Comments on the Reform of the Application of Article 82 of the EC Treaty

Prepared by the Commission on Competition

This paper is submitted to the European Commission by the International Chamber of Commerce (ICC). It has been prepared by its Commission on Competition.

This is the first ICC paper on reform of the application of Article 82 EC. It deals with a number of general points. We will in a subsequent paper address some specific forms of abuse of dominant position. We also intend to comment on the draft Guidelines when available.

We begin by reviewing the purpose of Article 82 and its implications for the benchmarks to be used.

We then comment on what we recommend as a modernized approach to dominance, relevant market and abuse.

We end by stating briefly how a modernized application of Article 82 would contribute to the pursuit of the objectives of the Lisbon Agenda.

1. Some general remarks

The purpose of Article 82

The EC Treaty makes clear that its competition rules are designed to establish "a system ensuring that competition in the internal market is not distorted" (Art. 3(1)(g)).

In applying Article 82, this means preventing practices of dominant firms that distort the normal functioning of the market.

"Normal functioning" of the market in the presence of dominant firms can have different meanings. It could mean a market that is efficient in the sense that it leads to optimal allocation of resources, provides to economic agents appropriate incentives to pursue innovation, efficiency and quality, and maximizes consumer welfare.[1] Under this interpretation, the rules on abuse of a dominant position are enforced against conduct of dominant undertakings where it is established that the conduct does not enhance efficiency and harms consumers.

1 M. Monti, "European Competition Policy for the 21st Century", in B. Hawk (ed) 2000 Fordham Corporate Law Institute ch. 15 at 257.

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"Normal functioning" of the market could also mean a market in which economic agents have access to the market and operate on the market without obstacles created by dominant undertakings. Under this interpretation the presence of a number of competitors on the market is of paramount importance and is considered, in and of itself, as necessary in order for the market to function so as to achieve the ultimate purpose of competition rules. Under this interpretation, the rules against abuse of dominant position are seen primarily as protecting competitors in order to protect competition. The drawback of this interpretation is that, by focusing on the presence of competitors, it may end up protecting less efficient competitors and prohibiting conduct of dominant undertakings that furthers Article 82's ultimate purpose of promoting an efficient market. In addition, protecting rivals against competition from the dominant undertaking may reduce their incentive to engage in robust and creative competition that can further efficiency and benefit consumers.

We consequently recommend that, when applying Article 82, the Commission move beyond findings relating to the effects on competitors and assess whether the conduct of a dominant undertaking is likely to have effects that promote or impede efficiency and benefit or harm consumers. As Commissioner Kroes has noted, "it is competition, and not competitors, that is to be protected"[2]. We elaborate this recommendation in the following sections.

The ultimate test

The Commission decisional practice and the case law of the EC courts have not provided clear guidance as to which interpretation is correct. Various concepts have been used as benchmarks for assessing whether the conduct .of a dominant undertaking is abuse, including "normal competition"[3], "competition on the merits"[4]; "genuine undistorted competition"[5]. These vague concepts need to be clarified and elaborated so as to reflect the purpose of the rules against abuse of dominance. In its Guidelines on the Application of Article 81 (3), the Commission has done so with respect to the concept of "restriction of competition" and has put forward consumer welfare as the ultimate test.

We are of the view that harm to consumers, which is expressly referred to in Article 82 (b), is the ultimate test of abuse of dominance[6], just as it is for Article 81. In *Continental Can*[7] the ECJ made clear that the purpose of Article 81 and 82 should be consistent. If harm to consumers is the ultimate test for "restriction of competition" under Article 81, it should be so as well under Article 82.

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2 N. Kroes, *Preliminary Thoughts on Policy Review of Article 82*, Speech at Fordham Corporate Law Institute (23 September 2005).

3 E.g. *Hoffman-Laroche*, [1979] ECR 461, para 91.

4 E.g. *AKZO*, OJ L 1985, L 375/1 para 81.

5 E.g. *Atlantic Container Lines*, judgment of the CFI of 30 September 2003 n.y.r., para. 1460

6 See also Jacobs AG in *Bronner*: "…the primary purpose of Article [82] is to prevent distortion of competition – and in particular to safeguard the interests of consumers." [1998] ECR I–7791 at. 7811

7 *Continental Can*, [1973] ECR 215, para. 25

It is our understanding that the Commission may wish to maintain the distinction made by the EC courts between practices directly damaging consumers ("exploitative abuse") and practices that do so less directly by restricting competition by efficient undertakings ("exclusionary abuse")[8].

In that event, Article 82 should be cautiously applied to conduct coming within the first category and only be applied to condemn a practice where it is established that the practice is likely to have a direct material adverse effect on consumer welfare in the form of higher prices or less output, so as to not stifle innovation and investment.

As to conduct coming within the second category, there is clearly a need for principles that distinguish legitimate competition by a dominant undertaking from exclusionary abuse. In making this important distinction, the Commission should not adopt a single test - such as the "profit sacrifice" test, and, for pricing behaviour, the "equally-efficient competitor" test or the "limiting production" test – for all forms of potentially exclusionary conduct because there is no consensus that any such test is applicable in all circumstances. The Commission should instead elaborate principles, such as commitment to promote efficiency and consumer welfare, and apply those principles to individual cases on the basis of a careful assessment of the particular facts[9]. These principles should be set out in guidelines, so that they can be taken into account ex-ante by undertakings when they decide on a given course of conduct.

Legal Certainty

As is clear from the above, we advocate that the Commission should move away from a legalistic "form-based" approach to a more economics-based approach in the application of Article 82. Such a move would be in conformity with recent developments in the other areas of EC competition law.

A more economics-based application of Article 82 would focus on increase in consumer welfare. It should not lead at the same time to reducing legal certainty as long as undertakings are in a position to assess whether their conduct has a legitimate efficiency-enhancing business justification. Much of the current uncertainty about the boundaries between permissible and prohibited business practices results from a form-based approach to certain pricing practices and the difficulty inherent in such an approach in determining whether new kinds of economic activity should be regarded as being of one type of form or another. Form-based approaches lack consistent and rigorous analysis of the concrete effects of a given practice and often have the effect of condemning profit-maximizing conduct that benefits consumers. The uncertainty that results from the condemnation of conduct that may not have any significant impact on competition or that may benefit consumers creates added risks for business, which itself reduces efficiency, and deters undertakings from applying business practices (e.g. certain pricing schemes) which in fact increase competition and are beneficial for consumers. The deterrence of desirable conduct is enhanced because of the lack of an official procedure for undertakings to

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8 *Ibid.* para. 26

9 See e.g., *Report by the Economic Advisory Group on Competition Policy ("EAGCP")* (July 2005) (advocating on "economics-based approach" to Article 82 "based on the assessment of anti-competitive effects of business behaviour").

make sure that a certain business practice is in conformity with the competition rules, the lack of coherent and clear case law and the level of fines inflicted for abuses of a dominant position.

We suggest that the Commission issue economics-based guidelines, which would guarantee an adequate level of legal certainty by making it clear that single undertaking conduct that enhances efficiency and benefits consumers is not an abuse, whatever its form and the degree of market power of the undertaking concerned. Such guidelines are all the more necessary to avoid inconsistencies, now that increased enforcement by NCAs and national courts is to be expected.

Such guidelines would also be to the benefit of competition authorities and courts by lowering enforcement costs.

2. Dominance

The current review of Article 82 is focused on the various types of abuse and the need to give clarity and guidelines in relation to conduct by dominant undertakings and the test to assess whether business practices may or may not be held to be abusive.

So far the Commission has not published any notice that gives guidance on the assessment of dominance or market power. There are documents where the Commission has given some indication on its thinking on dominance in other contexts:

- The Guidelines on Market Analysis and the Calculation of Significant Market Power in Electronic Communications;[10]
- References to the competitive assessment of mergers (which include the creation or strengthening of a dominant position) in the Guidelines on the Assessment of Horizontal Mergers [11]; and
- The Guidelines on the Application of Article 81 to Technology Transfer Agreements[12] provide some indication of the factors to take into account in assessing the market power of the parties to a technology transfer agreement that falls outside the thresholds of the Technology Transfer Block Exemption.

While the above documents, together with Commission decisions and the EC courts' case-law on dominance,[13] provide some insight into the Commission's thinking, the lack of a comprehensive framework for assessing dominance undermines legal predictability and business certainty. Therefore, specific guidance by the Commission on the assessment of dominance under Article 82 would also be welcomed in the context of the current review, since a finding of dominance is a basic element of the scrutiny of any business conduct under Article 82.

10 OJ 2002 C 465/6.

11 OJ 2002 C 31/5.

12 OJ 2004 C101/2

13 The ECJ has defined dominance as "a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately consumers". (*United Brands v European Commission*, [1978] ECR 207, para. 65)

By contrast, the OFT in the UK has published Guidelines on the Assessment of Market Power which explain how the OFT will assess whether undertakings have market power when investigating cases both under Articles 81 and 82 and under the respective UK law provisions (Chapter 1 and Chapter 2 of the Competition Act 1998). In particular, the OFT explains that a company is not dominant unless it has substantial market power and acknowledges that market power is not an absolute term but a matter of degree, and that the degree of market power will depend on the circumstances of each case, including whether and to what extent the company concerned faces competitive constraints from existing or potential competitors, and other factors (such as strong buyer power). This is consistent with the position of Commissioner Kroes, who has noted that "market shares are not – on their own – sufficient to conclude a dominant position exists" and that to show dominance, "a full economic analysis of the overall situation is necessary".

We believe that this approach is the correct and appropriate starting point for the assessment of dominance and we encourage the Commission to put in place a framework providing predictability as to the tools that will be used in assessing, in the specific circumstances of each case, whether an undertaking may be in a dominant position under Article 82.

In this context, the Commission should distinguish between the following scenarios:

- Cases where an undertaking is below the dominance threshold and, therefore, its conduct cannot be found to be abusive under Article 82;
- Cases where an undertaking may be held to be dominant; and
- Complex areas in fast-moving markets where caution is warranted in findings of dominance and the application of Article 82.

Cases where an undertaking is below the dominance threshold

The objective of Article 82 to promote efficiency will be furthered if undertakings have a clear understanding of when they will not be regarded as dominant. The Commission should thus develop some screening mechanisms to determine "safe harbors", e.g. undertakings with a low market share may presumptively be able to engage in certain unilateral conduct. Similarly there may be situations where an undertaking has large market shares for only a brief period of time, before the emergence of a new product or new competition, and therefore cannot be held to have any market power. Such mechanisms will reduce uncertainty and allow undertakings in "safe harbors" to engage in robust and creative competition for the benefit of consumers. In formulating its "safe harbors", the Commission should give special attention to the pronouncement of the ECJ in *Hoffman-Laroche*[14] that the fact that an undertaking is compelled by competitive pressure to lower its own prices is inconsistent with the independence vis-à-vis consumers and competitors that is the hallmark of dominance.

14 *Hoffman-Laroche*, supra n. 3.

Cases where an undertaking may be held to be dominant

It is now widely acknowledged that: (a) market shares are only the starting point that give a first indication of the market structure and of the competitive position of an undertaking; (b) market shares alone are not conclusive in determining whether an undertaking has market power; and (c) there is no specific market share threshold that reliably establishes that an undertaking has market power. In fact, what is of particular significance in assessing dominance is the exercise of market power over time, i.e. the ability to profitably raise prices above competitive levels.

The Commission is increasingly relying on economic analysis and empirical work in its investigations. That trend is taking place in the assessment of mergers and vertical agreements and Commissioner Kroes has indicated in recent statements that the Commission intends to use similar economic analysis in investigating potential abuses of dominant position under Article 82.

We support this commitment and recommend that the Commission give clear guidance about the economic framework, tools and evidence that it will use to assess the competitive constraints on undertakings (such as the structure of the market, existing and potential competitors, entry analysis and countervailing buyer power).

Complex areas in fast-moving markets

There has been some debate recently about the need to enforce competition law with caution and flexibility in fast-moving markets where the key features of certain industries (particularly high-tech and "new economy" industries, such as computer software and hardware, internet, mobile telephony and biotechnology) make it challenging to apply traditional competition law concepts and tools to analyse competitive issues[15]. Such industries are often characterised by huge investments in R&D and IPRs, network effects, high fixed sunk costs and low marginal costs. Competition in these markets is *dynamic* in the Schumpeterian sense that competition often takes place *for* the market in a "winner takes all" race. Undertakings may have high market shares, but are constantly subject to threat from innovative competitors and potential entrants. Some scholars and economists argue that the mechanical application of static models does not give true reflection of market power when applied to high-tech/new economy industries.

Therefore, the Commission should also give guidance on how it intends to assess dominance/market power in such fast-changing and complex markets.

15 See for example, Robert C. Lind and Paul Muysert, "Innovation and Competition Policy: Challenges for the New Millennium", [2003] ECLR 87; Christian Ahlborn, David Evand and Jorge Padilla, " Competition Policy in the New Economy: Is European Competition Law up to the challenge?" in LECG Global Competition Policy, Economic Issues and Impacts 2004.

Collective dominance

The Commission has taken the view that Article 82 also applies where two or more undertakings together hold a dominant position. The EC courts have endorsed this view and have set out conditions to be fulfilled in the cases that were brought before them. In the interest of legal certainty, some guidelines should be issued summarizing the case law. They should clarify that collective dominance does not apply to uncoordinated single undertaking conduct and that such conduct must be assessed based on the market power (or absence thereof) of the individual undertaking.

3. Relevant Market Definition

The purpose of market definition

In order to establish whether an undertaking already possesses *market* power (or is likely to achieve such a position in the future), it is necessary to define the relevant market in which the undertaking is alleged to have such power. If the definition of market power is the ability of an undertaking *"to behave independently of its competitors and customers",* it is clearly necessary to identify the competitors.

The purpose of the Commission's Market Definition Notice[16] was to create a common framework for identifying and defining the boundaries of competition between undertakings (the hypothetical monopolist test) that could be applied to all competition analyses: mergers, Article 81 situations, Article 82 investigations and state aid enquiries[17]

Differences between mergers, agreements and abuse of dominance

Important differences exist, however, in respect of the role that market definition plays in the different analytic frameworks:

- In the Article 81 arena, a precise market definition used to be relevant largely for non-full function joint ventures and vertical relationships. In the latter case, even that application disappeared once the *de minimis* and the block exemption market share thresholds were exceeded. A more economics-based approach to Article 81 in the post-modernisation world may re-focus the attention to an analysis of actual effects on the market which in turn will demand a more rigorous approach to market delineation[18].
- In respect of mergers the tide flowed in the other direction. The importance of a precise market delineation has somewhat declined, given the change of the substantive test from dominance to SIEC. In the new world of the SIEC test, the Commission will often directly look at the likely consequences of the merger on post-merger prices, without a detailed definition of the relevant market.

16 Commission Notice on the definition of relevant market for the purposes of Community competition law (OJ 1997 C372/5).

17 Paras 1 and 2 of the Market Definition Notice.

18 As was recalled by the CFI in *European Night Services* [1998] ECR II-3141 at paras 135 and 136, the assessment of whether an agreement has restrictive effects requires that account be taken of the actual conditions in which the agreement functions, in particular the economic context in which the undertakings operate, the products or services covered by the agreement and the actual structure of the market concerned.

- For Article 82 cases, market definition remains a crucial part of the Commission's analysis since the Commission will have to establish that the undertaking holds a dominant position in order to consider whether an abuse has taken place. However, unlike merger cases, where the analysis is prospective (i.e. will prices rise?) an Article 82 review will be historic (i.e. does a particular undertaking already hold market power?).

Avoid artificially narrow markets

It is now well understood that the inability to raise prices without facing significant substitution does not necessarily demonstrate wider markets (or significant competition) but could mean that the current price is already set at a supra-competitive level (the cellophane fallacy).[19]

The danger of the cellophane fallacy is that the relevant market in an Article 82 case *may* be narrower than in a merger situation, but only in very limited circumstances and not in *all* Article 82 cases.

A more economics-based approach to Article 82 therefore not only means avoiding the cellophane fallacy, but also, importantly, avoiding artificially narrow market definitions. There are a number of cases in which the Commission adopted a very narrow market definition, unconnected with the cellophane fallacy and contrary to the principles set out in the Market Definition Notice. The reason seems to lie mainly in the Commission's focus on demand-side considerations to the near exclusion of supply-side factors.

These examples can be grouped into two categories: (i) a too narrow focus on a particular customer segment and product characteristics; and (ii) a too rigid view of markets involving consumables (after-markets):

- *Too narrow focus on particular customers*

In *United Brands/Chiquita*[20] an important contributing factor in the Commission's market analysis was that bananas were a very important part of the diet of only one customer segment (i.e. the "young, sick and the very old")[21] and this seems to have been accepted by the Court: *"The banana has certain characteristics, appearance, taste, softness, seedlessness, easy handling, a constant level of production which enable it to satisfy the constant needs of an important section of the population consisting of the very young, the old and the sick"*[22]

19 The name is derived from the US Supreme Court case *United States v. DuPont* 351 US 377, (1956). There the court held that cellophane was part of a wider market including other flexible wrapping materials without realising that the price of cellophane was already at such a level that consumers were prepared to switch to other products which would not have been regarded as substitutes had the price been at competitive levels. For a detailed discussion of the cellophane fallacy see Bishop and Walker, The Economics of Competition Law (2nd ed) para 4.34 – 4.46 and the OFT's Discussion Paper 2, The role of market definition in monopoly and dominance enquiries (July 2001), paras 2.25 et seq.

20 Case IV/26.699 – *Chiquita* OJ 1976, L95/1

21 *Ibid.* para II.A.2.

22 *United Brands v. Commission* [1978] ECR 207 at para 31.

This conclusion seems to have been reached without sufficiently robust empirical evidence. Moreover, neither the Commission nor the Court considered whether the remaining customers (for whom switching to other fruit was viable and who could not be charged different prices) constituted a sufficiently large group constraining any price rises.

Similarly, in *Hilti*[23] the Commission decided that powder-actuated fastening systems (nail guns) form a distinct market from other fastening systems (such as welding, self tap screws or rivets, bolts and nuts). This was based purely on the fact that product characteristics differed and that there may not be full demand-side substitution.[24]

The Commission did not consider whether the pricing of one product constrains the pricing of the other products. On appeal, the Court of First Instance similarly failed to consider whether the number of marginal customers who could switch and who could not be charged different prices was sufficiently large to act as a constraint.[25]

- ***After markets (primary products and consumables)***

If the approach in Article 82 cases evolves away from *per se* prohibitions towards a more economics based approach, the relevance of market share and hence market definition may well decline, as the Commission focuses directly on the competitive harm. However, doing so without a robustly defined market removes a significant methodological safeguard against findings of dominance by instinct.

In the context of complementary products, concentrating on demand-side substitutability will lead to the definition of separate markets for the main product and for the spare parts or consumables for that product, since the main product and its spare parts or consumables will not be interchangeable, be it at the level of supply or demand.

The main product and the spare parts or consumables have been held to form separate relevant markets in cases like *Hugin*[26], *Hilti*[27] and *Tetra Pak*[28]. In these cases the Commission, upheld by the Court, defined the market for consumables or spare parts by reference to the primary product (e.g. "Hilti-compatible"). In such cases, the manufacturer was found to hold a dominant

23 Cases IV/30.787 and 31.488 – *Eurofix-Bauco v. Hilti*, OJ 1988 L 065/19

24 Ibid. para 61: examples are different technical possibilities of the various systems; the fact that certain characteristics differ radically and the fact that local building regulations prohibit the use of nailguns for certain applications.

25 *Hilti v. Commission*, [1991] ECR II 1439 at para 73.

26 *Hugin Kassaregister AB and Hugin Cash Registers Ltd v. Commission*, [1979] ECR 995, paras 5 to 7: the Court examined the "category of clients who require [spare] parts" and concluded that since there was a specific demand for Hugin's spare parts, those parts were not interchangeable with spare parts for cash registers of other makes.

27 Ibid, para. 69 and *Hilti AG v. Commission*, [1994] ECR I-667, para. 13. The courts first narrowly defined the market for the main product, in which Hilti was found to be dominant. The market for consumables (ie nails compatible with Hilti equipment) was defined as a separate market from the market for the equipment for which they were intended, in which Hilti was also found to be dominant, although there were other players in the market.

28 *Tetra Pak International SA v. Commission*, [1994] ECR II-755, para. 79 to 85 where the Court dismissed the argument based on a commercial link between the machines for packaging liquid foods and the packaging itself.

position on the market for these spare parts or consumables[29], although it may not have been dominant in the market for the main product.

In the context of complementary products, substitutability should be explored through the analysis of the effects of an increase in price of either the main product or the spare parts or consumables. An explicit analysis of the impact of a hypothetical price increase has not always been carried out, particularly in the cases mentioned above (albeit that an econometric study was presented in the *Hilti* case).

This type of analysis could show, for example, that in the case of a price increase of the main product A, consumers switch to competing products B and C and to their consumables or spare parts, since the purchase of a competing main product without its spare parts or consumables would be of no value to the customer. Similarly, in the case of an increase in the price of the consumables or spare parts, consumers switch again from product A to product B and C and their consumables or spare parts. In such a hypothesis, the conclusion to be drawn is that both the main products B and C and the consumables or spare parts, ie the whole system, lie in the same relevant market as the main product A and its consumables or spare parts.

More recent Commission decisions: no change in market definition

There has been an evolution in the Commission's analysis in recent decisions. In 1995, it announced that several factors had to be taken into account in order to assess dominance with respect to spare parts or consumables: price, life-time of the main product, transparency of prices of spare parts or consumables, prices of spare parts or consumables as a proportion of the main product value and information costs.

Although it examined two separate markets, taking these elements into consideration led the Commission in the *Pelican/Kyocera* case[30] to conclude that there was no dominance on the market for consumables. Particular features of both the market for consumables and the market for the primary product, such as the price of the consumables as a high proportion of the main product value, which was taken into account by customers from the outset, meant that consumers would switch to another main product if the price of consumables for the first main product increased. The Commission concluded that there was no evidence of possibilities for price discrimination between "old" or captive customers and new customers.

A similar more economics-driven analysis was carried out in the *Info-Lab/Ricoh* case in 1999[31], where the Commission held that the market for the main product and the market for consumables were interrelated in such a way that competition in the main product market also constituted an effective competitive constraint in the consumables market. Ricoh was not

29 This would also be the case where the spare parts or consumables are protected by patents or other intellectual property rights, for example in the case of the Hilti cartridge strips (compatible with the Hilti tools) for which Hilti held patents.

30 XXVth Report on Competition Policy, para. 86 and 87, p. 41 and 42. This decision concerned the manufacturer of computer printers and toner cartridges for those printers.

31 XXIXth Competition Report, p.169-170. This decision concerned toner cartridges and photocopiers. The complainant alleged that there was a market for empty toner cartridges compatible with Ricoh photocopiers, an argument that was dismissed by the Commission since powder and cartridge had to be considered as a single product.

dominant on the main product market and was not held to be dominant on the separate market for consumables.

The Commission therefore appears to have reconciled (i) the definition of two separate markets for the main product and the consumables with (ii) the conclusion that the manufacturer of a main non-dominant product may not be dominant on the market for consumables for the main product, by analysing the links in terms of competitive constraints between these markets.

Suggested improvements

This approach remains debatable in that the Commission still typically considers the main product and the spare parts or consumables to constitute two separate markets. The analysis of the competitive links between both markets, in particular with regard to switching costs, should, however, in appropriate cases, lead the Commission to conclude that the main product and its consumables or spare parts constitute a system which is in competition with other similar systems, where consumers would switch to another main product and its consumables or spare parts, if the price of the consumables or spare parts of the first main product were to increase by a small but significant amount.

Although its more recent analysis has led the Commission to conclude that the manufacturer may not be dominant on the market for consumables or spare parts, it could also reach (as it has done in the past) the opposite conclusion, even if the manufacturer is not dominant on the market for the main product. In such cases, manufacturers would have to apply different commercial policies to two complementary products, causing genuine difficulties from a business point of view.

It is therefore recommended that the Commission examine the competitive links between products and systems at the stage of market definition. The Commission would thus recognise, in line with economic analysis, that main products and their spare parts or consumables should, in appropriate cases, be considered as systems which, together with the other systems against which they are in competition, constitute a single relevant product market.

4. Abuse

On "abuse" we have three general comments that we hope the Commission will take into account in preparing its forthcoming guidelines. These are (1) forms of conduct not listed in Article 82, (2) the "legalistic" approach and (3) the treatment of "efficiencies".

Forms of conduct not listed in Article 82

It is established that the catalogue of the forms of abuse listed in Article 82 is an open one. However, in order to qualify conduct other than the forms listed in Article 82 as abuse, courts and regulators cannot limit themselves to finding that such conduct is capable of having or likely to have the effect of restricting competition. Even if one should deduce from the fact that by expressly listing certain forms of conduct as abuse the Treaty has introduced a presumption of abuse, courts and regulators can only treat forms of conduct other than those listed in Article 82

as abuse where, on the basis of a precise examination and convincing evidence, they find that the conduct has effects that run counter to the purpose of Article 82.

In identifying the constituent elements of the abuse, the Commission should make it clear that, while harm to competitors is necessary for conduct to be an abuse, it is not sufficient. After all, inventing better products or more efficient methods of distribution, reducing price or offering better terms of trade for the benefit of consumers, and more quickly adapting to changes in the market can disadvantage rivals and maybe even cause them to abandon business. Yet these forms of conduct enhance efficiency and consumer welfare, and should thus not be prohibited by Article 82. The Commission should articulate standards that make clear that conduct by a dominant firm would be deemed to be an abuse only if it does not promote efficiency or consumer welfare.

The Commission might be tempted to argue that even conduct that increases efficiency can be an abuse if it excludes competitors on the ground that, in the long run, the loss of competitors will reduce competition and, ultimately, consumer welfare. However, such an approach would require the Commission to establish that the long run harm from the reduction in competition exceeds the short run increases in consumer welfare and the long run improvement in efficiency attributable to the dominant undertaking's conduct. The Commission should be very reluctant to treat conduct as an abuse on the basis of such a tradeoff. Projecting and estimating the magnitude of long run harm to competition is almost always very difficult and uncertain. More importantly, were the Commission to attempt to meet that burden, it should explain how it addresses the risk of overstating long run competitive harm in the particular circumstances of the case under consideration. Indeed, dynamic, Schumpeterian competition inherently brings forth new innovations and new entry that were not anticipated and could not have been predicted. Efforts to assess long run harm to efficiency and to consumers as a result of exclusion of competitors clearly risks grossly overstating the harm if they fail to take account of these likely developments. Therefore, in cases where the conduct at issue generates short term efficiency and the Commission nevertheless considers prohibiting such conduct, it is the duty of the Commission - as the institution entrusted with the enforcement of competition rules aimed at promoting consumer welfare - to demonstrate that the balancing test between short- and long-term effects avoids the risk of overstatement of long term consumer harm.

"Legalistic" approach

Our second comment relates to the "legalistic" (form-based) approach mainly used so far when dealing with Article 82 cases. As the EAGCP Report points out "[t]he standard for assessing whether a given practice is detrimental to 'competition' or whether it is a legitimate tool of 'competition' should be derived from the effects of the practice on consumers" (at p. 8). A form-based approach is inadequate as a standard for such assessment. To illustrate this, we briefly analyse the treatment of rebate and discount structures.

The issue

In evaluating whether a discount or rebate ("rebate" for short) scheme constitutes an abuse under Article 82 EC, the European courts determine whether the rebate scheme is objectively justified[32]. If it is not, there is an evident danger from certain CFI rulings that a rebate by a dominant undertaking will be treated as *per se* having restrictive and/or discriminatory effects. As a result of developments in the case law, there has been a narrowing of the types of rebate considered legitimate when implemented by a dominant undertaking. This narrowing has reached a point where all rebates, including those calculated on a quantitative basis, are deemed to be abusive when established by a dominant undertaking, unless they are the result of economies of scale that are passed on to the customer[33].

For example, although the judgement is ambiguous, in *Michelin II*, the CFI appears to have taken the view that under Article 82 it may not always be necessary to show an actual effect on competition: rather, the conduct may be abusive if it "tends to restrict competition or, in other words, that the conduct is capable of having that effect" (para 239). Thus, the CFI appears to consider volume rebates as presumptively abusive, a presumption that can be rebutted if there is an objective justification of the rebate scheme. However, *Michelin II* suggests that only transaction-specific cost justifications will suffice: i.e. the grant of a specific rebate must be linked to economies of scope gained through sales to that particular customer, in that particular transaction[34].

Furthermore, the European courts have shown an increasing willingness to find behaviour to be abusive where there is no anti-competitive *effect*, or even any strong likelihood of anti-competitive *effect*, but merely the potential for harm. These developments have created a legal doctrine which has serious consequences for dominant undertakings and which seriously restricts the pricing structures and arrangements that they are permitted to establish. Indeed, as things now stand, the rules relating to discounting are considerably stricter than those applicable to single dealing and refusals to deal. In the case of single dealing, the courts have considered the actual exclusionary effects[35], while in the case of refusals to deal, the courts have developed a rule of reason approach[36]. The stricter treatment of rebate schemes appears difficult to justify: discounting reduces the cost to consumers and is not on its face exclusionary.

In examining how this position has been reached, it becomes clear that the legal and economic foundations for the doctrine are shallow and insufficient to support the edifice now constructed on them. In particular, these cases overlook the fact that rebates increase allocative efficiency and consumer welfare by increasing output and reducing prices. They are often preferred by

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32 *Hoffman La Roche v Commission*, [1979] ECR 461 at para. 90; *Michelin v Commission* (Michelin I), [1983] ECR 3461 at para. 73; *Irish Sugar v Commission,* [1991] ECR I-2969, para. 114 and 188; *Michelin v Commission* (Michelin II) n.y.r. at para. 98; *British Airways v Commission*, (n.y.r.) at para. 247 and 271.

33 *Michelin II* and *British Airways supra* n. 33.

34 *Michelin II*, *supra* n. 33, paras 98-110.

35 CFI judgment of 23 October 2003 in *Van den Bergh Foods* (nyr).

36 *Bronner*, [1998] ECR I-7791.

customers to alternative arrangements and are often the result of hard bargaining by customers to get the best price from undertakings that, because they are dominant, would otherwise charge higher prices. Conduct of this nature should be subject to Article 82 only if there is a compelling economic basis for doing so. Increases in allocative efficiency and consumer welfare ought to be regarded as objective justifications for rebates and should negate the assumption that such rebates are exclusionary by their very nature.

Summary of Existing Case Law

a) In *Hoffmann-La Roche*[37], the Court discussed exclusivity agreements and fidelity rebates which had a similar effect to exclusivity agreements, namely, tying customers to Roche for the supply of all, or a large proportion, of their purchasing requirements. These fidelity rebates were contrasted with quantity rebates based solely on the volume of purchases, on the basis that the fidelity rebates were:

"*… designed, through the grant of a financial advantage, to prevent customers from obtaining their supplies from competing producers*"[38].

This distinction also applied to fidelity-type rebates set at progressive rates but based on the percentage of a customer's estimated annual requirements.

No adequate explanation was provided why these rebates should be any more likely to prevent a customer obtaining supplies from competitors than a quantitative rebate, based solely on the volume of purchases, or even just a low price, when such a rebate or low price is also designed to encourage the customer to purchase more from the same supplier.

The rebates in Roche were also distinguished from pure volume rebates on the basis that they were not dependent on quantities fixed objectively, but based on estimates of the annual requirements of each customer. They were driven by an aim to obtain the maximum volume of a customer's requirements, rather than just the maximum volume of sales possible. The system was therefore discriminatory:

"*… applying dissimilar conditions to equivalent transactions with other trading parties*"[39].

The Court presumed that this discriminatory behaviour constituted an abuse without examining in detail whether, in practice, the rebates prevented customers from choosing their supplier or reduced consumer welfare.

b) The reasoning of the Court in *Michelin I*[40] is also based on the premise that fidelity rebates (but, apparently, not pure quantity rebates based "objectively" on volumes purchased):

"*… prevent customers obtaining their supplies from competing manufacturers*"[41].

37 *Hoffman La Roche* supra n.33

38 Ibid.at para.90.

39 Ibid at para.90.

40 Supra n.33

41 Ibid. para 71.

However, again, no adequate analysis or explanation is provided why rebates based on attaining a particular target percentage of the previous year's requirements are necessarily (and legally) more restrictive than quantity discounts linked solely to the volume of goods purchased. Because the percentage targets were calculated on an individual basis, the behaviour was deemed discriminatory and therefore abusive under Article 82 EC.

c) In *Michelin II*[42], the system for calculating rebates applied the same volume-based rules to all customers and was therefore not discriminatory. According to previous case law, as a pure quantitative rebate system, this system should have been considered legitimate. However, the Court held that even quantity rebates (applied by a dominant undertaking) are illegal unless they can be justified by economies of scale:

"*… a rebate system in which the rate of the discount increases according to the volume purchased will not infringe Article 82 EC unless the criteria and rules for granting the rebate reveal that the system is not based on an economically justified countervailing advantage but tends, following the example of a loyalty and target rebate, to prevent customers from obtaining their supplies from competitors*"[43].

d) The possibility of restrictive or discriminatory behaviour being justified by an economic analysis had been raised in *Roche* and *Michelin I*, but such analysis was not considered to be a factor in determining whether the behaviour itself was restrictive. (Quantitative rebates not based on targets relating to previous purchases by a customer had always been considered not to have a restrictive effect and economic justification related only to behaviour which had already been deemed restrictive or discriminatory.)

The lack of legal or economic basis for the legal doctrine

There is no basis for the premise that all rebate systems established by a dominant undertaking are abusive unless they are cost-justified. In the early case law, there is no adequate legal or economic analysis to distinguish quantitative rebates based purely on volumes purchased from "fidelity-type" rebates. Furthermore, the need to demonstrate that a quantitative rebate depends on cost savings in order not to be deemed restrictive is new in *Michelin II* and is largely unexplained. That requirement ignores all sorts of other efficiencies that are often realized by rebates (allocative efficiencies, economics of scope in the case of multi-product undertakings and distribution efficiencies).

The current case law is, in effect, a form-based rule: a rebate system which is transaction-specific, quantity-based and structured to reflect benefits of scale is legitimate if applied by a dominant company: all other rebates applied by a dominant company are, by default, unlawful, irrespective of effect or market analysis.

42 *Michelin* II *supra* n.33

43 *Ibid* at par-a. 59.

Form-Based –v- Effects
In *Michelin II*, the Court considered that the rebates were loyalty-inducing[44] and that this practice was capable of restricting competition[45]. Paragraph 60 of that judgment identifies two areas for economic and factual inquiry: (i) whether there is an economic justification for the rebate; and (ii) if not, whether the rebate has anticompetitive effects[46]. While there has been a tendency on the part of the Court to curtail the second analysis once it determines that there is no economic justification for the rebate under the first test, there is no legal requirement for it to do so. Thus, the failure to conduct such an analysis is inconsistent with both the legal test set forth in *Michelin II* and the Court's case law, which gives foreclosure effects a serious examination[47]. In particular, there should be no presumption that a particular type of discount and rebate will have an anti-competitive effect based on its form, especially as discounts and rebates produce immediate benefits in the form of lower prices in every instance whereas they may produce harm only on a limited set of circumstances. And, whether or not any inference of anti-competitive effects is based on evidence of actual market performance, it should be rebuttable with evidence of actual market performance.

Given the possible pro-competitive benefits of some rebates which are not quantity-based and structured to reflect benefits of scale, a blanket prohibition of all such schemes by dominant undertakings under Article 82 could discourage potentially efficient behaviour.

The need to move away from form-based rules

From an economic perspective, it is difficult to find any form of unilateral behaviour that will always be harmful to competition, without considering the market context in which the behaviour occurs. It is therefore difficult to find an economic rationale for a regime in which certain types of behaviour are *per se* unlawful once an undertaking passes over the threshold into dominance, especially when they are *per se* lawful below this threshold.

An effects-based framework of analysis under Article 82 would also be in line with the approach under the Article 81(3) Notice, in particular if the Article 82 Guidelines mandate the same requirements in terms of quantification and balancing the pro- and anticompetitive effects of unilateral behaviour. ICC believes that the draft Guidelines should fully acknowledge the analytical approach under Article 81(3) Notice.

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44 Ibid. at para. 95: "a quantity rebate system in which there is a significant variation in the discount rates between the lower and higher steps, which has a reference period of one year and in which the discount is fixed on the basis of total turnover achieved during the reference period, has the characteristics of a loyalty-inducing discount system".

45 It should also be noted, as was pointed out ibid. at 96, that the aim of any competition on price and any discount system is to encourage the customer to purchase more from the same supplier.

46 Ibid, at para 60, "In determining whether a quantity rebate system is abuse, it will therefore be necessary to … investigate whether, in providing an advantage not based on any economic service justifying it, the rebates tend to remove or restrict the buyer's freedom to choose his sources of supply, to bar competitors from access to the market, to apply dissimilar conditions to equivalent transactions with other trading parties or to trengthen the dominant position by distorting competition".

47 See Van den Bergh, supra n. 36.

A rebate scheme may create an incentive for a customer to purchase all his requirements from the dominant undertaking but it needs to be established that the scheme has a negative impact on consumers. If the rebate can be easily matched by rivals, only applies to some but not to others or is of short duration, it may well have no negative effects. A detailed market analysis of the actual effects is, therefore, indispensable.

On "efficiencies"

A third comment relates to efficiencies. Efficiencies occur when mergers, agreements or unilateral conduct give rise to reduced prices, improved quality or other positive effects that benefit consumers. Efficiencies may be either of a quantitative (cost) nature or of a qualitative (dynamic) nature. When unilateral conduct enables an undertaking to realize economies of scope or scale or to utilize more efficient production or distribution methods, it can reduce costs. Unilateral conduct can also increase output when, for example, it better aligns incentives of distributors and other producers of complements with the dominant undertaking. Unilateral conduct by undertakings can also promote dynamic efficiency, where it leads to increased research and innovation, or the development of new and improved methods of production and distribution. Unilateral conduct by dominant undertakings also increases allocative efficiencies whenever it reduces prices or increases output.

There is widespread consensus among economists that efficiencies are to be measured in terms of consumer surplus. This methodology explicitly underlies the Guidelines on the application of Article 81(3) and, less explicitly, the Guidelines on the assessment of horizontal mergers.

As a consequence, it is nowadays well established under EC competition law that static and dynamic efficiency gains are to be taken into account when assessing both horizontal and non-horizontal mergers and agreements. Similarly, under US law, under both Section 1 and 2 Sherman Act, efficiencies are factored into the analysis of courts and antitrust agencies of the net effect of the transaction at issue. In contrast, the scope for taking account of efficiencies under Article 82 seems at best very limited in a number of cases, non-existent in other cases and, on the whole, unclear. First, while case law under Article 82 (e.g. *Michelin II*, *Telemarketing*) postulates that an objective justification prevents a finding of an abuse of a dominant position, that notion appears to be interpreted in an extremely limited manner (see e.g. *Hoffmann-La Roche*; see also the Commission decision in *Microsoft*). Second, in addition to the (few) cases where the proffered objective justifications were considered – but rejected - , a number of practices, in particular in the field of rebates, are subject to a *per se* analysis. As a result, the treatment of efficiencies under Article 82 is cumbersome, at best.

We recommend that in its guidelines, the Commission expressly take account of all types of efficiencies for the following reasons:

- There is no economic support for a per se approach to the analysis of Article 82. On the contrary, there is consensus among economists that (unilateral) price- and non-price conduct of dominant firms may produce both pro- and anticompetitive effects. The ambiguous nature of conduct of dominant firms militates in favour of a full appreciation of the (positive and negative) effects on consumers. While it may perhaps be justified to treat

some restrictive agreements, such as horizontal price fixing and market sharing agreements, as per se violations under Article 81 because it is obvious that they will produce anticompetitive effects, a similar rationale does not apply in relation to conduct assessed under Article 82.

- Consideration of efficiencies in the assessment of conduct under Article 82 merely reflects the role of undistorted competition as a means towards the achievement of the Treaty objectives as set out in Article 2. As indicated above, conduct which generates dynamic or static efficiencies should not be deemed abusive unless it is demonstrated that the impact of this conduct on competition will result in consumer harm outweighing these efficiencies.
- Additionally, a full recognition of the role of efficiencies under Article 82 would be consistent with those (limited) Commission precedents and case law of the Community courts that support a weighing of the anticompetitive effects and claimed efficiencies. Conversely, a failure to acknowledge efficiencies would create unnecessary confusion as to the significance and scope of the efficiency defense as may be derived from those cases.

Furthermore, we believe that efficiencies in Article 82 cases should be assessed pursuant to the following principles:

- While efficiency claims under Article 81 are a defense against a finding of infringement under the conditions set out in Article 81(3), the assessment of efficiencies under Article 82 is an integral part of the finding of abuse. This is obvious from the wording of Article 82 (which does not include any provision mirroring Article 81(3)) in the light of Articles 2 and 3 of the Treaty. Therefore, it is for the authority investigating an alleged infringement of Article 82 to support any affirmative finding of abuse by evidence that the conduct at issue is not justified by efficiencies, in particular in those instances where the dominant company proposes a prima facie efficiency justification.
- The recognition of the principle that conduct of dominant firms may enhance efficiency would bring EC practice in line with the litigation-oriented framework under Regulation 1/2003. Indeed, while *per se* rules and limited efficiency defenses may have some benefits from a public enforcement point of view (by reducing enforcement costs), they send the wrong signal to the business community and will create much bigger overall costs by deterring efficient conduct or undertakings. There is no sound reason why national courts should be barred from evaluating business justifications in an attempt to arrive at an appreciation of the overall impact of the positive and negative effects of dominant undertaking behaviour. Typically, under such an approach a dominant undertaking is allowed to assert and substantiate that its conduct enhances efficiency, after which the burden of proof shifts to the plaintiff to rebut that claim as being unfounded or disproportionate.
- Efficiencies should be assessed in the same manner in all cases of alleged abuse. There is no support for the proposition that conduct restrictive of competition by companies with very high market shares (including monopolies) is unlikely to be justified by efficiency gains. Indeed, there is no correlation between market structure, on the one hand, and

price competition or innovation, on the other. Under the Treaty rules, conduct that is adopted by companies with very high market shares and generates efficiencies to the benefit of consumers must be permitted even if it may lead to the elimination of (presumably less efficient) competitors.

On refusal to license intellectual property rights

It is a well established principle under EC competition law that inroads on the rights of intellectual property holders are only allowed under exceptional circumstances. The underlying reason for this approach is the need to preserve companies' incentives to engage in research and development and other ventures aimed at generating innovative products and services. ICC believes that the future Guidelines on Article 82 should clearly signal that the Commission intends to adhere to the criteria developed by the Community courts. In this respect, ICC believes that patented and non-patented technical technology should be treated on the same footing and that the requirement that the refusal to license prevents the appearance of new goods or services be clearly set out.

5. The Lisbon Agenda

One of the Lisbon Agenda objectives is sustainable economic growth. It refers to stimulation of competitiveness and innovation as one of the policy tools. An economics-based approach to the application of Article 82, particularly as it takes efficiencies into consideration, is likely to promote competitiveness and growth. Moreover, by focusing on the effects on consumer welfare rather than on forms of conduct, such approach will, provided appropriate guidelines are issued, improve the regulatory environment in which undertakings operate, contribute to reduce their regulatory burden and thus allow them to become more competitive and innovative, while safeguarding consumer welfare.

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