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THE REQUIREMENTS FOR A COMMISSION NOTICE ON THE CONCEPT OF ABUSE UNDER ARTICLE 82 EC

CEPS SPECIAL REPORT

BY

JOHN TEMPLE LANG

Abstract

It has been widely felt that the law and economics under Article 82 EC on abuse of dominant positions are unsatisfactory, and that a Commission Notice stating and, where necessary, modifying the legal position is needed. This paper summarises the main points that a Notice needs to explain and gives the reasons why.

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The Requirements for a Commission Notice on the Concept of Abuse under Article 82 EC

CEPS Special Report/December 2008

John Temple Lang[*]

The European Commission is considering adopting a Notice, or at least enforcement guidelines, on the interpretation of Article 82. Certainly, a Notice is needed. The present legal position is both unclear and unsatisfactory. This paper outlines what such a Notice should try to achieve.

This paper uses the now generally accepted classification of abuses into exploitative abuses (taking advantage of dominant positions: Article 82(a)): exclusionary or anticompetitive abuses (reducing or impeding competition: Article 82(b)): discrimination (Article 82 (c)) and reprisal abuses (conduct warning or punishing another company for competing vigorously or complaining to a competition authority). Some questions arise in connection with at least the first three kinds of abuse, but it will be seen that the most important questions concern the second kind. It is the kind that is most frequently found or alleged. So this paper gives more emphasis to the issues concerning exclusionary abuses. The paper begins with these issues, and discusses the main issues concerning other kinds of abuses separately.

The structure of this paper is as follows:

Part I lists the requirements that a satisfactory Notice will need to fulfil.

Part II proposes a legal definition of exclusionary abuse based on Article 82(b).

Part III considers several basic questions about other kinds of abuses.

Part IV analyses pricing abuses, on which the Community law needs to be clarified or corrected.

Part V compares several economic tests of foreclosure or monopolisation, discussed in the USA, with Article 82(b).

Part VI sets out conclusions.

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Part I

Exclusionary abuses

There is a clear substantial divergence between the case law (or at least the language) of the Community Courts, as the Commission has persuaded the Courts to develop it, and an economically rational principle of exclusionary or anti-competitive abuse. There might be good reasons for some such divergence: for example, an economically rational principle might require dominant companies to have an unrealistic amount of information about the market, or might be capable of being applied only with hindsight *ex post*. However, it is now widely accepted that the divergence between case law and sound economics has now gone unnecessarily far, and needs to be corrected. Even the Commission has admitted, in writing and to the Court of Justice, that the law is ripe for reconsideration.

A useful concept or definition of exclusionary abuse should have a number of characteristics:

1. Clear legal principle

The concept of exclusionary abuse should be based on a clear legal principle with an identifiable legal basis. The Community Courts would be rightly reluctant to adopt any new or clarified principle that was based only on an economic theory. Judges are not as confident when choosing between economic theories as they are when applying legal rules. They must be aware that economists do not agree on the definition of exclusionary abuses. The Community Courts, and national courts applying Article 82, will not want to risk basing new judgments on an economic theory that may become outdated or unfashionable a few years later. This means that the starting point (even if it is no more than that) must be a legal one, and not an economic principle, however apparently well established.

2. A comprehensive principle

The concept of exclusionary abuse should apply to all kinds of exclusionary abuses, and not only to some of them. It is probably essential to have a different definition of abuse for the purposes of exclusionary conduct from that dealing with discrimination or exploitative conduct. But it seems impossible to imagine any grounds for having different fundamental principles of foreclosure for different kinds of conduct, all of which are said to have broadly exclusionary effects. Any such different principles would not only be unjustifiable in both legal and economic theory, but would also lead to unacceptably arbitrary distinctions between different kinds of exclusionary behaviour. Each kind of conduct must of course be analysed in its specific economic context, and some tests of abuse are clearly more useful for some kinds of conduct than for others, but analysis must be carried out on the basis of some identifiable principle or definition of exclusion or foreclosure.

To illustrate why any definition of exclusionary abuse must be comprehensive, it is enough to point out *e.g.*, that it does not seem to make sense to prohibit a predatory

price squeeze in circumstances where the integrated dominant company is free to refuse to deal.[1]

3. A definition that can be used with imperfect information

The definition must be capable of being applied and acted on by dominant companies on the basis of the information which is likely to be available to them, before they begin the course of conduct in question. It must also be capable of being applied by national competition authorities, even if they have not got perfect information.

4. The definition must not depend on intention

The definition must not depend on the intentions of the dominant enterprise, because if that is improper it can be concealed, and it is anyway hard to prove. The tests might instead depend on whether there is a rational legitimate explanation for *e.g.*, a price above average variable cost but below average total cost.

5. The definition must be consistent with Article 81

The definition of exclusionary abuse should be consistent with Article 81, but need not necessarily be based on the conditions of Article 81(3) in its application to efficiencies. Clearly the definition ought to allow efficiencies to be taken into account, but one cannot tell when an efficiency defence is needed unless one has a satisfactory definition of exclusionary abuse.

6. Only competitors as efficient as the dominant enterprise

The definition should not require the dominant company, or anyone else using it, to identify competitors that are not at the relevant time as efficient as the dominant enterprise, but which might in future become as efficient. That would need a knowledge of the future which it is impossible to require. It is a regulatory approach which has no place in competition law.[2]

7. The definition of exclusionary abuse must be consistent with the definition of discrimination under Article 82(c)

The definition of exclusionary abuse must be consistent with the definition of illegal discrimination under Article 82(c). This means, for example, that harm to consumers should be an essential element of abuse under both definitions. It also means that the legal position should be made clear in cases where both Articles apply, *e.g.*, where a vertically integrated dominant enterprise discriminates in favour of its own downstream activities.

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[1] 3A Areeda & Hovenkamp, Antitrust Law (2nd ed., 2002) Section 767 c3, at 129-130.

[2] But see Heimler, Below-cost pricing and loyalty-inducing discounts: Are they restrictive and, if so, when? 1 Competition Policy International (No. 2, 2005) 149-172, who says that "*where there is direct and strong evidence of near-term efficiencies*" the assessment of the exclusionary nature of rebates should be made on the basis of the average incremental cost of the dominant firm "*associated with the small but significant increase in the sales of the competitor.*" This does not appear to be a test that a dominant company could use.

8. Must distinguish procompetitive conduct

The definition must, as far as is humanly possible, enable lawyers and economists to distinguish between procompetitive offering of better bargains and legitimate long term strategies, on the one hand, and anti-competitive conduct, on the other. This distinction is not easy to draw, but the attempt must be made. The distinction necessarily involves identifying conduct which harms rivals because it offers better bargains to consumers, which is legitimate and desirable, and conduct which harms rivals without benefit to consumers or promotion of competition, which is exclusionary. Some such distinction is fundamental, and no solution can be satisfactory if it does not draw it.

This requirement must answer the question: how may a dominant enterprise respond to a competitive initiative of a rival?

This means that sooner or later the Commission must abandon its test of whether conduct is "*fidelity inducing*" or not. "*Fidelity*", in the sense of buying only from the dominant enterprise, may be the result of the dominant enterprise offering the lowest prices or the best bargains. The "*fidelity inducing*" test confuses low prices, which give an incentive to buy only from one source, with contracts obliging the buyer to buy only from that source, even when it is not in its interests to do so.

This is probably the most important of all these requirements.

9. No undefined residual category

The definition should state a comprehensive principle, and should not leave outside its scope an undefined residual category of conduct which is illegal because exclusionary. This does not mean that the definition must explicitly describe or list every possible kind of exclusionary abuse. But it does mean that the definition should not leave an undescribed open-ended residual category of behaviour within some vague and still undefined notion of exclusionary abuse.

10. No regulatory requirements

The definition of foreclosure or exclusionary abuse must be based on competition law principles. It should not try to give competition authorities power to adopt decisions based on regulatory policy. To explain the distinction, it is enough to say that competition law gives power to prohibit or prevent illegal conduct which restricts competition, while regulatory policy may give power to alter an existing legal situation to promote more competition. Articles 81-82 are competition law, not regulatory policy. It is not the business of competition law to alter legal situations.

11. Must deal clearly with pricing

The definition must indicate clearly what normal pricing practices are legal and what practices are illegal. On these questions at least there must be clear rules, even if they may be theoretically imperfect in some respects. Dominant companies cannot be expected to consult lawyers and economists every time they specify or negotiate a price for their products or services.

12. Complete exclusion from the market is not needed

Foreclosure of a competitor can be illegal even if it is not entirely shut out of the whole market. It is enough for an abuse if the conduct causes a handicap or difficulty, or forces competitors into niches,[3] provided that this is not caused merely by offering a better bargain or other conduct primarily benefiting consumers.

13. Cumulative abuses

The definition must be comprehensive enough to deal with situations in which the exclusionary effect results from the combination of two or more kinds of conduct, each one of which might, in other circumstances, be lawful. Similarly, the definition must deal with practices such as pricing which apply to several products simultaneously ("financial bundling"), or "leverage" of market power in one market to restrict competition in a second market.

14. Existing case law

The definition should maintain, or be consistent with, as much of the case law as is possible without sacrifice of clarity or soundness. It should therefore explain, at least by implication, the aspects of the case law which need to be regarded either as specific findings of fact or as unusual features of the cases which are unlikely to occur again. And it should be accepted that some aspects of the existing case law are so unsatisfactory that no overall solution can be found without correcting them.

15. Must be capable of being administered

To be satisfactory, any definition must be capable of being administered. That implies at least three practical requirements. First, it must be possible for courts, and not only for competition authorities, to apply the definition and to reach conclusions with reasonable confidence. This means *e.g.*, that the definition must not rely on sophisticated economic theories or predictions about the future. Second, the definition must lead to conclusions about what remedy or penalty would be appropriate. Third, it must deal clearly enough with the commoner kinds of cases, in particular pricing and refusal to supply cases, to prevent national competition authorities adopting widely divergent interpretations.

Short term and long term effects

Any test which involves benefits and harm to consumers and to competition may need to deal with what may be a difference between short term and longer term effects. To take a simple but important example, when a dominant company obtains a patent for a new invention, the short term effect is to deprive its competitors of the possibility of using the invention for their own purposes. However, in the long term, patent legislation is considered by competition law to be procompetitive, because it encourages companies to develop new inventions, and requires them to be disclosed so that they are available to all when the patent expires. This does not imply that exercise of patent or

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[3] See Case T-201/04 *Microsoft v. Commission* [2007] ECR II-___ para. 563, Sept. 17.

other actual property rights can never be abusive. It merely means that the normal use of patent law is legitimate because it is considered to be procompetitive in the long term. If abuse of a dominant position has involved a patent, the right remedy might be a compulsory licence or royalty-free use. If it is argued that patent protection is excessive for some reason, the right remedy is to alter the patent legislation, not to use competition law in individual cases.

Part II

The test of limiting the production, marketing or technical development of competitors, to the prejudice of consumers: Article 82(b)

There is a clear legal basis in Community law for a test using "*limiting*" rivals' possibilities and causing consumer harm. Harm to consumers is mentioned specifically in Article 82(b) which prohibits:

> "*the limitation of production, markets or technical development to the prejudice of consumers*"

It is clear from the long and well established case law of the Community Courts that this prohibits limitation by the dominant enterprise of the production, marketing or technical development <u>of its competitors</u>.[4] So harm to consumers is explicitly required by the clause of Article 82 which most clearly and obviously prohibits foreclosure and exclusionary abuse.

There are strong arguments, based on the need for a consistent interpretation of the whole of Article 82, for saying that harm to consumers should be an essential element in <u>any</u> definition of foreclosure or exclusionary abuse.[5]

Article 81(3) also requires consumers to get a fair share of the benefits of any agreement to which Article 81 applies.

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[4] Joined Cases 40/73 and others, *Sugar Cartel – SZV*, [1975] ECR 1663, paras. 399, 482-83, 523-527 ("*the system complained of was likely to limit markets to the prejudice of consumers within the measure of Article [82](b) because it gave other producers ... no chance or restricted their opportunities of competing with sugar sold by SZV*": para. 526); Case 41/83 *Italy v. Commission* (*British Telecommunications*), [1985] ECR 873; Case 311/84, *Telemarketing CBEM*, [1985] ECR 3261, para. 26; Case 53/87, *CICR v. Renault*, [1988] ECR 6039; Case 238/87, *Volvo v. Veng*, [1988] 6211; Joined Cases C-241/91P, *RTE* and *ITP* ("*Magill*"), [1995] ECR I-743 at para. 54 ("*The applicants' refusal to provide basic information by relying on national copyright provisions thus prevented the appearance of a new product, a comprehensive weekly guide to television programmes, which the applicants did not offer and for which there was a potential consumer demand. Such refusal constitutes an abuse under heading (b) of the second paragraph of Article [82] of the Treaty.*"); Case C-41/90, *Höfner and Elsner*, [1991] ECR I-1979 at 2017-2018 ("*Pursuant to Article [82](b), such an abuse may in particular consist in limiting the provision of a service, to the prejudice of those seeking to avail of it*": para. 30; Case C-55/96, *Job Centre*, [1997] ECR I-7119 at 7149-7150; Case C-258/98 *Carra*, [2000] ECR I-4217; Case T-201/04, *Microsoft*, [2007] ECR I-___ Sept. 17 para. 643-648 ("The circumstance relating to the appearance of a new product, as envisaged in *Magill* and *IMS Health* … cannot be the only parameter which determines whether a refusal to licence an intellectual property right is capable of causing prejudice to consumers within the meaning of Article 82(b) EC. As that provision states, such prejudice may also arise where there is a limitation not only of production or markets, but also of technical development": para. 647). Bellamy & Child, European Community Law of Competition (5th ed., 2001) pp. 754-755; Commission Decision, *P&I Clubs*, OJ No. L-125/12, May 19, 1999, paras. 128-133.

[5] Temple Lang, Anticompetitive abuses under Article 82 involving intellectual property rights, in Ehlermann and Atanasiu (eds.), European Competition Law Annual 2003: What is abuse of a dominant position? (2006) 589-658; Elhauge, Defining Better Monopolization Standards, 56 Stanford Law Review (2003) 253-344 (proposes a test of "*impairing rivals' efficiency*"); Faull & Nikpay, The EC Law of Competition (2nd ed., 2007) p. 351 says that conduct is an abuse if it "*is able to alter the structure of the market, by weakening or eliminating competitors*".

However, as well as harm to consumers, competition law makes it necessary to identify harm to competition if conduct is to be prohibited. Not everything that is bad for consumers could be prohibited under competition law, and some concept of harm to competition is needed to enable companies to decide whether a certain kind of conduct is legal or not. One cannot wait to see the effect on consumers, and decide with the benefit of hindsight whether it was legal. So even an economics-based or effects-based approach must include a definition of exclusionary abuse, foreclosure, or harm to competition. Without an operational concept of exclusionary abuse, one cannot tell whether *e.g.*, a price so low that rivals go out of business is beneficial or harmful to consumers. "*Limiting*" *rivals' possibilities* provides that definition.

Many reasons could be given for saying that it is essential to know whether the Community law on exclusionary abuses is based on Article 82(b) or not. If it is, then in margin squeeze cases there is no abuse unless there is harm to consumers. A margin squeeze rule, with no requirement of consumer harm, would be a regulatory rule which protects downstream competitors.

Similarly, in predatory pricing cases, a rule that does not require (long term) harm to consumers is a rule that protects competitors. Therefore, if Article 82(b) is the correct legal basis in such cases, it is normally necessary to show that recoupment is likely, in order to prove abuse.

Law and economics and the "*limiting*" test[6]

There is a legal basis in Article 82(b) for a definition of foreclosure or exclusionary abuse including a requirement of harm to consumers, and there is a simply stated principle of economics that suggests that conduct which benefits consumers is legitimate even if it harms rivals *e.g.*, by offering better bargains. So far therefore law and economics seem to correspond.

Limiting the production, marketing or technical development of competitors is illegal only if the possibilities open to them would not anyway be limited in the same way or to the same extent for reasons unconnected with the conduct in issue. It is that conduct which must have the limiting effect if it is to be considered illegal, and it is not an abuse if that conduct does nothing to alter the situation that would otherwise exist.

The essence of anticompetitive or exclusionary conduct under Article 82(b) is that it causes a difficulty, an obstacle, or a handicap for competitors that would not otherwise occur. This may be a barrier to entry into the market, or a handicap affecting their activities in the market. It may be an obstacle to production of goods or services, or an

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[6] See O'Donoghue and Padilla, The Law and Economics of Article 82 EC (Hart, 2006) pp. 185-194, 196-202; Salop, Section 2 Paradigms and the flawed profit-sacrifice standard, 2006 Antitrust Law Journal; Temple Lang, Anticompetitive non-pricing abuses under European and national antitrust law, in Hawk (ed.), 2003 Fordham Corporate Law Institute (2004) 235-340; Temple Lang, Abuse under Article 82 EC: Fundamental issues and standard cases, in Baudenbacher (ed.), Neueste Entwicklungen im europäischen und internationalen Kartellrecht, 13. St. Galler Internationales Kartellrechtsforum 2006 (Helbing, 2007) 95-168; Elhauge, Defining better monopolization standards, 56 Stanford Law Review (2003) 253-344; Eilmansberger, How to distinguish good from bad competition under Article 82, 42 Common Market Law Review (2005) 129-177.

obstacle to access to some or all of the buyers, or an obstacle to acquiring appropriate technology. The effect, in each case, is that consumers are deprived of the full benefit of the competitors' participation in the market.

One of the important consequences of recognising that Article 82(b) is the legal basis for prohibiting exclusionary abuses is that, if "*limiting*" the possibilities of competitors is clearly shown, it is not necessary to prove that the competitors have been or will certainly be forced out of the market altogether. "*Limiting*" their production, marketing or technical development is enough. As a matter of policy that seems sufficient: the law should not allow a dominant company to impose a lasting handicap on a competitor.

The limitation of competitors' possibilities test based on Article 82(b), which includes the requirement of harm to consumers, is similar to the tests suggested by various economists, and (not very clearly) by the DG Competition's Discussion Paper of December 2005. There is therefore some economic and official support for it, as well as a legal basis.

The OECD report on "Competition Law and Policy in the EU" (2005) said:

> "*A thorough-going economic approach to dominant firm conduct requires some methodologically clear means of identifying claims about exclusionary conduct that presents threats to sound competition and distinguishing them from demands from competitors for help in keeping prices up*."

As Vickers has said: "*There is no escape from the fundamental question of what is harm to, or distortion of, competition*".[7]

The "*limiting*" test in Article 82(b) and the requirements for a satisfactory definition of exclusionary abuse

The "*limiting*" test based on Article 82(b) seems to meet all the requirements listed above:

1. It provides a clear legal principle ("*limitation*" of the possibilities otherwise open to competitors, causing harm to consumers) with a clear legal basis.
2. It provides a comprehensive principle applicable to all the well-known categories of exclusionary conduct.
3. It can be used with imperfect or incomplete information.
4. It does not depend on the intention of the dominant company.
5. It is consistent with Article 81.
6. It does not require identification of competitors that are not yet as efficient as the dominant enterprise, but might some day became so.
7. It is consistent with the better interpretation of Article 82(c), that harm to consumers is needed if discrimination is to be an abuse.

[7] Vickers, Abuse of Market Power, The Economic Journal 115, F244-261 (2005) at F254.

8. It provides a test for distinguishing, apparently satisfactorily, between pro-competitive and anti-competitive conduct.
9. It leaves no undefined residual category of exclusionary conduct.
10. It does not justify regulatory measures.
11. It allows pricing conduct to be dealt with clearly.
12. It applies to partial foreclosure, as well as complete exclusion from the market.
13. It deals with cumulative abuses, multi-product situations, and “leverage”.
14. It builds on one line of long-established case law, and requires only moderate changes of existing case law on pricing. These changes are in fact the minimum changes that would be needed under any satisfactory reform. (They are discussed below).
15. It would be capable of being administered. It allows dominant companies to compete, but prohibits them from creating obstacles for competitors.

Only the “*limiting*” test under Article 82(b) will persuade the Courts

One of the difficulties which the Commission is now facing is that it needs to persuade the Community Courts that they should bring their case law into line with economic principles. This is necessary in particular in connection with pricing. The Commission will be able to do this only if it can convince the Courts that there is already a sound and well established legal principle which justifies and requires this adjustment. The Courts will not clarify their case law only on the basis of an economic theory, however fashionable, convincing, or widely accepted by economists, whether US or European. As the economists are far from being agreed, it is not likely that the Courts would be willing to adopt any particular economic theory. It is certainly unlikely that the Commission could persuade the Community Courts to alter their case law on the basis of an economic theory. But the Commission could ask the Courts to base themselves on an already existing line of cases, and on the clear words of Article 82(b).

The interpretation of Article 82(b) states a legal principle that justifies and necessitates the necessary adjustments. It seems to be the only interpretation of Article 82 which would enable the Commission to obtain this result. If the Courts are asked to choose between a line of cases based on the words of the Treaty and one or two judgments not based on any clear legal principle, the choice that they are likely to make is clear.

However, even if it is accepted that Article 82(b) provides a satisfactory definition of exclusionary abuses, several problems remain. Several fundamental questions about other kinds of abuse are discussed next.

Part III

Exploitative abuses – what is an "*unfair*" price?

Two reasons are traditionally given for saying that competition authorities should be slow to bring excessive pricing cases. First, it is said that high prices encourage market entry, and so are self-correcting. That is untrue, however, if there are high barriers to entry. Also, the statement is untrue of onerous non-price terms.

Second, it is said that competition authorities should not be "*price regulators*". But in excessive pricing cases the remedy need not be to impose a maximum price. A better remedy is likely to be removal of the barriers to entry, which must exist if the company in question is genuinely dominant, and which are often due to other conduct of the company itself. It is therefore simply incorrect to say that a rule about excessive pricing necessitates price regulation, even in the short term.

In any case, Article 82(a) cannot be disregarded or interpreted away. National competition authorities and courts apply rules on excessive prices. The Court of Justice has made it clear that it can be done.

There are several well-recognised tests of excessive prices:

- Comparison with the price with the dominant company's relevant production costs.
- Comparison with competitors' prices in the same market (making allowances for an "umbrella effect").
- Comparison with the dominant company's prices in similar but competitive markets.
- Comparison with competitors' prices in similar but competitive markets.
- Comparison with the "*economic value*" of the product.

In addition a number of other tests of exploitative abuse can be used in different circumstances.[8]

- If the prices are made possible as a result of exclusionary abuses committed by the same company.
- If the prices themselves are exclusionary, because they keep companies which would have to pay them from entering the market, or handicap those that enter.
- If the profits resulting from the price are very high in relation to the risks involved for the dominant seller.
- If the profits resulting from the price are much higher than the profits of all or most other companies in the chain of distribution or elsewhere in the same industry.

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[8] Temple Lang, Media, Multimedia and European Community Antitrust Law, 1997 Fordham Corporate Law Institute (1998) 377-448 at 422-428.

- If the company protects its own products from competitive constraints due to other companies' intellectual property rights.
- If the company has continuing costs that are clearly unnecessarily high, or let its costs rise without trying to control them, or failed to make obvious cost savings. (So excessive prices do not necessarily lead to excessive profits. It may be necessary to "disallow" unjustified costs in calculating profit margins).
- If the price has been increased substantially over a short period without any increase in costs or in investment needs, or other explanation.
- If the company obliges its customers to pay for products or services which it is not providing, or which they do not need, or charges the same high price to a variety of buyers including a substantial and identifiable sub-set who could easily be offered a lower price for what they really want.
- If the price was imposed or increased without warning, negotiation or consultation, or without any reason being given, or on a "take it or leave it" basis, or on the basis of inappropriate comparisons with other prices.
- If the dominant company took unreasonable advantage of reduced price elasticity of demand, or of weakening in the negotiating position of the other parties.
- If the price is a percentage of the buyer's total revenues rather than an absolute sum (in situations in which a royalty is inappropriate).
- If the prices charged by the dominant company to different categories of buyers are manifestly disproportionate in comparison with one another.
- If the price of a raw material or other input is so high that the price of the end product is uneconomic for a large proportion of potential final consumers or users.
- If the royalty in an intellectual property licence causes the exercise of the licence to be uneconomic (the "economic value" of a licence is zero if an efficient licensee cannot make money under it).
- If the company has acquired its dominance as a result of a commitment to charge reasonable prices or royalties, and such a commitment is required by Article 81(3).
- If the owner of a patent tries to charge a royalty based on the value added by its inclusion in a standard, instead of its previous value in a competitive market.

In practice it is desirable to use as many tests of exploitative abuse as are appropriate in the circumstances. When they all lead to the same conclusion, the result will be well established.

Must exploitative abuses be exclusionary?

The question has recently been raised whether exploitative abuses (by which the dominant company takes advantage of its market power to obtain unfairly high prices or to impose unreasonably onerous terms) can be committed if the conduct does not also involve exclusionary effects.

Exploitative abuses are prohibited by Article 82(a), which bans:

> "*directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions.*"

It says nothing about foreclosure or exclusionary effects. None of the judgments in which unfairly high selling prices or unreasonably onerous terms have been considered have suggested that Article 82(a) could apply only if there were also exclusionary effects. Indeed, the suggestion disregards the history of Article 82, because for some years there was doubt about whether Article 82 applied to purely exclusionary abuses, and these doubts were ended only progressively by judgments of the Court of Justice in *Sugar Cartel – SZV*, *Continental Can*, *Commercial Solvents, United Brands*, and *Hoffman LaRoche*.[9] The first Commission-sponsored study on Article 82 (as it now is), the Memorandum on Concentration in 1965, described abuse as using the possibilities resulting from dominance to obtain benefits which the dominant enterprise could not obtain if it were exposed to effective competition – that is, exploitation of market power.[10] That said, and implied, nothing about exclusionary effects.

In 2003, in the *Atlantic Container Line* judgment,[11] the Court of First Instance said that the responsibility of dominant enterprises "*is not limited solely to conduct likely to reinforce the dominance of the undertaking concerned or reduce the level of competition on the market, since Article [82] of the Treaty concerns not only practices which hinder effective competition but also those which, as in this case, may cause damage to consumers directly*", and cited the *Continental Can* judgment. In other words, abuses can be exploitative, harming consumers directly, even if they are not also exclusionary, hindering competition. Indeed, this is so clear that it is hard to understand why it was questioned.

Similarly, the UK Competition Appeal Tribunal was very clear in *Napp Pharmaceuticals v. Director of Fair Trading*[12]

> "*if ... the Director intended to ... say that the excessive pricing in the Community segment was abusive only because of Napp's exclusionary conduct in the hospital segment, any such view would have been erroneous in law. Nothing in United Brands suggests that the existence of exclusionary conduct is a prerequisite to a finding that prices are excessive contrary to [the UK equivalent of Article 82]*" (emphasis in original).

The UK Office of Fair Trading Guidelines on the interpretation of Article 82 and the corresponding UK law Chapter do not suggest that conduct must be exclusionary if it is to be found illegal,[13] and neither do any other national competition authority guidelines.

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[9] Joined Cases 40/73, *Sugar Cartel-SZV*, [1975] ECR 1663, paras. 399, 482-483, 523-527; Case 6/72, *Continental Can*, [1973] ECR 215; Cases 6 & 7/73, *Commercial Solvents*, [1974] ECR 223; Case 27/76, *United Brands* [1978] ECR 207; Case 85/76, *Hoffmann-LaRoche* [1979] ECR 461.

[10] Gerber, Law and Competition in Twentieth Century Europe (1998) 345, 356-358, 364-368.

[11] Joined Cases T-191/98 and others, [2003] ECR II-3725, para. 1124.

[12] At paragraph 434.

[13] See Assessment of Individual Agreements and Conduct, OFT 414 (1999) paras. 2.1–2.23.

The practical consequences of the view that an unfairly high price could be illegal only if it has exclusionary effects would be very odd. It would mean that an unfairly high price would be lawful if it was charged by a dominant company with no downstream operations, but the same price would be illegal if it was charged to its downstream competitors in such a way as to force them out of the downstream market. In other words, the law would protect competition, but not consumers. Indeed, the theory would make it impossible ever to have a case of excessive pricing of consumer goods, because there would be no exclusionary effects.

It is true, of course, that many exploitative abuses have some exclusionary side effects, if only because they deprive the companies paying excessive prices of funds that they could use for competitive purposes. High prices allow more scope for large rebates, so increasing any anticompetitive effects. Where a dominant company is accused of both exploitative and exclusionary abuses, as United Brands was, it would certainly be wrong to investigate some of the alleged abuses and not others, since they are likely to be related, and perhaps mutually reinforcing. In all cases where more than one kind of abusive conduct is occurring, the different kinds of conduct may make the other kinds possible, or make their effects more serious. So they all need to be considered together.

As a matter of competition policy, as already mentioned, it is often less necessary for competition authorities to attack exploitative abuses than exclusionary abuses, since they may be self-correcting if there are no barriers to entry. But barriers to entry do exist, and it would be irrational to say that consumers should be protected against exploitative prices only if they had exclusionary side-effects. It is also true that in cases of exploitative abuses the best and most effective remedies may be to lower or end the barriers to entry (especially if they result from the conduct of the dominant firm itself). In the case of excessive pricing of a patented product, for example, it might be more effective to order compulsory licensing rather than to indicate the "*right*" price level.[14]

Since there seem to be no legal arguments for the view, might there be an economic argument for saying that exploitative abuses should be prohibited only if they have exclusionary effects? The view seems to have arisen because US antitrust law does not prohibit exploitative abuses (US law deals with exploitative conduct by sector regulation instead), and because of Chicago School arguments that high prices are self-correcting in the long term (provided that there are no barriers to entry). But neither of these arguments leads to the conclusion suggested.

One other reason for the suggestion may be that exploitative abuse cases are thought to be difficult, and officials were looking for excuses to avoid them. However, in practice, competition authorities other than the Commission have been able to deal with excessive pricing cases, and so have national courts[15] (and indeed the Court of Justice). In any individual exploitative abuse case it is usually possible to apply a number of

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[14] In case 238/87, *Volvo v. Veng*, [1988] ECR 6211 both the Court and the Advocate General said that a compulsory licence of an intellectual property right might be the correct remedy in an excessive pricing case; Temple Lang, European Competition Law and Compulsory Licensing of Intellectual Property Rights – A Comprehensive Principle, 4 Europarättslig Tidskrift (2004) 558-588, at 573-576.

[15] *Napp Pharmaceutical Holdings v. Director General of Fair Trading*, Competition Appeal Tribunal 2002. See also *At the Races v. British Horseracing Board* [2007] EWCA Civ. 38.

tests, and if they all lead to the same conclusion, that conclusion is likely to be correct. The facts of specific cases will prompt tests which are useful in those circumstances to show that the price is reasonable or unreasonable, even though that might be difficult to discuss in the abstract. The UK Office of Fair Trading has been able to publish a Notice setting out useful tests for excessive prices.[16]

The conclusion therefore is that there is no basis for saying that exploitative conduct is illegal only if it is exclusionary as well.

This conclusion is reinforced, if any confirmation is necessary, by looking at Article 81. Under that Article no distinction of principle is made between agreements the main effect of which is to raise prices or otherwise harm consumers directly, and agreements the main effect of which is to restrict competition between the parties (or from third parties), so harming consumers indirectly.

Discriminatory abuses – is harm to consumers necessary?

Harm to consumers is mentioned expressly in Article 82(b), and could reasonably be considered necessary or inevitable under Article 82(a) and (d). There are several reasons for considering that harm to consumers must be shown if discrimination is to be considered illegal under Article 82(c):

- A ban on discrimination that did not result in harm to consumers would be positively harmful to the interests of consumers. A non-discrimination rule that discouraged selective price cuts would be thoroughly undesirable and anticompetitive.
- It would be irrational to require harm to consumers under Article 82(b), when the dominant company discriminates in favour of its own downstream operations, but not when it discriminates between non-associated companies. In the latter case a less strict test is appropriate, as the phrase "*competitive disadvantage*" suggests, since different treatment is more likely to be justified.
- If consumer harm was not necessary under Article 82(c), it would be infringed very often. This has never been seriously suggested. Indeed, it seems to have been widely taken for granted that harm to consumers is always necessary under Article 82(c).
- In duty to supply cases, it would be irrational to have lower requirements in the case of second or subsequent contracts under Article 82(c) than in the case of first

[16] Office of Fair Trading, The Chapter II Prohibition, paras. 4.8 to 4.10:

> "*… in general to be excessively high the price must be higher than it would normally be in a competitive market … to be an abuse, prices would have to be persistently excessive without stimulating new entry or innovation … prices would have to allow profits which significantly and persistently exceeded its cost of capital before an abuse could be established.*"

See Office of Fair Trading, Assessment of Individual Agreements and Conduct, Section 2, pages 3-7.

contracts under Article 82(b), when (if intervention is needed at all) the need to protect competition is greater.[17]

- If harm to consumers is necessary, Article 82(c) will deal with most cases in which discrimination is undesirable, the cases in which a dominant company discriminates against a customer because it is buying from a rival, *i.e.*, exclusionary abuses.
- If harm to consumers is necessary under Article 82(c), it makes little difference whether conduct is subject to Article 82(b) or to Article 82(c), and this explains why the Commission and the Courts do not say which clause is being applied. Article 82(c) applies to a subset of the cases that come under Article 82(b).

The question of cumulative abuses

A number of Article 82 cases concern the cumulative or combined anticompetitive or exclusionary effect of several kinds of conduct committed simultaneously, even if each kind of conduct might, by itself and in other circumstances, be lawful. For example, when the dominant enterprise treats other companies differently, the discrimination may be linked to other restrictive or exclusionary conduct, and both the discrimination and the other conduct may be illegal, that is, both Article 82(b) and Article 82(c) may apply.

In cases in which two or more kinds of conduct are linked in such a way that their combined effect is exclusionary, the kinds of conduct may be linked in several ways:

- One kind of conduct may make another possible, or take advantage of another.
- One kind of conduct may reinforce or worsen the abusive effect of the other kind of conduct.

In all such cases, whatever the details:

- The exclusionary or other abusive effects must be assessed in the light of all the circumstances. It is not a defence to say "*in itself, in isolation, this conduct would not be exclusionary*".
- The definition or definitions of exclusionary abuse must be broad enough to apply, when appropriate and necessary, to situations where the unlawful effects are caused by a combination of several kinds of conduct. This means, among other things, that there must be a single comprehensive definition of exclusionary abuse. It would be impossible to deal with cases of more than one kind of conduct if different rules applied to each of them. Cases in which the dominant enterprise has pursued a comprehensive overall exclusionary strategy to foreclose rivals often involve a variety of different devices, and are already complicated enough without unnecessary and artificial legal distinctions.

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[17] Temple Lang, Abuse under Article 82 EC: Fundamental Issues and Standard Cases, in Baudenbacher (ed.), Neueste Entwicklungen im europäischen und internationalen Kartellrecht, 13 St. Galler Internationales Kartellrechtsforum 2006 (2007) 95-168, at pp. 118-125; Geradin & Petit, Price discrimination under EC competition law: Another antitrust doctrine in search of limiting principles? 2 J of Competition Law and Economics (2006) 479-532 (who conclude that Article 82(c) should only be used where a non-vertically integrated firm discriminates between customers – secondary line injury price discrimination).

The first and simplest example of cumulative abuses was in *United Brands*. The company by contract prohibited its distributors from selling unripened bananas. The effect was to prevent arbitrage, and to oblige the distributors to sell ripe bananas only to local retailers. That made it possible for United Brands to discriminate in the prices charged to its distributors. The Court said that both the price discrimination and the prohibition on resale of unripe bananas were abuses.

This is an example of the general principle that it is likely to be illegal for a dominant company by contract to prohibit arbitrage so that it will be able to discriminate in price between different groups of customers. The prohibition on arbitrage is needed to make discrimination possible.

Another example of a situation in which one kind of conduct worsens the effect of another may be useful. In a margin squeeze case, the basic question is whether the gross profit margin between the vertically integrated dominant company's upstream price for the necessary input and the dominant company's downstream price for the end product allows the downstream competitors to make any profit.[18] It is usual to say that the test is whether the dominant company's downstream operations are profitable. This test is appropriate only if their transactions with their upstream operations are on an arm's-length basis, and if the upstream operations do not discriminate in favour of the dominant company's own downstream operations. If those two conditions are fulfilled, and on that basis, the dominant company's downstream operations are profitable, it is normally correct to say that an equally efficient downstream competitor should be able to make money too, and no illegal margin squeeze or exclusionary abuse is being committed.

However, that conclusion clearly does not apply if the dominant company is discriminating, in the terms on which it supplies a necessary input or otherwise, in favour of its own downstream operations. But the conclusion is inapplicable also if the dominant company is committing any other abuse that raises its downstream rivals' costs, deprives them of economies of scale, limits their access to buyers, technology or raw materials, or otherwise makes them less efficient. In such a situation the downstream competitor may <u>not</u> be an equally efficient competitor, but the fact that it is not is <u>due to</u> the other abuse. In such a situation it is essential to take into consideration the combined effect of the dominant company's upstream price for the input (or other discrimination in favour of its downstream operations), its downstream price for the end product, and its other exclusionary conduct, whatever it may be precisely. So for example if the dominant company has exclusive agreements with so many of the buyers of the downstream product that its downstream competitors cannot achieve necessary economies of scale, that result is likely to be illegal. The cumulative effect of all the dominant company's conduct is what matters. It might be illegal even if, in other circumstances, neither the dominant company's prices nor its agreements with its customers would necessarily be unlawful in themselves. The normal test of an unlawful margin squeeze is not applicable.

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[18] See Commission Decision Comp/38.784 *Wanadoo España v. Telefónica*, paras. 278-288; Bouckaert & Verboven, Price squeezes in a regulatory environment (Centre for Economic Policy Research, No. 3824, 2003); Grant, Defining a price squeeze in competition law, in Konkurrensverket, The Pros and Cons of Low Prices (2003 Stockholm), 71-96.

"*Fidelity-inducing*" conduct

As already mentioned, it is unfortunately necessary to comment on a test implied by a phrase used by the Commission to describe what it regards as illegal conduct. The Commission's thinking began with the proposition that a clause obliging a buyer to buy exclusively from the dominant company led to "*fidelity*". But buying only from a dominant company can occur even when there is no contractual obligation, if the dominant company consistently offers the best bargain or the lowest price. Therefore, the fact that a dominant company offers a price that is "*fidelity-inducing*", in the sense that the buyer in question is led to buy only from the dominant company, proves absolutely nothing. The crucial distinction is whether, at any time, the buyer is contractually free to choose between suppliers. The fact, if it is so, that the dominant company has offered an inducement (short of a contractual obligation) to buy from it is legitimate competition. It is not clear whether the phrase "*fidelity-inducing*" is merely the result of confused thinking, or is a relic of some economic theory under which dominant companies must not offer bargains so attractive that their rivals cannot match them, and are likely to leave the market. Whatever the explanation, the phrase is fatally ambiguous. It is dangerously likely to lead, and in fact has led, to regarding as illegal conduct the principal effect of which is to lead buyers voluntarily and acting in their own interests to buy only or primarily from the dominant company. Community competition law will never be on a sound basis until this phrase is eradicated from its vocabulary, since it fatally confuses legitimate and anticompetitive conduct. Competition law must not penalise a dominant firm that increases its own efficiency, even if it uses that efficiency to drive out rivals by offering better bargains.

"An effective competitive structure"

In the *Microsoft* judgment[19] the Court said that Article 82 applies not only to practices that may prejudice consumers directly, but also those which indirectly prejudice them by impairing an effective competitive structure. Therefore there was a breach of Article 82(b). In other words, if the exclusionary effect of conduct is clear and serious enough, that is sufficient in itself to cause harm to consumers under Article 82(b), and there is no need to show some other or more direct harm to consumers.

This is undoubtedly correct. The Court went on, however, to say that Microsoft impaired the effective competitive structure on the market in question "*by acquiring a significant market share on that market*." That phrase is correct if it means that the fact that Microsoft obtained a significant market share is evidence of the exclusionary effect of the conduct that "limited" the possibilities available to its competitors. However the mere fact that Microsoft obtained a large market share would not be enough, in itself, to prove that its conduct was illegal, since a large market share can of course be legitimately obtained.

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[19] Case T-201/04, *Microsoft*, [2007] ECR II-___ Sept. 17, para. 664-665, citing Case 85/76, *Hoffmann LaRoche* [1979] ECR 461, para. 125, and Case T-228/97, *Irish Sugar* [1999] ECR II-2969, para. 112.

This explains the Court's reference[20] to refusal to contract that is illegal because it excludes all competition from the company requesting it. That phrase covers several situations. First, the company requesting access might be the only actual or potential competitor, so the refusal eliminates all competition. Second, the refusal might be evidence that the dominant enterprise would refuse access to all other companies, and so all competition would be eliminated. Third, the refusal might be discriminatory, and directed only against one specific company. In that case, Article 82(c) is the relevant clause, and the Courts should decide whether the company in question is so important for some reason that harm to consumers is caused by the refusal.

Reprisal abuses

A Commission Notice on abuse under Article 82 should make it clear that it is illegal for a dominant company to adopt any kind of conduct that is likely to harm another company, as punishment or warning,[21] against complaining to a competition authority, or competing aggressively. This is a broader and more important principle than the rule that says that a dominant company may not refuse to supply as a means of obtaining an exclusive contract.

The "special responsibility" of dominant companies

The Community Courts have repeatedly said that a dominant company has a "special responsibility". This has sometimes been thought to imply some kind of quasi-regulatory obligations, not apparent from Article 82. However in *Atlantic Container Line*[22] the Court of First Instance said "*that special responsibility means only that a dominant undertaking may be prohibited from conduct which is legitimate where it is carried out by non-dominant undertakings*". The phrase therefore does not show that there is some underlying principle not based on the language of Article 82.

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[20] See Case C-7/97, *Bronner* [1998] I-7791, para. 41; cp Case C-418/01, *IMS Health v. NDC*, [2004] ECR I-5039, para. 47.

[21] Temple Lang, Reprisals and Overreaction by Dominant Companies as an Anti-Competitive Abuse under Article 82(b), [2008] European Competition Law Review 11-15.

[22] Joined Cases T-191/98 and others, [2003] ECR II-3275, para. 1460.

Part IV

The area most in need of reform: Pricing, practices rebates conditional on exclusivity[23]

A dominant enterprise that it not vertically integrated and is selling one product or service at only one market level may price its product in various ways that have been said to be exclusionary. A single price to all buyers, or several price levels available to all buyers for different quantities, give rise to no questions. Questions are said to arise (i) due to the terms on which the rebates are offered, and (ii) when the quantities for which price rebates are given are individualised, either by negotiations or by formulas that lead to individual targets or thresholds for each buyer.

Quantities leading to reduced prices may be described in several ways. The simplest is where the reduced price is given on condition that the buyer buys only from the dominant enterprise during a given period. In this situation the price reduction, in itself, benefits consumers, as all price reductions do. The buyers may choose to benefit from reduced prices rather than buying from a second source. Rivals are less able to sell to the buyers who contract on these terms. However, rivals are free to offer prices at or below the reduced price offered by the dominant enterprise. The problem arises because the buyer loses the benefit of the dominant company's reduced price if it buys even a small quantity from the rival. This increases the economic cost to the buyer of the rival's product, unless the rival reduces its price to compensate the buyer for the loss of the rebate. The amount of the compensatory price reduction will depend on the precise terms of the dominant company's rebate, which governs the cost to the buyer of its purchase from the second source. That cost may or may not be more than the rival is prepared to compensate for. The smaller the quantity bought from the rival, the greater the price reduction per unit that the rival needs to offer. The conditions for the rebate create a handicap for the rival which would not otherwise exist.

Even if the terms of the rebate merely mean that the buyer loses the rebate on the rest of its purchases from the dominant company during the period, the effect is that the dominant company withdraws its reduced price, and the buyer loses its option to buy at that price, for the rest of the period. If the rebate terms mean that the buyer has to pay more for quantities that it has already bought, the rival may need to offer compensation. But it may also have to offer compensation for the loss of the buyer's option to buy from the dominant company at the reduced price (the rival might do this by guaranteeing to sell at the same price during the rest of the period).

It is important to understand that this analysis does <u>not</u> depend on any particular concept of exclusionary abuse. It is simply an analysis of the effect of a relatively simple price condition. It is also important to understand that even if the exclusivity condition is considered to be exclusionary, it may still be necessary to consider its economic effects,

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[23] O'Donoghue and Padilla, The Law and Economics of Article 82 EC (2006) ch. 7; Spector, Loyalty Rebates: An assessment of competition concerns and a proposed structured rule of reason, 1 Competition Policy International (No. 2, 2005) 89-114; Heimler, Below-cost pricing and loyalty-inducing discounts: Are they restrictive and, if so, when? 1 Competition Policy International (No. 2, 2005) 149-172.

and whether there is an efficiency justification for it. The only question considered so far is whether the condition is inherently capable of being exclusionary. For the reasons given, it seems that it is.

However, the existence, as well as the extent, of any exclusionary effect depends on at least one more factor. If one or more rivals can supply all the buyer's requirements for the whole period, the buyer need not buy from the dominant enterprise at all. So one prerequisite for exclusionary effect is that the buyer needs to buy some part of its total requirements from the dominant supplier.

The extent of the exclusionary effects depends on various economic factors, apart from the precise terms of the contracts (size of rebate, length of period). It depends, of course, on how many customers of the dominant company are given rebates conditional on exclusivity. It depends on the extent of economies of scale in production of the product or service in question: if the dominant company is able to obtain greater economies of scale, as a result of the exclusivity condition, than it would otherwise obtain, and is able to prevent its rivals from achieving those economies of scale, it will increase the exclusionary effects. So if enough buyers obtained rebates conditional on exclusivity, the remaining buyers might not represent a demand sufficient to enable the rival producers to achieve comparable or adequate economies of scale. The shape of the economies of scale curve is therefore important, and it is not necessarily the same for all companies.

However, this illustrates the difficulty of adopting too precise or perfectionist an economic analysis. The dominant enterprise does not necessarily know what economies of scale its competitors are able to obtain. It may not know their market shares accurately enough to be able to assess which, if any, of them are obtaining economies of scale comparable to its own: it may not even be certain of their production methods. The question whether the dominant enterprise is acting illegally should not depend on it knowing information that it may not know (and cannot find out without infringing Article 81). The lawfulness of the dominant company's conduct should not depend on whether one or more of its rivals has comparable economies of scale (making its conduct lawful), or whether the rest of the market is so fragmented that none of them has (making its conduct exclusionary). In other words, the dominant company should not be made legally liable for their success or failure.

A similar analysis is appropriate if the condition makes the rebate conditional on the buyers buying more than a specified percentage of their requirements from the dominant company. The conclusion seems to be that a rebate given on condition that the buyer buys exclusively from the dominant enterprise is inherently exclusionary and unless justified is likely to be illegal irrespective of its precise economic effects, since these cannot be reliably foreseen by the dominant company. However, the dominant company must always know what justification there may be, *e.g.* if exclusivity is needed in order to make economic the investment in new capacity that is needed to supply this customer's requirements.

Pricing: individualised rebates for quantity

A rebate which is conditional on the customer buying more than a specified quantity within the relevant period, if the quantity is individually negotiated or is based on individual factors (*e.g.*, the extent of the increase over the same company's purchases in the previous period) raises different issues. The buyer does not pay a cost if it buys from a second source (although it may miss a chance to reach the threshold for the rebate). Competitors therefore have no handicap or obstacle that results from the terms of the rebate: it appears to be simple price competition.

Of course, the quantity in question, however expressed, may be so great that it necessarily represents all or almost all of the buyer's requirements. But the dominant enterprise does not necessarily know whether that is so. The buyer might at any time choose to buy at least a small quantity from a second source, (or might have underestimated its needs), and if it did, the dominant company's production plans would not be affected in any way. The buyer remains free at all times to choose between rivals' offers and the dominant company's reduced price, for the quantity in excess of the threshold. The conclusion is that if the rebate is "*incremental*", that is, if it is given only on the purchases above the threshold, the rebate is always lawful and procompetitive. This conclusion allows buyers to negotiate the best available price for whatever quantity they believe that they will buy, and rivals can offer better prices, without handicap or penalty, at any time if they wish.

This conclusion is particularly convincing in several situations. First, it is obviously appropriate if the downstream market is one in which there is demand flexibility, and the buyers should be encouraged to stimulate demand. In that situation there can be no precise advance estimate of the total quantity that the buyers will sell, and consumer welfare will be increased if as much as possible is sold.

Secondly, the conclusion is particularly clear where the total quantity to be bought in a given period is within the discretion of the buyer, because the products in question are *e.g.*, capital equipment or otherwise have no fixed relationship to the quantities that it is selling. This is a specific example of demand flexibility.

However, it is said that the analysis should be different if the rebate for quantity is "*retroactive*" in the sense that when the quantity is reached, the price is reduced not only for additional quantities, but for the volume already sold below the threshold during the relevant period. It is said that this means that the effective price of the last few units needed to reach the threshold may be unbeatably low, and that this gives the buyer an irresistible incentive to reach the threshold.

This comment, of course, may be true whether the threshold quantity is individually negotiated or not, and whether or not the quantity in question represents 100% of the buyer's purchases. A "*retroactive*" rebate is simply a low price conditional on buying a certain quantity. The fact that the effective price for a few units may be very low is irrelevant, because there is no situation in which rivals would ever be bidding only to supply those units. Rivals are not being placed under any handicap or obstacle, except that which results from an offer of an attractive overall price.

So the conclusion is that quantity rebates, even if individualised and "*retroactive*", are not exclusionary, and should be recognised as lawful, irrespective of their precise economic effects.

If this was accepted, it is probably the most important single improvement that could be made in the interpretation of Article 82. It is also the change that would do most to bring the law into line with commercial practice, and would enable lawyers, for the first time for years, to give economically rational legal advice with confidence.

These conclusions on pricing practices fulfil the requirements listed in Part I. They rest on a clear legal principle (Article 82(b)). They are comprehensive, in the sense that they deal with all widespread pricing practices (margin squeezes and price "*bundling*" applying to several products must be dealt with separately). These conclusions can be applied using imperfect information, and they do not depend on intention (an efficiency justification is not the same as intention). They are consistent with Article 81, and with the concept of discrimination. They benefit only competitors as efficient as the dominant enterprise, and they distinguish clearly between procompetitive and anticompetitive conduct. They do not create an opportunity for regulatory measures, and they do not require complete exclusion of competitors from the market as a precondition for official action. Unlike the present law, they are capable of being administered with confidence.

However, it has to be accepted that they seem to be inconsistent with at least some features of the existing case law. This is not surprising: the features in question are those which have been most widely criticised by economists, by business people, and by lawyers. They are probably the features that the Commission had in mind when it frankly told the Court of First Instance (in the *British Airways* case) that the case law was ripe for reconsideration. What are these features?

Essentially there are only two. The first, found primarily in the two *Michelin* judgments, suggests that incremental rebates given for quantities can be exclusionary. The second, found in the *British Airways* judgment, suggests that retroactive rebates are exclusionary. Can these judgments be explained in a way that is consistent with the conclusions suggested here?

In the two *Michelin* cases, in particular in the second, it is very obvious that the overall aim and effect of the company's policy and a rather complicated series of agreements between Michelin and its tyre distributors was to lead them, in practice, to buy exclusively from Michelin. The quantity rebates did not operate in isolation. Indeed, it seemed that distributors had reason to fear that if they did not buy the quantities envisaged from Michelin, they might lose money over the whole year. On this interpretation, the *Michelin* judgments should not be understood as ruling that a quantity rebate, without more, is exclusionary.

What the *British Airways* judgment said about rebates is harder to explain or to justify. The Court of Justice said that the *Michelin* judgment was based on individual sales objectives (para. 65), and that there are two questions: can rebates make "*market entry very difficult or impossible for competitors*", and can they make it "*more difficult or impossible*" for the distributors "*to choose between various sources of supply*"? (para.

68). Thus, the Court of Justice said, the CFI was right to examine whether the bonus scheme of British Airways had a "*fidelity-building effect*" (para. 77).

It has to be said that these questions are ambiguous, and that they are not capable of distinguishing between procompetitive and exclusionary effects. Low prices "*make market entry very difficult or impossible for competitors*" and have a "*fidelity-building effect*". In other words, the Court of Justice, the CFI and the Commission all asked questions that were ambiguous and inherently incapable of drawing the necessary distinctions. On one issue the Court was clearly wrong. Low prices do not "*make it more difficult or impossible … to choose between different sources of supply*": they only make it less likely that the buyer will buy from the more expensive source.

It therefore seems reasonable, and indeed necessary, for the Commission to accept that it persuaded the two Community Courts to apply a test that was unsatisfactory. If that was accepted, one could simply put the *British Airways* judgment aside as having been based on a mistake by the Commission. However, this solution would make it essential for the Commission to adopt a new test that genuinely and correctly distinguished between procompetitive and exclusionary pricing. But the Commission will have to do this anyway.

The difficulty remains that the Court in *British Airways*[24] said that "*the decisive factor is rather the underlying factors which have guided the previous case-law of the Court of Justice*". Neither the Court nor the Advocate General gave any indication of what these "underlying factors" might be. However, if there are underlying factors other than those found in or derived from the words of Article 82, one thing is clear. Competition is fundamental to EC law and policy. A dominant position, if lawfully acquired, is legal, and a dominant enterprise must therefore be allowed to maintain its dominance by legitimate competition, if it is able to do so. Any other view would deprive consumers of the benefits of competition from dominant enterprises, which by definition are likely to be significant. Therefore "underlying factors" must not lead to any interpretation of Article 82 which would prevent a dominant enterprise from competing legitimately. The essential distinction between procompetitive conduct that increases the efficiency of the dominant enterprise or leads to better bargains, and anticompetitive conduct that handicaps competitors, is not clarified, and cannot be modified, by "underlying factors".

[24] Case C-95/04P, *British Airways* [2007] ECR I-___, March 15, para. 64, and Advocate General's conclusions, para. 41.

Part V

Exclusionary abuses, economic tests of foreclosure, and the prospects for convergence of European and U.S. law

Hawk[25] has commented on the proliferation of proposed tests and approaches suggested by US economists for determining whether conduct is unlawful as abusive or monopolistic under Section 2 of the Sherman Act. He said that:

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[25] Hawk, Conduct Element in Abuse of Dominant Position, in Monti and others (eds.), Economic Law and Justice in Times of Globalisation: Festschrift for Carl Baudenbacher (2007, Nomos, Stämpfli) 393-403. He listed the following papers:

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Symposium - Identifying Exclusionary Conduct Under Section 2, 73 Antitrust L.J. 1 (2006).

James S. Venit, Exceptional Circumstances: The IP/Antitrust Interface after IMS Health, European Competition Law Annual 2005 (forthcoming).

> "*… the breadth and depth of the debate about these proposed tests puts to shame the recent formulation in the debate about Article 82 in the simple/primitive terms of form-based versus effects-based tests or analysis.*"

Barry Hawk's comment is justified. Many of the comments on the Commission's Discussion Paper were superficial and did not deal with basic issues.

In Europe it must be kept in mind that whatever tests are adopted must be capable of being used by a large number of national competition authorities and national courts with different degrees of economic expertise. It is therefore essential to adopt tests that do not necessitate economic sophistication or very complete and accurate market information on the part of all courts or enforcers.

It is <u>not</u> a requirement for a European Commission policy on Article 82 that its concept of exclusionary abuse should correspond to the US concept of monopolisation. That is fortunate, since there is, at present, no agreement in the US on that concept, just as there is no agreement between European economists.[26] The number of US economists' papers proves this. However, it would be unwise for the Commission to ignore, or to refuse to learn from, the valuable current discussion in the USA. Any concept of exclusionary abuse under Article 82 will certainly be analysed and criticised in the light of the US discussion. Of course some convergence between the EC and US rules on exclusionary abuses and monopolisation would be desirable. But it should also be remembered that US antitrust law does not include a concept of exploitative abuse, and that US law on discrimination (under the Robinson Patman Act, not under Section 2 of the Sherman Act) is even more profoundly unsatisfactory (and anticompetitive) than the current uncertainty about exclusionary abuses under Article 82. Americans should not talk as if their antitrust law was satisfactory.

What follows are some comments on the tests that have been suggested in the USA for use with Section 2 of the Sherman Act. It will be seen that one comprehensive test has been suggested, and several tests that are appropriate only to certain types of conduct.

John Vickers, Abuse of Market Power, 115 Econ. J. F. 244 (2005).

Gregory J. Werden, Identifying Exclusionary Conduct Under Section 2: The No-Economic Sense Test, 73 Antitrust L. J. 413 (2006).

Gregory Werden, Identifying Single-Film Exclusionary Conduct: From Vague Concepts to Administrable Rules, in: 2006 Fordham Competition Law Institute (B Hawk ed. 2007).

General Approaches to Defining Abusive Monopolistic Practices – Roundtable, 2006 Fordham Competition Law Institute (B. Hawk ed. 2007). Contributions to this Roundtable are cited below.

See also Allan, Article 82: A Commentary on DG Competition's Discussion Paper, 2 Competition Policy International (2006) 43-83. See also the papers of the OECD Roundtable on competition on the merits (DAF/COMP/WD(2005)).

[26] Elhauge, Defining Better Monopolization Standards, 56 Stanford Law Review (2003) 253-344: *Amicus* brief by Baumol, Ordover, Warren-Boulton and Willig, saying that US courts and legal and economics scholars have not been able to develop "*workable standards*" for deciding when conduct is exclusionary, so there is no universal economic test: Brief of *Amici Curiae* Economics Professors, at 3-4, *Verizon Communications v. Trinko*, 305 F. 3rd 89 (2d. Civ. 2002); Hovenkamp, Exclusion and the Sherman Act, 72 Univ. of Chicago Law Rev. 147, 147-148 (2005) ("*The scope and meaning of exclusionary conduct under the Sherman Act remains poorly defined*").

The "*Impairing Opportunities of Rivals, with Consumer Harm*" test

Under this test, unilateral exclusionary conduct is illegal if it is reasonably capable of creating, enlarging or prolonging monopoly power by impairing the opportunities of rivals, and either does not benefit consumers, or is unnecessary for the benefits provided to consumers, or causes harm disproportionate to the benefits.[27]

This test is very similar to that under Article 82(b). It is a comprehensive test covering all kinds of exclusionary conduct.

In connection with this test, it is said that it must be possible to decide that the conduct is anticompetitive with reasonable confidence, and it must be possible to design a remedy likely to increase competition or a penalty creating the right degree of deterrence. However, these two requirements ought to be equally necessary under any test. They are important, however, because they are more easily applied in the case of some kinds of conduct than with others.[28]

This test has several important advantages:

- It provides a test for cases of conduct restricting innovation. Innovation is so important economically that it is a very great advantage of any suggested test that it deals with restrictions on innovation, as well as price or output restraint.
- It does not make the dominant company into "*a trustee for the scale economies of its rivals*"[29] or involve what is in fact regulated markets.
- It provides a test for protection of the competitive process, which is presumed in the long term to promote efficiency and consumer welfare, without introducing a criterion that would lead to protection of competitors. The competitive process, on this view, is competition without handicaps or impairment due to exclusionary conduct by dominant companies.

The "*Exclusion of Equally Efficient Rivals*" test

Under this test, unilateral exclusionary conduct is illegal (only) if it is likely in the circumstances to exclude from the market an equally or more efficient competitor.[30]

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[27] Areeda & Hovenkamp, Antitrust Law, Vol. 3, (2nd ed. 2002) 651 a. The earlier definition excluded "*competition on the merits*".

Brodley, The economic goals of antitrust: efficiency, consumer welfare and technological progress, 62 New York University Law Review 1020 (1987).

Hovenkamp, Signposts of Anticompetitive Exclusion: Restraints on Innovation and Economies of Scale, in Hawk (ed.), 2006 Fordham Corporate Law Institute (2007) 409-431, 412-413.

[28] Lao, Defining Exclusionary Conduct under Section 2: The Case for Non-Universal Standards, in Hawk (ed.), p. 434, 437-439.

[29] Hovenkamp, *op.cit.*, in Hawk (ed.), 2006 Fordham Corporate Law Institute (2007) at p. 425:

cp. The Commission's Discussion Paper, which would require the dominant company to adjust its price to allow a new entrant to obtain a "*required share*" of the market.

[30] Posner, Antitrust Law (2nd ed., 2001) 194-195; Vickers, Abuse of Market Power, The Economic Journal 115, F244-F261, at F256-258.

This test is clearly appropriate in predatory pricing cases, and it is useful (although harder to apply) in margin squeeze cases. But the test does not ask whether the conduct has a legitimate purpose.

This test also has several weaknesses, and gives rise to several questions:

- If a patent is obtained by fraud and then used to exclude competitors, those excluded are not necessarily more efficient or equally efficient. Making false claims about a rival's product or false patent claims might be exclusionary irrespective of the rival's efficiency.
- The test is very little use in cases of conduct restricting innovation.
- Except in predatory price cases and margin squeeze cases, it is too difficult for an antitrust authority to compare the efficiency of different companies. It is quite impossible for a dominant company to compare its own efficiency with that of a rival, so as to judge whether a given course of conduct would be lawful under this test.
- The test presumes that the entry of a less efficient competitor would not stimulate competition and reduce prices if the dominant company is charging monopoly prices. That may in some circumstances make this an unsatisfactory test, but it seems impossible to modify this test to make it useful to determine when a less efficient competitor will have a welfare-enhancing effect. (The solution, in excessive pricing cases, is to reduce or eliminate barriers to entry).
- This test cannot be applied to many kinds of undoubtedly exclusionary abuses involving non-price or non-market conduct, *e.g.*, false declarations to regulatory authorities, or concealment of essential patents from standards bodies, or refusal to licence patents essential for standards. It would not easily be applied to *e.g.*, acquisition by a dominant company of the only alternative technology.[31]

Other important questions that arise are:

- In many cases, efficiencies such as network effects or economies of scale can be obtained only be denying them *pro tanto* to competitors.
- This test has to deal with the question of whether legitimately acquired economies of scale entitle a dominant company to exclude rivals with lesser economies of scale, and therefore higher unit costs. If the lower prices of the company with greater scale economies were illegal, one result would be to reduce competition and protect competitors. So this test provides no protection for what is imprecisely called the "*competitive structure*" of the market.
- A dominant company may also have economies of scope that are not available to its rivals, who are therefore less efficient, at least in this respect.
- The rationale for the test is inapplicable where the dominant company has competitive advantages due to its previous or present status as a statutory monopoly or a State-owned or privileged enterprise.
- This test would inhibit "*the only competition that dominant firms are likely to face in many instances – competition from less efficient rivals*".[32]

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[31] See Case T-51/89, *Tetra Pak* (*BTG Licence*) [1990] ECR II-309.
[32] Lao, *op. cit.*, p. 446.

Since this test avoids most false positives, if conduct meets this test, it should normally be regarded as illegal. But if it was the only test used, some exclusionary conduct would be permitted.

If conduct does exclude equally efficient rivals, it also limits rivals' possibilities, and infringes Article 82(b). So this test can be regarded as a specific example under Article 82(b).

It seems from the comments of Paulis[33] that in price rebate cases the Commission is likely to want to protect "*the small entrant, the dynamic entrant, who has a cost basis that is not up to the cost basis of the dominant firm but which needs to be taken care of in order to maintain and also … to ensure some growth of dynamic competition*", even when the dominant company's price is above cost. Unfortunately it does not seem possible to do this without using a test of abuse that would have seriously anticompetitive consequences. This comment clearly calls for protection of new "*not yet as efficient*" entrants against legitimate competition. It also implies interference in what should be regarded as a "*safe harbour*", unconditional price reductions above the dominant company's costs. It seems grossly undesirable for a competition authority to order a company that is already selling above cost to raise its prices further. If this is what "*protecting the competitive structure*" means, it is anticompetitive, not procompetitive. It is regulatory, not competition law.

The "*No economic sense*" and "*Profit sacrifice*" tests

Under the "*no economic sense*" test, unilateral exclusionary conduct is illegal (only) if it would make no economic sense for the company but for its tendency to eliminate or lessen competition.[34]

The "*no economic sense*" or "*no rational explanation*" test risks being circular, because it says conduct is illegal if the only explanation for it is that it is intended to foreclose, and this necessitates a definition of foreclosure, which is exactly what we are trying to define. This is important, because a rival can be "*foreclosed*", in the sense of being excluded from the market, if the dominant company legitimately offers better bargains. The suggested test does not deal with the situation in which the dominant company knowingly sells at a price that is barely above its marginal cost ("limit pricing").

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[33] In Hawk (ed.), 2006 Fordham Corporate Law Institute (2007) at 573.

[34] Werden, The "*No Economic Sense*" test for Exclusionary Conduct, 31 J. Corp. L. 293 (2006); Melamed, Exclusive Dealing Agreements and other Exclusionary Conduct – Are there Unifying Principles, 72 Antitrust L.J. 375 (2006); see Lao, Defining Exclusionary Conduct under Section 2: The Case for Non-Universal Standards, in Hawk (ed.), 2006 Fordham Corporate Law Institute (2007) 433-468, 440-446 and Werden, Identifying Single Firm Exclusionary Conduct: From Vague Concepts to Administrable Rules, pp. 509-540; Vickers, Abuse of Market Power, 115 The Economic Journal (2005) F244-F261, at F253-F258; Salop, Exclusionary conduct, effect on consumers, and the flawed profit-sacrifice standard, 73 Antitrust L.J. 311 (2006).

This test arose from, and is certainly useful in, predatory pricing cases. However, both the "*no economic sense*" and the "*profit sacrifice*" versions have several weaknesses:

- Whether short term profits are sacrificed has no logical connection with whether the conduct is undesirable. Failing to maximise profits is not the same as selling at a loss.
- These tests do not deal with conduct that has <u>both</u> anticompetitive effects and other benefits to the dominant company.
- Many kinds of exclusionary conduct cost nothing. Giving false information, or giving no information, to a governmental body or a standard setting organisation or to the market costs no more than providing accurate information.
- Raising rivals' costs, an undoubtedly exclusionary practice, normally involves no sacrifice of profits.
- The test is very little use in cases of conduct restricting innovation, or other conduct increasing the dominant company's market power. Profit sacrificed in one year to buy an asset or develop a patent that may drive rivals out of the market later is "*profit sacrifice*" in the short term, but is clearly procompetitive.
- The test looks only at the intention and incentives of the dominant company and not at the effects of the conduct.
- The "*profit sacrifice*" test would prohibit some conduct that promotes efficiency, such as procompetitive price reductions to launch a new product or enter a new market.
- The "*profit sacrifice*" version of this test is unsatisfactory, because some unquestionably exclusionary conduct involves <u>no</u> profit sacrifice, *e.g.*, margin squeezes, and because some unquestionably procompetitive conduct involves a sacrifice of profit – all price reductions do.
- The "*profit sacrifice*" test can be impossible to apply in a meaningful way: sacrifice compared to what? One would have to try to measure what profits would have been made if there had been no undesirable conduct. Clearly, a rule that made profit maximising legally obligatory, either in the short term or in the longer term, would be unworkable.
- The "*profit sacrifice*" test is also unsatisfactory because it suggests that a dominant company should charge as much as it can, and that if it does not, the remedy should be a mandatory price increase. That is not what competition law is supposed to achieve.

This test also raises problems of timing: when will the dominant company ultimately get its lost profit back for reasons other than having foreclosed competitors?

All efforts to modify or re-state these two tests necessarily require one to distinguish between desirable ways of making profits (which may legitimately exclude rivals) and undesirable ways of making profits (which exclude rivals in undesirable ways).

If this test can be rewritten to avoid false positives, then conduct that meets this test should be regarded as illegal. However, if it was the only test used, some exclusionary conduct would be permitted. Conduct that infringes this test, if it could be precisely expressed, is likely to limit rivals' possibilities also, and so can be regarded as a specific example under Article 82(b).

The "*Raising Rivals' costs*" test

Monopolising the most efficient methods of production or distribution raises rivals' costs.[35] Rivals' costs may also be raised directly by *e.g.*, charging them high prices for a necessary input, or indirectly by discriminating in favour of buyers who do not buy from the rivals.

This test deals with conduct restricting innovation, if it affects rivals' costs. Like the last two tests, any conduct which fulfils the test should be regarded as illegal: it is unlikely to create false positives. But it cannot be sufficient as a comprehensive principle.

This test also encounters serious difficulties if the way in which the conduct raises rivals' costs is by depriving them of economies of scale. This was discussed above, in connection with equally efficient rivals.

So this test has several weaknesses:

- Every sale made by the dominant company instead of a rival will reduce the economies of scale obtained by the rival, and raises the rival's unit costs to that extent. But that is surely legitimate competition.
- If the dominant company produces more than is necessary to achieve its own lowest costs, the excess benefits consumers, but will reduce the economies of scale available to rivals. Such overproduction is not necessarily deliberate, and a company with a new product may not know for some time at what level of production it will reach its lowest production costs.

The same uncertainty can be caused every time the company makes any significant change in its production or distribution systems.

Raising rivals' costs, of course, limits their possibilities, contrary to Article 82(b). Lowering the value of rivals' products, *e.g.*, by depriving them of network effects, is just as exclusionary as raising their costs.

The "*Consumer Welfare Effect*" test

The "*pure*" test of whether the unilateral conduct, on balance, promotes or harms consumer welfare sounds attractive,[36] at least in theory. It is said in the Commission's Discussion Paper to be the best test to apply. The evaluation under this test is said to be "*really about whether consumers are harmed from (sic) higher prices, reduced quality or (in some cases) reduced innovation*".[37] It has been shown, above, that harm to consumers should be regarded as an essential element in all kinds of abuse under Article 82.

However, conduct can hardly be found illegal and exclusionary merely because it lessens consumer welfare. This test needs to be combined with a requirement that indicates what kinds of conduct are inherently likely to cause exclusionary effects. The harm to consumers must also be harm to competition.

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[35] Salop, *op. cit.*, 479-480.

[36] Salop, The controversy over the proper antitrust standard for anticompetitive exclusionary conduct, in Hawk (ed.), 2006 Fordham Corporate Law Institute (2007) 477-508.

[37] Salop, p. 483.

This test would necessitate an analysis of the relative efficiency, in the future, of different courses of action. It would be impossible for a dominant company to act on it with confidence when it began a new kind of production or a new distribution practice. A test that is difficult to apply even with hindsight would give so little predictability that it would be unacceptable.[38] It would also involve a detailed analysis of the facts and forecasts in every case under Article 82, which would make the law impossible to administer. Courts are not well equipped to measure even short term effects on prices, production volumes or product quality.

A pure consumer welfare effects test[39] necessarily involves balancing of future harm and benefit, and would do this without the prior requirement that the conduct must "*impair the opportunities*" of rivals. If a prior requirement is added, the reformulation leads essentially to the "*impairment*" or "*limiting*" tests. But consumer harm is an essential element in any satisfactory definition of exclusionary abuse, because it prevents or should prevent protection of competitors.[40]

A consumer welfare effects test, without an "*impairment*" requirement, would be especially difficult (indeed, often impossible) to apply to innovation cases.

Of course, in exploitative abuse cases there is always harm to consumers. But this does not help to clarify the rules on exclusionary conduct.

The question of innovation

Because innovation is usually unpredictable, it presents special problems for any test that requires the future effects of any given conduct to be assessed. But innovation is vital, because the economic costs if innovation is restricted by exclusionary conduct are likely to be much greater than the economic costs of monopoly pricing.

In cases in which innovation is said to be restrained, neither the "*no economic sense*" test nor the "*equally efficient rival*" test[41] nor the "*consumer welfare*" test are likely to be helpful. What is needed is a test of whether the conduct is inherently likely to restrict future or current innovation by rivals. One must also avoid imposing a remedy that restricts innovation by the dominant company. For cases in which innovation by rivals is impaired, the "*impairment*" and "*limiting*" tests seem to be the most satisfactory.

Although innovation is a large subject, some comments may be useful. It is necessary to distinguish cases involving independent products, complementary products, and inputs.

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[38] This is one of the objections to the approach advocated by the group of economists in their 2005 paper for the Commission.

[39] Lao, *op. cit.*, pp. 448-451; Werden pp. 534-540. As described by Paulis, The Burden of Proof in Article 82 Cases, *op.cit.*, 469-476, 472-474, it would be difficult if not impossible for the dominant company to decide whether a new pricing policy would be considered legal or not. Paulis did not mention, and does not seem to consider, any prior "*impairment*" or "*limiting rivals' possibilities*" requirement.

[40] Vickers, Abuse of Market Power, 115 Economic Journal (2005) F244-F261, at F258-F259.

[41] Hovenkamp, *op. cit.*, at 413.

- Wholly new products are procompetitive, and dominant companies should not be discouraged from introducing them. Equally, they should not be allowed to prevent rivals from producing them.
- Product innovations or improvements by dominant companies in markets where there is no significant effect on complementary products should be legal.[42]
- The situation where the conduct has effects on complementary products is more complicated. If the principal or only effect of the conduct is to handicap rivals, by making their complementary products incompatible with the dominant company's product, that would be illegal (assuming harm to consumers was shown) under the "*impairment*" test and the "*limiting*" of rivals' possibilities test under Article 82(b), (if indeed those tests need to be considered separately).

In this context, the comment of the Court of First Instance in *Microsoft*[43] is important. The Court said that while it may be illegal to prevent the emergence of a new kind of product, it could also be illegal to <u>limit</u> the development of an improved product by rivals. The Court specifically based this on the words of Article 82(b), thereby confirming that it is the principal legal basis for prohibiting exclusionary abuses.

Interference with rivals' possibilities for developing their complementary products can be by deliberately changing the features of the dominant company's product that control interoperability,[44] or merely by refusing to supply the information needed for interoperability.

- Impairing or limiting rivals' possibilities can be by creating new barriers to entry, creating barriers to entry into new markets, or creating handicaps or difficulties that would not otherwise exist in new or existing markets, in each case whether the rivals already exist or may emerge in the future.
- Where the products are not complementary, but the dominant company's product is an essential input in the rival's product, the Community Courts have held that it is illegal for a refusal to supply to prevent the development of a new kind of product for which there is a clear and unsatisfied demand.[45] But it must be a defence if the dominant company is itself about to produce the new product. It cannot be illegal for the dominant company to refuse to supply an input that is merely a competitive advantage, however important. An input is "*essential*" only if without it a rival cannot produce a product at all; it is not essential in the legal sense merely because it is a competitive advantage.[46]

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[42] In the US *Microsoft* case, 253 F. 3d. 34, 64-68 (D.C. (in 2001) the Court distinguished between product design decisions and new product introductions.

[43] Case T-201/04, *Microsoft* [2007] ECR II-___ Sept. 17, para. 647 ; see Temple Lang, European Competition Law and Compulsory Licensing of Intellectual Property Rights – A comprehensive principle, in 2004 Europarättslig Tidskrift 558-588.

[44] *Dell Computer* 121 F.T.C. 616 (1996); *Decca Navigation* OJ No. L-43/27, 1989.

[45] Case C-418/01 *IMS Health v. NDC*, [2004] ECR I-5039.

[46] Temple Lang, The application of the essential facility doctrine to Intellectual Property rights under European competition law, in Lévêque & Shelanski, Antitrust, Patents and Copyright: EU and US Perspectives (Elgar, 2005) 56-84; Temple Lang, European Competition Law and Compulsory Licensing of Intellectual Property Rights – A Comprehensive Principle, 4 Europarättslig Tidskrift (2004) 558-608.

- The distinction to be drawn therefore is that a dominant company need not positively help a rival to innovate, but that if its conduct has created a difficulty for the rival, it may have a duty to eliminate the difficulty.

These conclusions seem reasonable. They can all be based on the "*impairment*" and "*limiting*" tests.

Conclusion

The conclusion seems to be that both under Article 82(a), in the case of exploitative abuses, and under Article 82(b), in the case of exclusionary abuses, multiple tests may be needed. If conduct excludes an equally efficient competitor, makes no economic sense except to restrict competition, or raises rivals' costs (other than merely selling and so reducing their economies of scale), it is likely to be contrary to Article 82(b) and should be illegal under Article 82, if harm to consumers results.

However, conduct that is legal according to those three tests should also be assessed under the "*impairment*" or "*limiting*" test, including in that test, as Article 82(b) necessitates, the requirement of harm to consumers. The "*impairment*" and "*limiting*" tests represent both sound economics and sound law. They would also bring European and US law into line, as far as exclusionary abuses are concerned. No one of these tests would be satisfactory, nor could the competition authorities rely on all of them, without a residual test as well. This multiple-test approach is legally justified because conduct that is unlawful under the first three tests is also illegal under the "*limiting*" test set out in Article 82(b). The multiple-test approach also has the advantage, described by various economists and lawyers,[47] that narrower tests than Article 82(b) can be applied to specific kinds of conduct when that is useful.

Reliance on Article 82(b) and the "*limiting*" test is also necessary because, unless one accepts Article 82(b) as the principal or only legal basis for exclusionary abuses, there is no legal justification that would allow the Commission to choose any of the other tests. The Commission is obliged to interpret Article 82 according to competition law. It is not free to choose tests purely as a matter of economic policy. Too much of the recent discussion of Article 82, including the Commission's own Discussion Paper, has assumed that the Commission was free to choose whatever fashionable economic theory most appealed to it. It is not. Whatever it does, it must have a legal basis.

Relying on Article 82(b) and the "*limiting*" rivals' possibilities principle has another advantage that needs to be stressed. It sets a boundary or limiting principles to the scope of exclusionary abuses. Only conduct that falls under Article 82(b) can be regarded as exclusionary. Neither the Commission nor a national competition authority is free to adopt any new economic theory that would prohibit conduct not within Article 82(b) (unless of course it is exploitative or discriminatory and so within the other clauses of Article 82). Article 82 is not a basis for regulatory approaches or for adoption of economic theories that cannot be based on the text of Article 82. Both the Commission and the Community Courts need to remember this. But provided that conduct is prohibited by Article 82(b), competition authorities and courts are free to develop and apply new economic theories.

This is important because under Article 3 of Regulation 1/2003 national competition law may be stricter than Article 82 in cases of single-firm conduct. Although no definition of abuse can prevent national authorities from making use of this

[47] *E.g.*, in Hawk (ed.), 2006 Fordham Corporate Law Institute (2007) Roundtable discussion.

possibility,[48] it would be undesirable to adopt a definition which gave those applying it scope for detecting "*underlying factors*",[49] other than exclusionary effects, that could be said to be based on Article 82. In fact the useful scope for stricter national laws is very limited, and should probably be confined to joint dominance cases (because Community law is not clear) and to individuals' responsibility for infringements of competition law.[50]

A "*pure*" consumer welfare test cannot be justified under Article 82. Conduct is not illegal merely because the Commission believes that it is undesirable for consumers. Apart from exploitative or discriminatory actions, conduct can be contrary to Article 82 only if it restricts or reduces competition. The "*pure*" consumer welfare test would not only be difficult to apply in practice, it would also be unjustifiable legally. It is a fundamental weakness in the Discussion Paper that it does not make this clear.

Clarification or reform of the US antitrust law under Section 2 of the Sherman Act is beyond the scope of this paper, but it seems reasonable to say that if the "*impairment*" test was used as a general or residual test in US law, in addition to the three narrower tests, this would deal with most of the cases of false negatives that the narrower tests would lead to, and would constitute the multiple approach that many US experts now increasingly prefer.

Since the only two comprehensive definitions of exclusionary conduct, in Europe and the USA, are essentially the same, and both appear satisfactory, they obviously constitute a basis for a very significant degree of convergence.

The European Commission needs urgently to adopt a sound definition of exclusionary abuse. It is absurd to impose large fines for price fixing and at the same time to have an interpretation of Article 82 that discourages price reductions.

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[48] Article 10 EC may however limit the extent to which national competition authorities may adopt measures that substantially limit competition or protect competitors against competition.

[49] See Case C-95/04P, *British Airways* [2007] ECR I-___ March 15, para. 64 and Advocate General Kokott's conclusions, para. 41.

[50] Temple Lang, Anticompetitive non-pricing abuses under European and national antitrust law, Hawk (ed.), 2003 Fordham Corporate Law Institute (2004) 235-340, at pp. 327-335.

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