. As Commissioner Neelie Kroes recently stated, this approach is based on “solid economic thinking,” the ultimate aim of which is to promote efficiency and protect consumers, not competitors.\(^1\) DG Competition’s recently issued Discussion Paper on the application of Article 82 of the Treaty to exclusionary abuses provides an important opportunity to examine the extent to which the Commission’s avowed new approach will in fact be reflected in its future enforcement practices.

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In some respects, the Discussion Paper provides grounds for optimism. In setting out the rules DG Competition intends to apply in analyzing exclusionary conduct by dominant firms, the Discussion Paper appears to dispense, at least in part, with the *per se* rules and the rigid, formulaic analysis that has characterized EU competition policy in the past, in favor of a more realistic and explicitly economics-based approach. The Discussion Paper also acknowledges the importance of promoting consumer welfare in analyzing abusive conduct under Article 82 and seeks to clarify how the Commission’s enforcement activity can further this central goal.

These aspects of the Discussion Paper are welcome. The attempt to articulate, within the confines of existing case law, an approach that would allow DG Competition to enforce Article 82 in a manner that takes account of both the pro- and anti-competitive effects of challenged conduct could spur precisely the type of strong competition and consumer benefits that EU competition policymakers have said they advocate.

A close reading of the Discussion Paper, however, suggests that a bolder approach is necessary to unlock the full competitive potential of the European economy. In particular, closer scrutiny suggests that the specific proposals of the Paper do not match its stated goals. As described more fully below, the Commission should revise those aspects of the analysis that stray from the consumer-focused and economically-grounded approach endorsed elsewhere in the Paper and should provide clearer guidance on how Article 82 will be applied in specific cases. Failure to make these changes will deter leading firms operating in Europe from undertaking pro-competitive conduct for fear of disadvantaging rivals and thereby incurring liability under Article 82.

Part I of this paper sets out preliminary observations on certain core themes raised by the Discussion Paper. Parts II and III examine its discussion of dominance and the general analytic framework applicable to exclusionary conduct, respectively. Part IV discusses the proposed approach to tying and bundling, while Part V focuses on the analysis of refusals to supply.

### I. Preliminary Observations

The purpose of the Commission’s competition rules, according to the EC Treaty, is to establish “a system ensuring that competition in the internal market is not distorted.”

2 Article 82, in turn, addresses those market distortions that arise from “an abuse by one or more undertakings of a dominant position within the common market.”

3 While the Commission recognizes several categories of dominant-firm abuse, the Discussion Paper focuses solely on so-called “exclusionary” abuses. An exclusionary abuse consists of conduct undertaken by a dominant firm the likely effect of which is to foreclose competition—specifically, conduct that is “likely to completely or partially deny profitable expansion in or access to a market to actual or potential competitors and which ultimately harm[s] consumers.”

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2 EC Treaty, art. 3(1)(g).

3 *Ibid.*, art. 82.

In several instances, the Discussion Paper begins its analysis with a statement of general principles that emphasizes economic effects and consumer welfare, only to follow this with a more detailed discussion that resembles in many respects the Commission’s traditional, competitor-focused approach. Thus, despite the Commission’s apparent good intentions, the Discussion Paper in fact gives inadequate attention to three key pillars of an economics-oriented approach grounded in consumer welfare.

**Efficiency and consumer welfare**

Any analysis of whether a company has engaged in abusive conduct should ultimately turn on the conduct’s effects on efficiency and consumer welfare. This holds true regardless of the type of conduct at issue (e.g., discounts, rebates, etc.). While market share, market power, and related concepts may provide useful tools in analyzing market dynamics and competitive effects, the ultimate test of whether unilateral conduct violates Article 82 should turn on the conduct’s actual effect on efficiency and consumer welfare. Where pro-competitive effects outweigh the negative impact on competitors, such that the conduct generates a net gain in efficiency or consumer welfare, this should constitute an absolute bar to liability.5

To its credit, the Discussion Paper acknowledges the importance of consumer welfare under Article 82. A close reading of the analytic framework, however, as well as its application to conduct such as tying, bundling, and refusals to supply, indicates that dominant firms will often be confronted with an obligation to place the interests of rivals over those of their customers, irrespective of the impact on consumer welfare. As discussed in greater detail later in this paper, aspects of the analysis also suggest that DG Competition will continue to rely on legal presumptions, thresholds, and procedural rules that are systematically biased against the most successful (and presumably most efficient) firms and that will almost certainly deter such firms from competing aggressively.

Competition law should seek to minimize the risk of both “false positives” (finding an abuse where none in fact exists) and “false negatives” (permitting conduct that is in fact abusive). The former can be just as anti-competitive and costly to society as the latter. Competition authorities cannot escape their responsibility to promote competition by systematically deciding to resolve the benefit of the doubt against dominant firms, especially because such firms often have achieved dominance precisely as a result of their efficiency. Yet strong presumptions against dominance pervade the

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5 This recommendation shares some common ground with the “first principles” approach to competition enforcement set out by economist Steven Salop:

The “first principles” approach centres on an examination of the competitive effects of the conduct at issue. This is appropriate because competitive effect is the true core of antitrust. Although market power and market definition have a role in the antitrust analysis, their proper roles are parts of and in reference to the primary evaluation of the alleged anti-competitive conduct and its likely market effects. They are not valued for their own sake but rather for the roles they play in an evaluation of market effects.

Discussion Paper—greatly magnifying the risk of false positive determinations and undermining efficiency and consumer welfare.

- **“Forms and rules” vs. principles and balancing of interests**

The Discussion Paper attempts to address long-standing criticisms that have been levelled at EU competition law’s formalism—specifically, its focus on the “form” of challenged conduct rather than its actual effect in the market and its tendency to favour rigid rules over a more flexible and context-specific weighing of competing interests. While form- and rules-based analysis may promote predictability and legal certainty, these benefits can be illusory given the difficulty of predicting how competition regulators will classify new kinds of economic activity. More importantly, form- and rules-based analysis by its nature cannot capture the full economic complexity of specific market dynamics and therefore risks prohibiting conduct that may promote efficiency or benefit consumers with little or no distortion to competition.

While the Discussion Paper seeks to mark a clear departure from the formalism of past Commission competition policy towards a more economics-based, contextual approach, it does not go far enough. For instance, where in the past the Commission might have adopted a *per se* rule regarding dominance or abusive conduct, the Discussion Paper often states that it is “highly” or “very” likely that dominance or abuse will be found (or conversely highly or very “unlikely” that a finding of no dominance or abuse will be found).\(^6\)

This shift towards a more flexible approach is a step in the right direction, but it is likely to provide only limited comfort to firms that the full dynamics of their competitive situation and the economic effects of their conduct will be fully considered. Because almost all unilateral conduct by dominant firms will have both pro- and anti-competitive effects, even the less rigid analysis set forth in the Discussion Paper runs a substantial risk of proscribing conduct that, on balance, promotes consumer welfare.

- **Dynamic markets**

A great deal has been written in recent years about the challenges of applying traditional competition rules to “dynamic” markets. Dynamic markets are typically characterized by some combination of rapid innovation, intense competition based more on product innovation than on price, high sunk costs and low marginal costs, strong network effects (sometimes), and heavy reliance on intellectual property rights and other intangible assets (e.g., patents, trade secrets, know-how) as compared to

\(^6\) See, e.g., *Discussion Paper*, at ¶ 31 (“It is very likely that [market shares over 50 percent], which have been held for some time, indicate a dominant position.”); ¶ 90 (stating, in describing the efficiency defence, that it is “highly unlikely that the exclusionary conduct of a dominant company with a market position approaching that of a monopoly . . . can be justified on the ground that efficiency gains would be sufficient to outweigh its actual or likely anti-competitive effects and would benefit consumers”); ¶ 92 (“It is therefore, also when assessing the no-elimination-of-competition requirement, highly unlikely that abusive conduct of a dominant company with a market position approaching that of a monopoly . . . could be justified on the ground that efficiency gains would be sufficient to counteract its actual or likely anti-competitive effects.”).
tangible assets (factories and warehouses). Examples of such markets include online businesses, computer hardware and software, mobile telephony, and biotechnology.

Building on the work of Austrian economist Joseph Schumpeter, economists and competition lawyers often view the competitive battle in dynamic industries as taking place between markets rather than within markets. Also, competition in these markets is often characterized as a “winner-takes-all” battle, where firms with high market shares nonetheless continually face strong competitive constraints from new entrants and “disruptive” innovations in related but distinct markets.

Applying traditional competition analysis and concepts to dynamic markets can be extremely challenging. As economist Jerry Ellig has written:

> In textbook economic theory, numerous competitors with access to the same technology and resources compete on price. In a growing number of real industries, competitors with different technologies and resources compete on the basis of product attributes and performance as well as price. Indeed, product performance may be much more important to many customers than price. . . . Declaring that a firm has market power if it can sustain a “significant but non-transitory price increase” completely misses the performance dimension of competition.\(^7\)

As a result, the rigid application of traditional antitrust rules to such markets risks severely restricting competition, innovation, and consumer welfare. As noted in a recent summary of a report on this issue commissioned by the UK’s Office of Fair Trading:

> [T]here can be serious costs to [competition-based regulatory] intervention [in dynamic markets], and unintended consequences can often be the result. Therefore, the competition authorities should only intervene in dynamically competitive markets where the potential for anti-competitive harm is large and the potential benefits from intervention are great. This is probably a good principle for competition policy in general. It is even more appropriate for dynamic markets where effects of intervention are likely to be particularly difficult to predict.\(^8\)

The Discussion Paper does not give sufficient attention to the special challenges raised by dynamic markets, nor does it suggest any intent on DG Competition’s part to apply Article 82 more flexibly or cautiously when dealing with such markets. On the contrary, the Paper’s discussion of tying, bundling, and refusals to deal in particular suggests that the Commission intends to apply the same

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analysis and rules to dynamic industries that compete on innovation and product features as it applies to more traditional industries that compete on price. Such a position bodes ill for the EU’s high-tech industries and for the EU’s Lisbon Agenda.

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In sum, while the proposed framework set out in the Discussion Paper appears to indicate some progress on each of these issues, it is also fair to say that much more needs to be done to ensure that EU competition law is solidly anchored in economic realities and fully serves the goals of promoting efficiency and consumer welfare. These and other concerns are discussed in more detail below.

II. Dominance

Commentators have often complained that EU competition policy tends to define dominance too broadly and that leading firms are thereby deterred from engaging in aggressive competition, including discounts, rebates, and other activities that often have strong pro-consumer benefits. EU policy has also been criticized for placing inordinate reliance on market share in determining dominance and for defining markets too narrowly.

Although to some extent these criticisms have been addressed in the Discussion Paper, it does not go as far as it could or should in addressing them. Specific concerns are as follows:

A. Clearer Guidance on Competitive Constraints

As the Discussion Paper recognizes, the basic test for dominance is whether an undertaking has “the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers."9 Thus, where a firm is forced to modify its behaviour in response to other economic actors in (or who have an effect upon) the relevant market, this will normally signify that the firm lacks the level of market power necessary to act over an extended period without regard to whether it is inefficient or its conduct harms consumer welfare.

To ensure that this test in fact encourages aggressive competition, however, it is vital that the Commission clearly spells out the types of evidence that will normally indicate that an undertaking is subject to competitive constraints such that it cannot be held dominant. Otherwise, leading firms may be deterred from engaging in conduct that might disadvantage competitors but that benefits consumers.

An example of the type of guidance that is needed is set out in paragraph 27, where the Discussion Paper observes that “the fact that an undertaking is compelled by the pressure of its competitors’ price reductions to lower its own prices is in general incompatible with the independent conduct which is the hallmark of a dominant position.” While this is undoubtedly correct, there is no reason to limit this proposition to price reductions. Firms may, as a result of competitive pressures, engage in all sorts of pro-consumer conduct, such as increasing investments in R&D, investing in more efficient production or distribution methods, and improving product quality or features in response to

similar actions by rivals. Furthermore, these competitive constraints are not, as the Discussion Paper implies, limited to constraints imposed by rivals, but might also emanate from other sources, such as “strong buyers” or competitive threats in related markets.  

The Commission could provide much-needed guidance in this area by providing further examples as to the types of evidence that prove the existence of competitive constraints and will therefore normally disprove a claim of dominance.

Instead, the Discussion Paper lists several factors that “may” indicate a lack of competitive constraints, such as charging “higher than normal” profits and “increas[ing] its price while benefiting from falling costs.” While such evidence may indeed arise in an anti-competitive context, these factors can also be fully consistent with a finding of no dominance in certain circumstances. Also, by listing a broad range of factors that “may” indicate dominance and providing only few and limited examples of evidence that is inconsistent with dominance, the Discussion Paper implies that the Commission endorses a very expansive concept of dominance, one that is not necessarily linked to actual effects in the marketplace.

Similarly, the Discussion Paper’s analysis of barriers to expansion and entry sets forth a list of barriers that have the potential to insulate leading firms from competitive constraints, and suggests that the Commission will evaluate these factors in determining whether rivals could “reasonably replicate [these] circumstances”—which is a difficult and speculative analysis at best. More useful would be a clear statement from the Commission that evidence that rivals are expanding or able to expand their operations, or that new firms are entering or are able to enter the market, is inconsistent with a finding of dominance.

B. Less Reliance on Market Shares

EU competition policy has also been criticized for its perceived over-reliance on market shares in determining dominance under Article 82. While a dominant undertaking typically does enjoy a high market share, the obverse is not true—i.e., high market share often is not an accurate indicator of dominance. This is because, in many situations, other factors—such as low barriers to entry, the possibility of disruptive innovations, and strong buyer power—will impose competitive constraints even on firms with high market shares. This is particularly true in dynamic markets, where high market share is often an indicator of innovative capacity, and where it is not uncommon for firms with high market shares to be overtaken by a new, innovative entrant or an innovative firm in a separate market, and within a relatively short time frame. A strong reliance on market share to determine dominance in these markets can carry a high cost to consumer welfare. Also, given the tremendous variation that exists between and among markets, reliance on a single market share threshold to evaluate dominance across all markets risks being substantially over-inclusive.

While the Discussion Paper acknowledges that an analysis of market shares provides merely a “starting point” and “useful first indication” for evaluating dominance, other passages suggest that

10 The Discussion Paper analyses the roles of “strong buyers” in paragraphs 41-42, but limits their significance in imposing meaningful competitive constraints.

11 Ibid., ¶ 40.

12 Ibid., ¶ 29.
the Commission continues to focus inordinately on market shares, and that market share at or above certain numeric thresholds will create a strong—in practice, possibly irrebuttable—presumption that the undertaking in question is dominant. For instance, the Discussion Paper states that undertakings holding 50 percent or more of the market “very likely” hold a dominant position. The Paper also suggests that, where a firm holds a market share above 75 percent, any pro-competitive efficiencies generated by the conduct in question will be given lower priority than the conduct’s impact on competitors. While the latter point goes to the issue of abuse, rather than dominance, it nonetheless demonstrates an overly heavy and ultimately formalistic reliance on market shares, one that risks under-estimating other factors that more accurately reflect whether an undertaking in fact is subject to competitive constraints. More importantly, this principle illustrates just the kind of doctrinaire approach to competition policy that Discussion Paper’s authors disavow in other contexts. There is simply no economic basis for discounting a firm’s pro-competitive, welfare-enhancing, efficient behaviour simply because it holds a particular percentage share of the market.

We also suspect that many businesses would be surprised and troubled by the Discussion Paper’s suggestion that firms with market shares as low as 26 percent may nonetheless be found dominant. Although we recognize that this is intended in part to summarize existing case law, the Discussion Paper would provide greater guidance to industry if it included a clearer statement on the types of circumstances in which such low market shares could nevertheless support a finding of dominance—circumstances that we expect would be exceedingly rare.

In our view, market share thresholds should be used primarily to establish levels below which a finding of dominance cannot be supported or would be very unlikely. For all market shares above such thresholds, the Commission should engage in a full-scale economic analysis of whether the undertaking in question has the ability to act “independently of its competitors, its customers and ultimately of the consumers.”

III. Framework for Analysis

Section 5 of the Discussion Paper sets forth the general framework that DG Competition uses to analyse exclusionary abuses, including the specific types of abuse discussed later in the Paper. Thus, the following comments apply to DG Competition’s Article 82 analysis generally and supplement the more specific comments set forth in Parts IV and V of this paper.

These comments focus on a fundamental flaw that runs throughout the analytic framework—namely, that potential efficiency gains and other consumer benefits resulting from challenged conduct are systematically undervalued. The framework does this in three ways: (1) by stating that certain categories of conduct will incur liability even if the benefits of the conduct outweigh the negative

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13 Ibid., ¶ 31 (“It is very likely that very high market shares, which have been held for some time, indicate a dominant position. This would be the case where an undertaking holds 50 % or more of the market, provided that rivals holds a much smaller share of the market.”) (footnotes omitted).

14 Ibid., ¶¶ 91-92.

15 Ibid., ¶ 31.

16 These include predatory pricing, single branding and rebates, tying and bundling, and refusal to supply.
effects on competitors; (2) by placing the burden of proving efficiency gains on the accused undertaking; and (3) by imposing an inordinately high standard of proof on firms seeking to benefit from the efficiency defence. We discuss each topic in turn.

A. Interests of Competitors vs. Consumers

As noted in Part I, the ultimate goal of competition policy is to promote efficiency and consumer welfare — in the words of Commissioner Kroes, “ultimately the aim is to avoid consumers harm.” Thus, competition law should in general prohibit only conduct whose negative impact on competition outweighs any efficiency gains or consumer benefits, such that, on balance, consumer welfare will suffer. A logical consequence of this position is that, while harm to competitors should be a necessary condition to finding conduct abusive under Article 82, it should never be considered a sufficient condition for doing so.

In various instances, however, the Discussion Paper turns this logic on its head by placing greater emphasis on the impact of challenged conduct on competitors than on whether the conduct will ultimately promote efficiency or consumer welfare. Examples include the following:

- The Discussion Paper states that foreclosure may be found where “rivals are disadvantaged and consequently led to compete less aggressively” and explains that rivals may be disadvantaged when the dominant firm is able to “reduce demand for the rivals’ products.” Although the meaning of this statement is unclear, it could be read to impose quite severe limits on dominant-firm conduct. For instance, a dominant company that is able to attract new customers on the basis of an innovative product might thereby “disadvantage” rivals because it reduces demand for their products and leads them to “compete less aggressively.” Penalizing such conduct, however, is inconsistent with the view that dominant companies should be encouraged to compete aggressively on the merits. Absent clarification, this standard could deter dominant companies from engaging in conduct that, from an economic standpoint, is ultimately pro-competitive. A better approach, in our view, would be to state explicitly that conduct by a dominant firm is abusive only if its net effect is to harm consumer welfare.18

- Certain passages in the Discussion Paper suggest that the overall analysis rests on an assumption that, because conduct that harms competitors could decrease consumer welfare in the longer term, efficiencies generated by such conduct should be discounted.19 From both an economic and a practical perspective, however, such an assumption is unwarranted. Accurately predicting long-run harm to competition or consumers resulting from conduct that is otherwise efficiency-enhancing is almost always a difficult and highly speculative undertaking. Such predictions are particularly unreliable with respect to dynamic markets

17 Ibid., ¶ 58.

18 See, e.g., Commissioner Neelie Kroes, Preliminary Thoughts on Policy Review of Article 82, at 3 (23 Sept. 2005) (stating that, in the analysis of exclusionary conduct under Article 82, “ultimately the aim is to avoid consumers harm”).

19 See, e.g., Discussion Paper, ¶¶ 54-60.
and run the serious risk of under-estimating the capacity of rivals and new entrants to exert competitive pressures through product innovation or other means. Rather than assume long-term harm to consumers whenever competitors are disadvantaged, the analysis should examine, based on the unique facts of each case, whether the impact on competitors will cause long-run harm to consumers and whether such harm, if any, exceeds both short- and long-run gains in consumer welfare.

- In its discussion of discounting and other price-based conduct, the Discussion Paper states that DG Competition may at times declare the use of price discounts by dominant firms unlawful in order to “protect competitors that are not (yet) as efficient as the dominant company.”\(^{20}\) There is little economic basis, however, for sacrificing the clear and immediate benefits of lower consumer prices in favour of protecting inefficient rivals (who will, of course, face less competitive pressure to become more efficient if their dominant competitor is barred from doing so). This condition also places on dominant firms the impossible task of trying to guess, \textit{ex ante}, whether efficiency-enhancing conduct that only disadvantages the least inefficient of their competitors will nonetheless be found abusive.

- In the discussion of the “meeting competition” defence, the Discussion Paper states that a dominant firm, when deciding upon alternative courses of action, must weigh “the interests of its competitors to enter or expand” into the market.\(^{21}\) In truly competitive market, of course, businesses will be focused first and foremost on advancing the interests of their customers, not their competitors. Thus, most dominant firms will be ill-equipped to evaluate which of various possible options will least disadvantage their competitors. Furthermore, given the uncertainty over how this requirement will be applied in practice, dominant firms will likely forego even pro-consumer conduct in meeting competitive threats if such conduct also has the potential to make it more difficult for competitors to “enter or expand” into the marketplace.

- The Discussion Paper also states that, where a firm holds a market share above 75 percent, any pro-competitive efficiencies generated by the conduct in question will automatically be given lower priority than the conduct’s impact on competitors.\(^{22}\) There is no plausible economic rationale for such a position. Firms, whether dominant or not, should never be under an obligation to place the interests of their competitors over those of consumers. Such a rule will end up protecting less efficient rivals and restricting the behaviour of dominant firms in a manner that undermines Article 82’s very purpose of promoting efficient markets and consumer welfare. Protecting rivals against competition in this manner will also reduce their incentives to compete aggressively.

- The Discussion Paper introduced additional uncertainty in its discussion of presumptions of abuse at paragraph 60. If, as the first sentence provides, certain exclusionary conduct “is clearly not competition on the merits,” “clearly creates no efficiencies” and “only raises

\(^{20}\text{Ibid.} \text{, \S} \text{ 67.}\)
\(^{21}\text{Ibid.}, \S \text{ 82, 83.}\)
\(^{22}\text{Ibid.}, \S \text{ 91-92.}\)
obstacles to residual competition,” such conduct is abusive by definition and, accordingly, no presumption is necessary. If, however, this statement suggests that the Commission will focus on the form of challenged conduct in making an initial assessment of abuse, and that it will then fall to the dominant company to rebut that presumption through factual evidence, this approach is unwarranted for the reasons noted above. Also, in the interests of certainty, it would be more helpful if the Discussion Paper were to articulate circumstances in which abuse cannot be found, rather than, as in paragraph 60, cases in which the Commission will necessarily assume that an exclusionary abuse has occurred.

**B. Burden of Proof**

The extent to which a dominant firm’s conduct promotes efficiency should be a central part of any analysis of abusive conduct. Indeed, an explicit consideration of efficiencies in the assessment of conduct under Article 82 is essential to determining whether that conduct has distorted competition in the marketplace. If the efficiencies generated by a dominant firm’s actions outweigh their negative effects on competition (if any) such that the net effect of the conduct advances consumer welfare, the conduct should not be considered abusive.

The Discussion Paper, however, indicates that DG Competition intends to continue its existing practice of placing on defendant undertakings the burden of proving that efficiency gains from their conduct outweigh any negative effects on competition. Placing on dominant firms the burden and risk of being able to “prove their innocence” in this manner—rather than requiring competition authorities to rebut any prima facie efficiency claims as an essential part of their case—will discourage dominant firms from engaging in efficiency-enhancing conduct. In contrast, placing the final burden of proof with regard to efficiencies on the competition authority makes sense, among other reasons because the competition authority is likely to be in a better position to obtain information on efficiencies in the course of its investigation and also has the time and resources to develop appropriate analytic tools for measuring efficiencies—resources that a dominant firm would is unlikely to have to the same degree. As a matter of institutional design, the burden should fall on the entity best placed to carry it — the competition authority.

In addition, in contrast to the bifurcated approach under Article 81, the assessment of efficiencies is an integral part of the analysis of whether or not conduct constitutes an abuse under Article 82. In an Article 81 case, once the Commission has shown that an agreement restricts competition, the burden shifts to the defendant to establish that it is eligible for an exemption under Article 81(3). This bifurcated approach flows from the text of Article 81 itself. In contrast, Article 82 is a unified analysis where the analysis of whether the dominant firm has committed an illegal abuse necessarily includes an analysis of efficiencies. The assessment of efficiencies is part of this analysis because, if the efficiencies generated by the dominant firm’s conduct outweigh any anticompetitive effects, there is no abuse. Regulation 1/2003 reflects this essential difference between Articles 81 and 82 because it specifically places the burden of proof of establishing that the conditions for exemption under Article 81(3) are met on the defendant, but does not place the corresponding burden on the defendant

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23 Ibid., ¶ 60.

24 Ibid., ¶¶ 77, 79.
in an Article 82 case. The only reasonable inference is that the burden must fall on the party charging abuse.

For these reasons, it should be for the authority investigating an alleged infringement of Article 82 to support any finding of abuse by evidence that the conduct at issue is not justified by efficiencies, in particular in those instances where the dominant company puts forward a prima facie efficiency justification.

C. Standard of Proof

In addition to placing the burden on defendant companies to prove that their conduct is justified on efficiency-enhancing grounds, the Discussion Paper also indicates that such a defence will have to meet four conditions, two of which are interpreted in such a way that they will systematically place the interests of rivals of the dominant firm over the goal of enhancing efficiency. These include that the dominant firm demonstrate:

- That the conduct in question was “indispensable” to realize the claimed efficiencies. To satisfy this condition, the defendant must “demonstrate that there are no other economically practicable and less anticompetitive alternatives to achieve the claimed efficiencies.” This requirement, however, ignores the business realities in which firms operate. In most cases, businesses undertaking an efficiency-enhancing measure—such as a new distribution system or method of production—simply lack the resources and information to determine whether there might be alternative courses of action that would have less impact on rivals. Faced with the prospect that a competition authority (or a competitor who has complained to the competition authority) will, at a later date, question whether a different course of action could have had less adverse impact on rivals, many dominant firms might well forgo altogether bold and innovative measures to improve efficiency and instead choose the safer path of sticking with business as usual.

- That “competition in respect of a substantial portion of the products concerned is not eliminated.” Businesses undertaking efficiency-enhancing conduct must also ensure that they do not thereby eliminate competition in a “substantial” portion of the products concerned. This condition expressly places the interests of competitors and the competitive process over the goal of improving efficiency. The Discussion Paper also draws from this condition the very troubling conclusion that undertakings with market shares exceeding 75 percent face a virtual prohibition on using the efficiency defence to justify actions that

25 Ibid., ¶ 84.

26 Ibid., ¶ 86.

27 This condition also applies to the “meeting competition” defence and is subject to the same criticisms in that context as well. See ibid., ¶ 82.

28 Ibid., ¶ 91 (“Ultimately the protection of rivalry and the competitive process is given priority over possible pro-competitive efficiency gains.”).
disadvantage rivals—regardless of the magnitude of the efficiency gains and corresponding consumer benefits. This makes no economic sense.

Taken together, these aspects of the analytic framework set forth in the Discussion Paper run the risk of deterring dominant firms from undertaking a wide range of conduct that could improve efficiency and consumer welfare—i.e., conduct that is ultimately pro-competitive. This concern is magnified in the case of dynamic markets, where competitive constraints often take the form of “disruptive” innovations that constantly threaten to destroy the entire market.

IV. **Tying and Bundling**

Section 8 of the Discussion Paper sets forth a framework for analyzing tying and bundling arrangements. The Discussion Paper recognizes that tying is a common business practice that often has strong pro-competitive effects. Economic research in recent decades has shown that tying often produces efficiencies and spurs innovation, and it is now broadly accepted that tying may result in lower production, transaction and distribution costs. DG Competition’s own economic study on Article 82 notes that cases of anticompetitive tying are “relatively scarce.”

The pro-competitive effects of tying are particularly pronounced in the case of technical tying. When companies innovate by technologically linking formerly separate products, consumers usually benefit. Efficiencies may result from improved product performance, more useful functionality, or improved quality. Pricing efficiencies are also common as double marginalization may be eliminated. In addition, technical tying may lead to “system-based” competition, which is often more intense than “component-based” competition. For example, by offering consumers a bundled product that consists of the PC, the screen, the keyboard, the mouse, and other peripherals that are designed to work together, PC manufacturers are able to offer consumers a product that has fewer glitches, saves them the time and trouble of purchasing components separately, and at a better price than if the components were purchased separately.

The Discussion Paper states that the Commission will generally find tying or bundling to be abusive if four factors are met: (i) the company concerned is dominant in the tying market; (ii) the tying and tied goods are two distinct products; (iii) the tying practice is likely to have a market distorting foreclosure effect; and (iv) the tying practice is not justified objectively or by efficiencies. It adds,

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29 *Ibid.*, ¶¶ 91-92 (stating that its “highly unlikely that abusive conduct of a dominant company with a market position approaching that of a monopoly, or with a similar level of market power, could be justified on the ground that the efficiency gains would be sufficient to counteract is actual or likely anti-competitive effects”).


33 *See* EAGCP Report, pp. 40-41 for a discussion of many of the advantages to technological integration.
however, that in applying this test, the Commission intends to focus on the economic effects of the purported tie or bundle and its impact on consumer welfare.\textsuperscript{34}

This endorsement of an effects-based approach contrasts to the Commission’s past treatment of tying and bundling. Until recently, the Commission and the European Courts adopted what many would consider a per se approach to tying, meaning that if conduct were determined to constitute tying or bundling, it would be presumed to be anticompetitive regardless of the actual effects of the arrangement. In comparison to past practice, therefore, the Discussion Paper’s endorsement of a more effects-based analysis is a positive and welcome step.

Nonetheless, a close reading of the Discussion Paper suggests that elements of the Commission’s traditional hostility to tying and bundling remain, and that tying arrangements by dominant firms in many cases will be viewed as suspect until proven otherwise. For instance, the rules on who bears the burden of showing efficiencies and the standard of proof that must be met to discharge this burden are weighted so heavily against the dominant firm that, as a practical matter, it is very questionable whether adequate consideration will be given to the efficiencies or other consumer benefits that may result from a particular tie or bundle. Indeed, the Discussion Paper adopts an approach in which certain proxies are used to measure anticompetitive effects, with certain older presumptions against tying remaining embedded in the analysis.

Given the frequent pro-consumer effects of tying and bundling, this approach is misguided, particularly when applied to high technology industries and other dynamic markets. In such markets, suppliers integrate new functionality into their products at a rapid pace. Indeed, increased integration of new features into information technology and consumer electronics products as well as the broader convergence among these and other “new economy” sectors is one of the key drivers of the “new economy.” Both common sense and economic research indicate that such tying often benefits consumers – when the same product may be used to make phone calls, take pictures, and read e-mails, time and money are saved.

The proposed analysis, by contrast, will deter leading firms from integrating new features and functionality into their products. This will leave consumers with fewer product choices, thereby weakening rather than strengthening competition. A better approach—one more fully grounded in economic analysis and market realities—would be to begin from the principle that tying and bundling are generally pro-competitive, and therefore will be considered non-abusive unless proven otherwise.

In addition to the overarching concern that the proposed analysis fails to take account of the common benefits of tying, specific concerns include: (i) the proposed “distinct products” analysis; (ii) the discussion of market foreclosure; and (iii) the treatment of the efficiency defence. We discuss each in turn.

\textsuperscript{34} See Discussion Paper, ¶ 56; see also Commission Discussion Paper on Abuse of Dominance - Frequently Asked Questions, at 2.
A. The Distinct Products Test

1. Demand for the Tying Product

In assessing whether a purported tie or bundle involves two distinct products, the Discussion Paper provides that “two products are distinct if, in the absence of tying or bundling, from the customers’ perspective, the products are or would be purchased separately.”35 This focus on consumer demand follows from the ultimate purpose of Article 82 as an instrument to protect consumers.

The Discussion Paper errs, however, in viewing separate consumer demand for the tied product as an indicator of distinct products. Specifically, the existence of consumer demand for the tied product does not illuminate whether there is consumer demand for the tying product without the tied product, or whether any particular tying arrangement produces efficiencies. For example, the fact that there is consumer demand for spark plugs and shoe laces provides no basis for concluding that autos with sparkplugs or shoes with laces involve two distinct products, or that there is any consumer demand for sparkplug-less autos or lace-less shoes.36 In short, analysis of independent supply ultimately asks the wrong question and, in doing so, may prevent the emergence of efficient, pro-competitive tying arrangements.

2. Technical Integration

The distinct products test might also lead to incorrect results in cases involving the technical integration of two products that were previously distinct on the ground that, by definition, the test is backward-looking. For instance, when a company adds new functionality to an existing product, such as radio functionality to an alarm clock, a new market emerges for that product that is neither the market for clocks nor radios. Under the consumer demand test, clocks and radios would always be considered as separate products because, until their integration, they were always purchased separately.

The Discussion Paper fails to resolve this problem, which means that technological integration of previously distinct products almost inevitably will be considered to be a tie. The Discussion Paper states that, in cases of such integration, the test should be “whether consumer demand has shifted as a consequence of the product integration so that there is no more independent demand for the tied product.”37 The problem with this approach is that, unless the market shifts overnight so that consumers no longer purchase the products separately, it is unlikely that a dominant firm will be able to make such a showing. A better approach would be simply to ask whether the company integrating the previously distinct products can make a prima facie showing of efficiency gains. Since technical tying is normally efficient, market-leading companies would be able to continue producing

35 Ibid., ¶ 185.
37 Ibid., ¶ 187. Similarly, note 125 suggests that it would be necessary to show that “the whole industry in the future will offer the integrated product instead of two separate products.”
innovative products benefiting consumers without running afoul of the prohibitions on tying—unless the competition authority could rebut the innovating firm’s prima facie case.

3. **Commercial Usage**

If the evidence on commercial usage shows that the products are not offered separately so that there is only one product, the matter should end there because tying is only possible if there are two distinct products. While this point seems fairly obvious, the Discussion Paper contains language that suggests that a dominant firm may be held to have infringed Article 82 even if commercial usage indicates that products are not distinct.\(^\text{38}\) This language harbours the potential for confusing the analysis because it could be read as saying that, even if commercial usage shows that the products are sold together so that there is only one product, a firm may be held in violation of Article 82. This interpretation would eviscerate the distinct products requirement and, indeed, would not make sense because, by definition, tying requires two products.

The confusion presumably stems from the fact that the “commercial usage” portion of the Article 82 test may be used in two ways in a tying case: as part of the separate products test and, in cases where separate products are shown to exist, as a justification for why the tying practice is not abusive. This is precisely what happened in Tetra Pak.\(^\text{39}\) Tetra Pak first pleaded commercial usage in the aseptic packaging market to show that packaging machines and cartons were one integrated system. When the CFI rejected this argument on the grounds that commercial usage in the neighbouring non-aseptic packaging market showed that machines and cartons were sold separately, Tetra Pak then pleaded commercial usage as justifying the practice i.e. that since most firms did not sell the products separately, there was no abuse. The CFI rejected this argument as well, noting that, even if a dominant firm were able to show that the most firms did not sell the products separately, this would not necessarily mean that they tying practice was justified.

It would be helpful for the Discussion Paper to clarify that commercial usage can be decisive on the separate products issue, even if it is not on the question of justifications for the tying practice. If commercial usage shows that there is no separate demand for the products, the matter should end there because tying is only possible if there are two distinct products. If there is separate demand for distinct products (even though commercial usage may show that many firms bundle the products), commercial usage may become relevant in considering whether the tie is justified.

\(^\text{38}\) Paragraph 186 states that “[c]ommercial usage may … indicate that two products are not distinct,” but the footnote to that sentence states “[h]owever … commercial usage does not automatically bring a certain practice outside the scope of Article 82.”

B. Market Foreclosure Effect

1. In General

The Discussion Paper also provides that a tying arrangement would be prohibited if it “is likely to have a market distorting foreclosure effect that would result in harm to consumers.”

This inquiry is typically the key to establishing whether a tying arrangement is permissible. It is therefore vital that leading companies have clear guidance on the amount of foreclosure that is permissible, and that the efficiencies generated by tying are given proper weight in the analysis. The proposed foreclosure analysis set out in the Discussion Paper does not, however, satisfy either goal.

Unfortunately, the Discussion Paper’s description of what constitutes foreclosure is very vague. Market foreclosure effects are described as conduct that has “the capability, by its nature, to foreclose competitors from the market.” Total foreclosure is not necessary; it is enough if competitors are “disadvantaged, which is deemed to occur when demand for their products is reduced.”

The Discussion Paper goes on to state that a tying practice will be presumed to result in market-distorting foreclosure where it ties a “sufficient part” of the market, but fails to provide guidance as to the meaning of “sufficient.”

Under this vague foreclosure standard, any tying arrangement that has the effect of reducing demand for a competitor’s product could be deemed to have a prohibited foreclosure effect, irrespective of the benefits to consumers or whether these effects are solely the result of competition on the merits. Unless clearer guidance is provided on the degree of foreclosure that is presumed to give rise to anticompetitive effects, companies will be left in a state of uncertainty in assessing tying arrangements. Indeed, under the current standard, any dominant firm that adopts a tying strategy that reduces demand for a competitor’s products—which presumably would be one of the goals of any successful tying strategy—would be open to challenge. To give companies as much concrete guidance as possible, it would be helpful to have more precise indication of the degree of foreclosure that is considered to be abusive.

The Discussion Paper also fails to provide clear guidance on the effect of bundling by competitors of the dominant firm with respect to the analysis of market foreclosure. At one point, it suggests that bundling is less problematic if competitors also offer bundles. At another point, it indicates that the foreclosure effect might be greater if others in the industry also bundle. This inconsistency should be resolved in favour of the former position: the fact that other firms in the market also offer bundles is a strong presumption that bundling generates efficiencies and meets consumer demand. Additionally, the dominant firm ought to be able to compete with bundles offered by its competitors.

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40 Ibid., ¶ 183.
41 Ibid., ¶ 58.
42 Ibid.
43 Ibid., ¶ 188.
44 Ibid., ¶¶ 195, 202.
45 Ibid., ¶ 197.
2. Foreclosure by Mixed Bundling

The Discussion Paper provides the following guidance on the point at which a mixed bundle might give rise to foreclosure: “[c]ompetitors are foreclosed if the discount is so large that efficient competitors offering only some but not all of the components, cannot compete against the discounted bundle.” The Discussion Paper then indicates that such foreclosure will exist unless “[t]he incremental price that customers pay for each of the dominant company’s products in the bundle … cover[s] the long run incremental costs of the dominant company of including this product in the bundle.

The adoption of this long-run incremental costs standard is inconsistent with business reality because it requires companies to price bundles to cover average long-run variable costs, which includes sunk fixed costs that are unrecoverable. This approach ignores the economic reality that, when businesses decide how to price a product, they do not consider costs that are “sunk” or “unrecoverable,” i.e., that would be incurred regardless of whether any products were ever sold. Indeed, if they were to consider such sunk costs in their pricing decisions, they would engage in the so-called “sunk-cost fallacy”, which is when a business person makes decisions based on the fallacy that money already irreversibly spent on a project might be “unspent” or recovered if the project is abandoned.

In effect, the Discussion Paper’s reliance on long-run incremental costs to measure foreclosure is based on the assumption that an automobile factory can be converted into a semiconductor plant and that a steel worker can be retrained to become a software engineer—all without cost. These assumptions do not reflect economic reality. The impracticality of making economic decisions based on “long run” analysis was perhaps best articulated by John Maynard Keynes, who said “in the long run, we are all dead.”

A more appropriate cost standard would be marginal costs (MC) or at least Average Avoidable Costs (AAC). When business people decide whether or not to make a marginal sale at a particular price, they generally consider the marginal cost of making that sale. The Discussion Paper uses AAC as the appropriate measure of cost in the context of its analysis of predatory pricing and that same reasoning supports AAC as the appropriate measure of cost in the mixed bundling context. Indeed, the only time the Discussion Paper uses the long-run average incremental cost measure in the predatory pricing context is when addressing pricing by monopolies that are (or were) established by law.

3. Standard of Proof

The standard of proof the Commission is required to meet to establish harmful foreclosure effects is too low, particularly in light of the fact that the analysis of foreclosure effects can be speculative in nature. In the case of tying, actual market foreclosure is not required by the Discussion Paper—it is

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46 Ibid., ¶189.
47 Ibid., ¶190.
48 Ibid., ¶108.
49 Ibid., ¶124-26.
enough that such foreclosure is “likely”\(^\text{50}\) to occur. In other words, the mere risk of foreclosure can result in a finding against a dominant company. In *Tetra Laval*,\(^\text{51}\) the European Court of Justice (“ECJ”) held that, in the context of merger cases, the Commission must put forward convincing evidence to block a merger, as the Commission is trying to predict the future effects of the merger on a market. The ECJ stated:

> [a] prospective analysis of the kind necessary in merger control must be carried out with great care since it does not entail the examination of past events - for which often many items of evidence are available which make it possible to understand the causes - or of current events, but rather a prediction of events which are more or less likely to occur in future if a decision prohibiting the planned concentration or laying down the conditions for it is not adopted.\(^\text{52}\)

The ECJ then explained that it was “particularly important” for the Commission to put forward convincing evidence in cases involving conglomerate mergers, *i.e.*, where the parties are on neighbouring markets and there is a concern that they will be able to leverage their power in one market to increase their power in another.

As the analysis of market foreclosure effect under Article 82 will often entail a prediction of future effects, the Commission should set a similarly high standard of “convincing evidence” for foreclosure in tying cases. In establishing foreclosure, the Commission must address a chain of causation that is similar to that involved in a conglomerate merger case, which, in the words of the ECJ, are “dimly discernable, uncertain and difficult to establish.”\(^\text{53}\) Establishing foreclosure not only requires the Commission to predict what will happen in the future if the tying practice continues, but requires it to establish that the dominant firm has the ability and the incentive to leverage its dominant position on the tying product’s market to foreclose competition on the tied product’s market. A standard of proof that requires convincing evidence will help ensure that companies will not be deterred from bringing new products to market as a result of concerns about remote, potential, and highly speculative foreclosure effects.

### C. Efficiencies

As discussed above, there are grounds for concern both about the burden of proof placed on the dominant firm as well as the standard of proof that it must meet to establish the existence of efficiencies. Procedural rules that create presumptions against the dominant firm are particularly out of place in the case of tying and bundling practices, which are recognized to be pro-competitive in most cases.

The Discussion Paper fails to acknowledge that bundling can be used to create value for consumers in markets characterized by network effects and in multi-sided markets. In fact, with regard to

\(^{50}\) *Ibid.*, ¶183.


\(^{52}\) *Ibid.* at ¶42.

\(^{53}\) *Discussion Paper*, ¶44.
network effects, the Discussion Paper indicates that foreclosure effects of a bundle may be even greater when there are network effects.\footnote{Discussion Paper, ¶199.} In fact, in such markets, bundling is a valuable strategy to gain broader distribution of the products or service that is subject to network effects. And the broader the distribution, the greater the value produced for all consumers. This is particularly true when the product or service in question has low (or no) marginal costs, because the supplier can without cost include the product or service in bundles with other products. In this respect, the guidelines interpret Article 82 to outlaw business practices that create wealth for society and generate large consumer benefits.

Bundling can generate similar efficiencies in multi-sided markets, \textit{i.e.}, markets where products or services must be matched with other products or services to have value. Newspapers encompass multi-sided markets. They are sold to readers, but they also sell advertising space to advertisers. The reader is not only a “customer” of the newspaper, the reader is also a supplier of “eyes” that the newspaper sells to advertisers. The complex business models resulting from multi-sided markets often require bundling practices because the consumption on one side of the market is being “sold” on the other side of the market, and piece-meal consumption on one side of the market breaks down the interdependent ecosystem.

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In sum, the analytic approach to tying and bundling set out in the Discussion Paper retains many vestiges of the Commission’s traditional hostility to tying and bundling by dominant firms. A more economics-based approach, by contrast, would take into account the frequent pro-competitive and pro-consumer benefits of tying, particularly the kind of tying that involves product integration, which is so central to the increasing level of convergence in high-tech and other “new economy” sectors.

V. Refusal to Supply

It is well established that firms generally have the right to decide whom to supply, including whether to supply at all. It is also widely recognized that forcing dominant firms to grant access to their inputs can deter innovation—both by discouraging dominant firms from investing in innovation in the first instance, and by encouraging smaller rivals \textit{not} to innovate and instead to “free ride” on the innovations of others. The Discussion Paper acknowledges both principles\footnote{Ibid., ¶¶ 207 (“Undertakings are generally entitled to determine whom to supply and to decide not to continue to supply certain trading partners. This is also true for dominant companies.”); ¶213 (“The knowledge that they may have a duty to supply against their will might lead companies not to invest in the first place or to invest less. Other companies may be tempted to free ride on the investment made by the dominant company instead of investing themselves.”).} and also accepts that there may be objective reasons or efficiencies that justify refusals to supply.\footnote{Ibid., ¶ 218.}

Nonetheless, the actual analysis set forth in the Discussion Paper seems in many respects to ignore these important principles. The Paper provides only a general framework for analysis, and then peppers this analysis with numerous suggestions that dominant companies could be under an
obligation to supply in a variety of circumstances, none of which is adequately explained. As a result, the Paper provides little guidance to firms trying to assess whether they may exercise their normal right not to supply. In fact, rather than clarifying existing principles, the Paper introduces new uncertainties.

While the Discussion Paper’s analysis applies broadly to all forms of refusal to supply, the discussion that follows focuses on the Commission’s analysis of refusals to license intellectual property rights, including trade secrets. Whether dominant firms should be under an obligation to license intellectual property rights against their will is an area of great importance and substantial controversy. Regrettably this is also an area where the Discussion Paper introduces particular uncertainty and the Commission’s proposed approach diverges most from existing principles that have been established in recent case law,--all with negative implications for the achievement of the Lisbon Agenda goals.

A. Initial Observations

Intellectual property rights are vital to industrial competitiveness. Uncertainty as to when a company may be required to license its intellectual property rights will have a chilling effect on innovation, in particular in dynamic markets where firms invest large sunk costs in research and development and take on high risk—based on the expectation that they will be able to amortize the cost of failed efforts and recoup substantial profits on those risks that actually pay off.

The Discussion Paper’s analysis of refusals to supply provides the Commission with an important opportunity to send a clear message that intellectual property rights do not deserve or receive less protection in Europe than in other parts of the world and that leading firms will be forced to license these rights only in exceptional circumstances. It also provides an opportunity to improve the regulatory environment for dominant companies by increasing legal certainty in this area of law. To these ends, the Commission should set clear limits on dominant firms’ obligations to license, and articulate clearly the circumstances in which refusals to license will not violate Article 82. The Discussion Paper, however, fails to achieve these key goals.

Far from clarifying the issues, the Discussion Paper contains vague language that may actually open the door to increased use of compulsory licensing. This approach departs from limiting principles developed by the ECJ through a line of recent judgments. Moreover, several aspects of the Discussion Paper’s analysis are based on holdings in the Commission’s much-debated Microsoft decision of March 2004. That decision, however, is under appeal, and several of its holdings are at odds with current ECJ case law. Using the quasi-legislative process of the Discussion Paper to lend support to a decision that is under appeal is simply contrary to the principle of good administration. It is also against the principle of legal certainty, as some of the principles developed in the

Discussion Paper will no longer be valid if the Commission’s decision against Microsoft is partially or fully overturned.\(^{58}\)

B. Specific Comments

1. New Product

The Discussion Paper acknowledges the well-established principle that a refusal to license an IPR can be considered abusive only in “exceptional circumstances,”\(^{59}\) but proceeds to place a broad gloss on such circumstances that is at odds with existing case law. In discussing when a refusal to license an IPR may constitute an abuse, the Paper articulates essentially the same test proposed for refusals to supply generally, but then adds the condition that the refusal to supply “prevents the development of the market for which the licence is an indispensable input, to the detriment of consumers.”\(^{60}\) The Discussion Paper elaborates that this condition is only met where the company requesting the licence “does not intend to limit itself essentially to duplicating the goods or services already offered on this market by the owner of the IPR, but intends to produce new goods or services not offered by the owner of the right and for which there is a potential consumer demand.”\(^{61}\) This language is taken almost verbatim from the ECJ’s judgment in *IMS*.\(^{62}\)

Remarkably, the Discussion Paper then proceeds to set forth circumstances in which a refusal to license may be abusive that go well beyond those so carefully articulated by the ECJ. More specifically, the Discussion Paper states that a dominant firm’s refusal to license its IPR may be abusive if the IPR-protected technology “is indispensable as a basis for follow-on innovation by competitors . . . even if the license is not sought to directly incorporate the technology in clearly identifiable new goods and services.”\(^{63}\) This statement is clearly inconsistent with *IMS* and its progeny. It represents a substantial expansion of EU refusal to supply doctrine beyond the limits that the ECJ has carefully articulated in its case law because the circumstances in which an IPR might be “indispensable” to any conceivable form of “follow-on innovation” is likely to be far broader than indispensability to the creation of a new product or service. At a minimum, this new standard will expose dominant companies to massive legal uncertainty when exercising their IPRs and would vest the Commission and national competition authorities with significant new powers to decide on a case-by-case basis whether to compel dominant companies to license their technology.

A far better approach would be to clarify that an IPR holder is not required to create new competition in its own market—even if it has a dominant position—and that compulsory licenses

\(^{58}\) The Commission’s use of the Discussion Paper as a platform to support its decision against Microsoft contrasts with the Commission’s decision to wait for the outcome of the GE/Honeywell case before issuing guidelines on vertical and conglomerate mergers.

\(^{59}\) *Ibid.*, ¶ 239.

\(^{60}\) *Ibid.*, ¶ 239.


\(^{62}\) Case C-418/01, *IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG*, 2004 ECR I-5039 at ¶ 49.

\(^{63}\) Discussion Paper, ¶ 240.
may only be required when the refusal to license prevents the appearance of a new product in a secondary market where the dominant company is not present. If the IP owner is required to license its rights to competitors in a market in which it is already active, this license would represent a serious encroachment on the very essence of its right. While even a license in the case of a secondary market is troublesome as it encroaches on the IP owner’s right to choose not to grant a license at all, it does less violence to his right than a license in the very market where he is already exploiting his right.

2. **Interoperability Information**

The Discussion Paper states that a “special case” arises when a dominant firm refuses to supply information needed for interoperability that allows the firm to leverage its dominance from one market to another. This assertion of “special” circumstances is not supported by reference to any case law, nor are the Commission’s reasons for this novel position explained. Moreover, the Discussion Paper neither defines what constitutes “interoperability information” nor explains the conditions under which a refusal to license such information may be held to be abusive.

The Discussion Paper’s treatment of a refusal to supply interoperability information raises concerns on several levels. First, there is no readily apparent economic, legal, or practical reason why a refusal to supply interoperability information should be analysed differently, or held to different standards, than any other refusal to supply IPRs. A refusal to supply should be deemed abusive only if it illegally forecloses competition, and there is no reason to think that interoperability information poses any unique issues in this regard.

Second, the concept of “interoperability” is open to any number of different and even conflicting interpretations, even in a single market and even with respect to a single product. Some may interpret “interoperability” as being satisfied where two products can exchange basic data, while others might interpret it to include any information that makes a specific product distinct from its competitors. Such an open-ended term is a poor basis on which to impose a duty to disclose—particularly as this information might be highly valuable and innovative.

Finally, the Discussion Paper does not reflect any appreciation of the fact that firms often have legitimate, pro-competitive reasons for refusing to disclose interoperability information. Virtually all technology companies refuse to disclose certain information about their products—including information that others could use for interoperability purposes—in order to prevent cloning of those features or characteristics that make their products distinctive. Such efforts to preserve product differentiation, however, promote competition by expanding consumer choices and leading firms to compete on factors other than simply price. The failure to take this factor into account renders the Discussion Paper’s proposed analysis deeply flawed and risks imposing a duty on dominant firms that will actually deter competition and innovation.

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3. Compulsory Licensing of Trade Secrets

The Discussion Paper states that, where interoperability information “may be considered a trade secret it may not be appropriate to apply to such refusals to supply information the same high standards for intervention as those” that apply to IPRs generally.”65 The Discussion Paper does not explain why it would not be appropriate to treat trade secrets like other forms of IPRs, nor does it give any indication of the standard that the Commission considers is appropriate in these circumstances.

The proposition that trade secrets are entitled to less protection under Article 82 than other forms of IPRs has no foundation in law, economics, or market realities. First, there is no basis in EC law to accord less protection to trade secrets. The ECJ has never suggested that trade secrets should be treated as an inferior form of intellectual property or handled differently for competition purposes than other IPRs.66 Article 287 of the EC Treaty in fact requires Community officials not to disclose confidential information and business secrets.67 Moreover, DG Competition’s own guidelines on technology transfer agreements allow licensors of know-how to impose severe restrictions on their licensees in order to protect their business secrets. The Commission has justified this on the ground that trade secrets cannot be recovered once they are disclosed.68

Second, imposing a broader duty to disclose trade secrets than other forms of IPRs has no economic basis. Trade secret protection, like patent and copyright protection, provides an economic incentive for firms to invest in innovation by giving them a legal basis to prevent others from using or copying the results of their investments. The Discussion Paper’s proposal would weaken incentives for firms to invest in research and development, because they would face a greater risk of not being able to earn a profitable return on such investment. Because much information that is protected by trade secrets actually provides competitive value—by enabling firms to be more efficient, build superior products, and better understand their customers’ needs—the Discussion Paper’s proposal would in all likelihood result in an overall decrease in competition.

Finally, the importance of robust trade secret protection to firms across the economy can hardly be overestimated. For some companies, trade secrets are their most valuable assets, representing millions of euros of R&D expenditure. Trade secrets are key assets of industries that rely on complex manufacturing and business systems, such as the automotive, defence, and pharmaceutical sectors, among many others. Trade secrets are also used to protect ingredient formulas and production processes in the food, beverage, and cosmetic sectors. The consumer electronics, medical device, biotechnology, and information technology sectors also rely heavily on trade secret protection.

65 Ibid., ¶ 241.
66 On the contrary, the courts have held that EC law protects the interests of companies not to have their trade secrets divulged. See Case 53/85, Akzo Chemie v. Commission, 1986 ECR 1965, ¶ 28.
68 Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, at para.112.
In these circumstances, there is all the more reason to apply the same high standard for compulsory licensing of trade secrets as is used for all other forms of IPRs. And, where compulsory licenses are imposed for trade secrets, they must be permitted to include confidentiality provisions, for once a trade secret is publicly divulged, its protection ceases and the competitive value to its owner can never be recovered.

4. Evaluation of Investment Motivations

The Discussion Paper states that a refusal to supply is more likely to be deemed abusive “when it is likely that the investments that have led to the existence of the . . . input would have been made even if the investor had known that it would have a duty to supply.”\(^6\) The Paper notes that this might be the case, for instance, where “the investments behind innovations leading to intellectual property rights may not have been particularly significant.”\(^7\) It also suggests that it will be for the Commission, not the dominant firm, to decide whether the investment would in fact have been made irrespective of the risk of compulsory supply.\(^8\)

This novel standard for determining whether a refusal to license is abusive is problematic on several grounds. First, it has no apparent basis or support in ECJ case law, which expressly holds that a dominant company is under a duty to license its intellectual property rights against its will only in exceptional circumstances. Dominant companies are not required to show the economic motivations underlying their investments in order legitimately to refuse to license their rights.

Second, this standard appears to rest on a flawed understanding of the investment motivations of dominant firms. A firm might invest in an input, even knowing that it will be forced to supply that input to rivals, for any number of reasons, such as the overriding need to improve efficiency, in order to meet customer demand, or to counter competitive threats by rivals. These motivations, however, are precisely the type of motivations that competition law should encourage because they improve consumer welfare. They should hardly be held against the dominant firm and cited later as the basis for compelling supply to competitors. And while it is possible, as the Discussion Paper seems to assume, that a firm’s decision to invest irrespective of the risk of a duty to supply indicates an absence of competitive constraints, it might just as well indicate that the firm faces strong competitive constraints—whether from rivals, customers, or others.

Finally, given the open-ended and inherently \textit{ex post} nature of the proposed inquiry, there is a large risk that competition authorities will assume the role of systematically (and wrongly) second-guessing the investment decisions of dominant firms. This is particularly troubling given that courts and competition authorities do not have the technical resources or competence to address the various issues that would be necessary under the analytic framework described in the Discussion Paper. For example, courts and competition authorities would seem ill-equipped to determine whether an innovation is “particularly significant,” or the effect of a compulsory license on incentives for follow-on investment. The proposal standard would thus introduce a high degree of uncertainty into the

\(^6\) \textit{Discussion Paper}, ¶ 236.

\(^7\) \textit{Ibid.}

\(^8\) \textit{Ibid.}
analysis of refusals to supply, one that would raise substantial risks for leading firms and which is directly at odds with the more narrowly-tailored analysis endorsed by the ECJ.

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European competition law in the area of refusal to supply IPRs is relatively settled, following *IMS Health* and other recent cases. These decisions clearly hold that a duty to license IPRs to rivals arises only in “exceptional circumstances.” The Commission should refrain from attempting to broaden this standard or weaken existing protection for IPRs, as doing so will only deter innovation, increase business uncertainty, and ultimately harm competition and consumer welfare.