International Chamber of Commerce
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ICC Comments on the European Commission discussion paper on the application of Article 82 of the Treaty to exclusionary abuses

Executive Summary

General Comments

The International Chamber of Commerce (ICC) welcomes the opportunity to comment on the European Commission's ("the Commission") Discussion Paper. We hope that our comments will be helpful. We welcome the opportunity to expand upon our comments, if necessary.

In the currently contemplated guidelines there are positive aspects, mainly in the central concern to enhance consumer welfare and to protect competition and not competitors. We recommend that such a welfare-based approach be more supported in the overall design of these guidelines. Consumer welfare does not necessarily equate to the public interest more generally, and short term consumer welfare and the wider public interest may differ. The interrelationship between the purposes of antitrust and the wider public interest should be made more explicit.

Consistent with a welfare-based approach would be a clearer acknowledgement that as specific business conduct may simultaneously give rise to (short term) efficiency gains and (longer term) negative effects, the reviewing agency necessarily must take account of both effects in its (initial) finding of abusive behavior. Moreover, as the contemplated guidelines are likely to be relied upon by a large number of decision makers, including national courts, it would be helpful if the guidelines would make clear that - in *ex ante* assessments of conduct under Article 82 - the finding of an abuse of a dominant position is subject to a rigorous standard of proof, relating to the successive future chain of events ultimately giving rise to the negative effects on consumers required under Article 82. In *ex post* reviews, a key element in the evaluation is the causal connection between the alleged abuse and those negative effects.

Section 3: Market definition in Article 82 cases

We invite the Commission in particular to further consider the risk of market definitions that are artificially narrow, in particular with regards to new technologies which relevant markets are, more than any other, likely to be excessively segmented.

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Section 4: Dominance

The stress on market shares in the evaluation of dominance (paragraphs 29-33) appears in clear contrast with the conclusions of the modern theory of market leadership: market leaders have larger market shares exactly when they are constrained by effective and potential competition since, in this case, they adopt more aggressive (pricing and investment) strategies which expand their market shares. In other words, there is not necessarily a positive correlation between the presence of larger market shares and a dominant position and, especially in highly dynamic markets, there is not unambiguous theoretical support for a statement saying that "[m]arket share is only a proxy for market power" (paragraph 32). As a recent DG Competition's study on Article 82[1] has correctly pointed out, "the case law tradition of having separate assessments of dominance and of abusiveness of behavior simplifies procedures, but this simplification involves a loss of precision in the implementation of the legal norm. The structural indicators which traditionally serve as proxies for 'dominance' provide an appropriate measure of power in some markets, but not in others", as indeed in high-tech and New Economy industries (*e.g.*, computer hardware and software, online businesses, mobile telephony and biotechnology).

Section 5: Framework for analysis of exclusionary abuses

In particular, we would encourage the Commission more fully to ensure that the interests of consumers are always paramount of those of competitors, to move even further away from form-based rules and presumptions towards a more economics- and fact-based approach, and to expand the avenues through which account may be taken of the efficiency-enhancing effects of challenged conduct.

Section 6: Predatory pricing

The Discussion Paper substitutes the standard *Areeda-Turner test* based on average variable cost ("AVC") with the average avoidable costs ("AAC"), a sort of average marginal (or incremental) cost of the extra output to serve the predatory sales. Unfortunately, the AAC can be higher than the right theoretical concept whenever it accounts for fixed costs. Moreover, the AAC can be much more difficult to measure than the AVC since it is almost always impossible to precisely define which costs are sustained for a given output and isolate the extra output (supposedly the predatory output) from total output. Finally, there are well-known conditions, as in the presence of network externalities, under which pricing below marginal cost is a normal competitive strategy for a market leader. Hence it would be better to substitute the concept of AAC with that of average variable cost, in line with the traditional economic interpretations of the *Areeda-Turner test*.

Section 7: Single branding and rebates

Overall, the Discussion Paper contemplates a more flexible approach than in the past. It appears to depart from a *per se* prohibition and make the assessment of rebates conditional on the existence/likelihood of foreclosure effects. In principle, the Commission intends to conduct an analysis of the market conditions in order to show that foreclosure effects are at least likely. ICC

[1] Patrick Rey (Coordinator), *Report by the EAGCP 'An Economic Approach to Article 82',* July, 2005.

also welcomes the introduction of an efficiency defence that dominant companies can use in order to justify their rebate systems. However, several passages in the Discussion Paper seem to cast doubts on a genuine change of approach.

Section 8: Tying and bundling

While the Discussion Paper purports to adopt a more balanced approach that takes into account that tying and bundling can be pro-competitive, we are concerned that this approach is not carried through into the details of the analysis. A close reading suggests that certain older presumptions against tying remain embedded in the analysis, which, taken together, risk perpetuating the current situation in which tying and bundling are viewed as suspect unless proven otherwise. In our view, this would be a mistake, and we urge the Commission instead to adopt an approach that would better reflect that basic principle that tying is generally pro-competitive.

In addition to our overarching concern that the proposed analysis fails to take account of the quite common benefits of tying, our specific concerns include: (i) the proposed "distinct products" analysis; (ii) the discussion of the "market foreclosure effect"; and (iii) the treatment of the efficiency defence.

Section 9: Refusal to supply

I. Controversial Issues

The Section of the Discussion Paper on Refusal to Supply seems to start from the existing case-law, but still raises many controversial policy issues that, ICC submits, warrant further consideration by the European Commission, such as <u>necessary or sufficient conditions</u>, <u>different thresholds</u>, <u>indispensable input</u> and <u>foreclosure effect</u>.

The thresholds to argue efficiencies and objective justifications seem to be too high to be realistically successful in practice. Furthermore, the Discussion Paper fails to acknowledge that an input may become indispensable simply as a result of a company's superior business performance. ICC submits that a duty to deal/supply should not be imposed simply because consumers prefer the dominant company's products.

II. Refusal to Licence IPRs

In setting out the exceptional circumstances where refusal to licence an IPR may constitute an abuse, the Discussion Paper starts from the principles and approach well-established in the case-law of the Court of Justice (notably and most recently, *IMS Health*). However, it then fails to give guidance on some key issues still left open by *IMS Health* and, in some instances, expands the scope of potential compulsory licensing to cover cases beyond the requirements of exceptional circumstances set out in *IMS Health*, thus potentially having a chilling effect on incentives to invest and innovate.

Section 10: Aftermarkets

We recall the comments made in our submission dated 12 December regarding aftermarkets[2]. In particular, we suggest that the Commission examine the competitive links between products and systems at the stage of market definition. The Commission would thus recognize, 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 other systems against which they are in competition, constitute a single relevant product market.

We believe that the complex, multi-step analysis of aftermarkets set forth in the Discussion Paper would be both unnecessary and counterproductive. The Discussion Paper appears to acknowledge that harm to customers through actions by a supplier of aftermarket products and services is a limited concern. The only example provided is one in which a supplier adopts a "policy change" with respect to aftermarket products or services. (paragraphs 261-262). We submit that it is preferable to address this limited concern regarding "installed based opportunism" through private contracts rather than by attempting to apply Article 82 to single-brand aftermarkets and treating a "policy change" as a potential abuse of dominance.

We hope that our comments on DG Competition's Discussion Paper will be helpful. We welcome the opportunity to expand upon our comments, if necessary.

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[2] Pages 9 -11.

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Prepared by the Commission on Competition

General Comments

The International Chamber of Commerce (ICC) welcomes the opportunity to comment on the European Commission's ("the Commission") Discussion Paper. We hope that our comments will be helpful. We welcome the opportunity to expand upon our comments, if necessary.

In the currently contemplated guidelines there are many positive aspects, mainly in the central concern to enhance consumer welfare and to protect competition and not competitors. We recommend that such a welfare-based approach be more supported in the overall design of these guidelines. Consumer welfare does not necessarily equate to the public interest more generally, and short term consumer welfare and the wider public interest may differ. The interrelationship between the purposes of antitrust and the wider public interest should be made more explicit.

Consistent with a welfare-based approach would be a clearer acknowledgement that as specific business conduct may simultaneously give rise to (short term) efficiency gains and (longer term) negative effects, the reviewing agency necessarily must take account of both effects in its (initial) finding of abusive behavior. Moreover, as the contemplated guidelines are likely to be relied upon by a large number of decision makers, including national courts, it would be helpful if the guidelines would make clear that - in *ex ante* assessments of conduct under Article 82 - the finding of an abuse of a dominant position is subject to a rigorous standard of proof, relating to the successive future chain of events ultimately giving rise to the negative effects on consumers required under Article 82. In *ex post* reviews, a key element in the evaluation is the causal connection between the alleged abuse and those negative effects.

Section 3: Market definition in Article 82 cases

The approach developed in the 1997 Communication to which the Commission's document refers[3] solves most of classical cases covered by Article 82.

[3] Paragraph 12 and following of the Discussion Paper

Nevertheless, we believe that improvements can be made and we refer to the suggestions made in our previous comments on the reform of Article 82.[4] We invite the Commission in particular to further consider the risk of market definitions that are artificially narrow, in particular with regard to new technologies which relevant markets are, more than any other, likely to be excessively segmented.

An over-subjective definition of the market according to the criticized abuse should also be avoided as much as possible. One should rely on objective criteria. In this respect, it is regrettable that the Commission plans on too often setting aside the SSNIP test, which offers companies a certain predictability and assists competition authorities in evaluating the market under a dynamic and realistic perspective. The Commission correctly identifies a central problem of market definition in relation to dominant companies and notes in its discussion of the SSNIP test and the cellophane fallacy that the test is inappropriate. However, there does need to be some test and no alternative is proposed. This demonstrates the weakness of the current position and the unpredictability of the law.

Moreover, the application of a test premised solely on product characteristics may well result in an overly narrow market definition. This could lead to erroneous findings of dominance in the overly narrow market.

Section 4: Dominance

Following a traditional definition, Section 4 of the Discussion Paper associates dominance with "a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers" (paragraph 20). Such a definition requires "a leading position on that market" compared to the rivals (paragraph 22) and the lack of "effective competitive constraints" (paragraph 23) in the process in which "the undertaking and the other players act and inter-act on the market"(paragraph 23).

Given the positive emphasis put on an economics-based approach to competition policy, it is important to notice that this definition of dominance is clearly associated with two situations examined by economic analysis: the pure monopoly, as an extreme case of dominance, and the market leadership where the dominant undertaking faces some competitors, which is clearly the most interesting case. It should be noticed that, according to standard economic analysis, a market leader can really act independently of its rivals (so as to satisfy the above condition for dominance)[5] only when the number of competitors is exogenously set and further entry is impossible, while a market leadership constrained by effective competition and potential entry cannot be associated with dominance: in this case, modern economic theory tells us that leaders tend to be aggressive (pro-competitive) in their pricing and investment strategies, conquering

[4] ICC, *Comments on the Reform of the Application of Article 82 of the EC Treaty* (12 December 2005), pp.7 to 11.

[5] And potentially it can implement anti-competitive strategies, that is engage in abusive conduct.

larger market shares in a way that has nothing to do with dominance as defined above, and which is also beneficial to consumers.[6]

As a consequence of the approach of the Discussion Paper, it would be better to eliminate a certain ambiguity in the statement at paragraph 27 which says that "the fact that an undertaking is compelled by the pressure of its competitors' price reductions to lower its own prices is in general incompatible with [...] the existence of substantial market power" and hence with dominance. In particular:

1) this should be always true and not just "in general", since in this case the market leader is constrained by effective competition and cannot act independently from it, as the definition of dominance would require;

2) this should be extended to any other form of aggressive competition that is not only competition on prices, but also competition on quantities or on alternative forms of strategic investments.

Hence, the fact that an undertaking is compelled by the pressure of its competitors' aggressive strategies to adopt aggressive (pricing and investment) strategies should be always incompatible with dominance.

The emphasis on market shares in the evaluation of dominance (paragraphs 29-33) appears in clear contrast with the modern theory of market leadership: market leaders have larger market shares exactly when they are constrained by effective and potential competition since in this case they adopt more aggressive (pricing and investment) strategies which expand their market shares. In other words there is not necessarily a positive correlation between the presence of larger market shares and a dominant position and, especially in highly dynamic markets, there is no unambiguous theoretical support for a statement saying that "[m]arket share is only a proxy for market power" (paragraph 32). As a recent DG Competition's study on Article 82[7] has correctly pointed out, "the case law tradition of having separate assessments of dominance and of abusiveness of behavior simplifies procedures, but this simplification involves a loss of precision in the implementation of the legal norm. The structural indicators which traditionally serve as proxies for 'dominance' provide an appropriate measure of power in some markets, but not in others", as indeed in high-tech and "new economy" industries (*e.g.*, computer hardware and software, online businesses, mobile telephony and biotechnology).

Finally, the part on dominance clearly refers to competition *in* the market, while it is hardly useful to evaluate cases where competition *for* the market takes place. In these cases, typical of the New Economy, competition is dynamic and innovators conquer large parts of a market, so that any static analysis of market shares cannot say anything about dominance. In other words, a

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[6] See Franco Modigliani (1958), "New Developments on the Oligopoly Front", *Journal of Political Economy*, 66, 3, June, pp. 215-32, and Federico Etro (2006), "Aggressive Leaders", *Rand Journal of Economics*, Vol. 37, Spring.

[7] Patrick Rey (Coordinator), *Report by the EAGCP 'An Economic Approach to Article 82'*, July, 2005.

market can be currently dominated by a single firm, but if many other firms which are not even active in this market are investing in R&D to enter into it, as it happens in many high-tech sectors, this market is substantially competitive in a dynamic sense. Nevertheless, any leader in such a competitive winner-takes-all market would be always characterized as dominant by the static and market-share-based approach of the Discussion Paper.

Moreover, modern economic theory tells us that in these dynamic sectors market leaders, as long as they are constrained by effective competition in the market for innovations, invest more than their competitors and hence are more likely to remain leaders.[8] In this sense, statements saying that "high market shares, which have been held for some time, indicate a dominant position" can be true in some sectors, but not in high-tech sectors with competition *for* the market. That is, in dynamic markets, incumbents, with rare exceptions, are under permanent threat of entry and must continue to innovate if they wish to maintain this incumbency. In conclusion, the general impression is that there is an excessive reliance on market shares to evaluate dominance, and that this can be highly misleading especially for dynamic markets.

We agree that market share is logically a criterion of limited significance within a system where the definition of the relevant market is questionable as a result of the weakness of the SSNIP test as an aid to market definition.

The part on barriers to expansion and entry (paragraphs 34-40) concerns a concept which is far from unambiguous in economic theory. The definition of these barriers as "factors that make entry impossible or unprofitable while permitting established undertakings to charge prices above the competitive level" (paragraph 38) applies to legal barriers but not to other factors which are sometimes seen as barriers. For instance, high fixed costs of production and R&D or investments needed to develop network externalities or learning by doing advantages, do not make entry impossible: the correct definition in these cases would be that these factors endogenously limit entry or endogenously determine how many and which firms profitably enter. The difference is not just in the definition but also in the economic consequence, since modern economic theory has shown that when entry is impossible market leaders may behave in an anti-competitive way, but when entry is constrained by technological or demand conditions they (always) behave in a pro-competitive way even if such factors limit entry and the market leaders obtain high market shares.

It should also be noted that barriers to entry can be cumulative, which is a point not covered in the Discussion Paper. It should also be noted that legal barriers may have effects long after their formal removal, as in the case with post patent right protection.

[8] See Etro, "Innovation by Leaders", *Economic Journal*, Vol. 114, 281-310 (2004).

Section 5: Framework for analysis of exclusionary abuses

Section 5 of the Discussion Paper sets out the basic analytic framework that the European Commission intends to use in analyzing exclusionary abuses under Article 82. We welcome the Discussion Paper's statement at the outset that the essential objective of this analytic framework "is the protection of competition on the market *as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources*."[9] We likewise agree that "the purpose of Article 82 is not to protect competitors from dominant firms' genuine competition based on factors such as higher quality, novel products, opportune innovation or otherwise better performance, but to ensure that these competitors are also able to expand in or enter the market and compete therein *on the merits, without facing conditions which are distorted or impaired* by the dominant firm."[10]

Despite these welcome pronouncements, we have some concern that they are not fully carried through into certain aspects of the analytic framework. In particular, we would encourage the Commission more fully to ensure that the interests of consumers are always paramount of those of competitors, to move even further away from form-based rules and presumptions towards a more economics- and fact-based approach, and to expand the avenues through which account may be taken of the efficiency-enhancing effects of challenged conduct. We address each of these issues in turn.

1. Promoting interests of consumers over competitors

The analysis of whether an undertaking has engaged in abusive conduct under Article 82 should ultimately turn on the conduct's actual effects on efficiency and consumer welfare. Thus, if the pro-consumer benefits of a dominant undertaking's conduct are significant, it should be immune from liability even if it disadvantages certain competitors. As we noted in our December 2005 Comments, inventing better products or more efficient methods of distribution, reducing prices or offering better terms of trade, and more quickly adapting to changes in the market can disadvantage rivals and maybe even cause them to exit the market. Yet these forms of conduct often also enhance efficiency and consumer welfare.

This focus is particularly important with respect to fast-moving markets such as those commonly found in high-tech and "new economy" industries (e.g., computer hardware and software, online businesses, mobile telephony and biotechnology). These industries are often characterised by massive R&D investments, strong reliance on IPRs and other intangible assets, network effects, high fixed sunk costs and low marginal costs. Competition in these markets is dynamic in the sense that competition often takes place for the market in a "winner-takes-all" race. Leading firms in these markets might enjoy high market shares yet be subject to massive competitive pressure to constantly create better products at lower prices due to threats from innovative competitors and potential entrants. Undertakings that hold a significant share of the market at any given point of time may see this share decrease rapidly and significantly following the development and supply of a new and more attractive product by an actual or potential competitor.

[9] *Discussion Paper,* paragraph 54 (emphasis added).

[10] *Ibid.* (emphasis added).

In certain respects, the analytic framework set forth in the Discussion Paper provides grounds for optimism that the Commission is moving toward a stronger focus on consumer welfare. Yet others aspects of the framework suggest that competitors' interests will at times trump those of consumers and force dominant undertakings to forego competitive behaviour that in fact would generate efficiency gains or promote consumer welfare. For example:

- In spelling out the concept of foreclosure, the Discussion Paper states that "it is sufficient that the rivals are disadvantaged and consequently led to compete less aggressively."[11] This proposition gives cause for concern. First, this statement is not consistent with standard economic theory which has made clear that an aggressive behaviour of the market leader inducing a less aggressive competition of its competitors is not sufficient to create any harm to consumers (actually the net effect is typically the opposite happens).[12] The inconsistency of this statement is even more clear when it is claimed that "[r]ivals may be disadvantaged where the dominant company is able to … reduce demand for the rivals' products" (paragraph 58) which is really what any aggressive or pro-competitive strategy would do. Putting together the two sentences, we are told that in order to establish foreclosure it would be sufficient that the strategy of the dominant firm reduces demand for the rivals' product: but this amounts to banish any pro-competitive strategy by market leaders. Moreover, the above statement could arguably support the conclusion that a dominant undertaking in a market characterized by network effects could be guilty of abuse if it is able to attract new customers on the basis of a new, superior technology. This view is contrary to the basic principle that dominant undertakings should be permitted—and indeed encouraged—to compete aggressively on the merits. Allowing a finding of abuse merely where competitors are "disadvantaged" would penalise dominant undertakings for engaging in a wide range of conduct that is ultimately pro-competitive. In our view, this aspect of the analytic framework should be revised to clarify that conduct by a dominant undertaking would be deemed to be an abuse only if its net effect is to harm consumer welfare.[13]

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[11] *Ibid.*, paragraph 58.

[12] As pointed out by well established economic doctrine (Drew Fundenberg. and Jean Tirole, 1985, "The Fat Cat Effect, the Puppy Dog Ploy and the Lean and Hungry Look", *American Economic Review*, 74 , May, pp. 361-68), an aggressive behaviour of the market leader can lead to more aggressive competition by a competitor (generally under competition in prices) or to a less aggressive one (typically under competition in quantities) with positive consequences for the consumers in the first case and only ambiguous ones in the second. Moreover, when entry of competitors is endogenously taken into account (which should be the relevant case), an aggressive behaviour of the leader does not affect each single competitor but can reduce entry, with net effects for consumer welfare and allocation of resources which are always positive (Etro, 2006). Hence, an aggressive behaviour of the market leader inducing less aggressive competition of the competitors is not sufficient to create any harm to consumers or to deteriorate the allocation of resources.

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

- The analytic framework posited by the Discussion Paper is particularly troubling in dynamic markets where competition is often *for* the market. Competitors in these markets invest vast amounts in research and development with the hope of winning a large portion of the market. Some succeed while others, ultimately, do not. Dynamic markets are unique in this way, in that there is no sustainable market equilibrium with a number of players of differing sizes co-existing in the market. Rather, there are successive innovation races, resulting in "winners and losers" as part of a Schumpterian "gale of creative destruction". The analytic framework presented in the Discussion Paper runs the risk of interfering with this natural competitive process and therefore, inefficiently obstructing the workings of a dynamic market.

- On a related point, the analytic framework seems to rest on an assumption that, because conduct that harms competitors may perhaps decrease consumer welfare in the longer term, any efficiencies generated by such conduct should be discounted.[14] In our view, such an assumption is unwarranted. Accurately predicting the magnitude of long-run harm to competition or consumers resulting from conduct that is otherwise efficiency-enhancing is almost always a difficult and uncertain undertaking. Such predictions are particularly unreliable with respect to dynamic markets and run the serious risk of under-estimating the capacity of rivals and new entrants to exert competitive pressures through product innovation or other means. Accordingly, we would urge the Commission not to *assume* long-term harm to consumers from immediate impact of the conduct on one or more competitors, but rather to examine, in each particular case, whether there is any evidence supporting the view that the impact on competitors will cause long-run harm to consumers and whether such harm, if any, exceeds the short-run increases in consumer welfare and both short- and long-run efficiency gains attributable to the dominant undertaking's conduct.

- The Discussion Paper states that the Commission may at times prohibit the use of price discounts where doing so will "protect competitors that are not (yet) as efficient as the dominant company."[15] In our view, there is no economic justification for barring dominant undertakings from decreasing prices simply in order to protect less efficient rivals—particularly since such a prohibition will mean that these rivals will face even *less* competitive pressure to become more efficient. This condition also places dominant undertakings in the untenable position of having to guess what level of rival inefficiency will be used to judge whether the dominant undertaking's own efficiency-enhancing conduct is lawful.

- The Discussion Paper also states, in its discussion of the "meeting competition defence", that a dominant undertaking has an obligation to weigh "the interests of its competitors to enter or expand" into the market when deciding upon alternative courses of action, and that dominant undertakings can only benefit from this defence if they prove there was no less anti-competitive alternative.[16] In the real world, the best businesses are focused on advancing the interests of their customers, not their competitors—which, of course, is one sign of a competitive market. Thus, most dominant undertakings will be ill-equipped to

[14] *See, , e.g., Discussion Paper*, paragraphs 54-60.

[15] *Discussion Paper*, paragraph 67.

[16] *Ibid.*, paragraphs 82, 83.

evaluate which of various possible options will least disadvantage their competitors. We would therefore recommend that this requirement that dominant undertakings weigh the interests of competitors be dropped from the analysis.

- The Discussion Paper states that, where an undertaking holds a market share above 75%, any pro-competitive efficiencies generated by the conduct in question will be given lower priority than the conduct's impact on competitors.[17] In our view, undertakings—whether dominant or not—should *never* be under an obligation to place the interests of their competitors over those of consumers. Such a rule will end up protecting less efficient rivals and restricting the behaviour of dominant undertakings in a manner that undermines Article 82's purpose of promoting efficient markets and consumer welfare. Protecting rivals against competition in this manner will also reduce their incentives to compete aggressively.

- We have some questions about the Discussion Paper's statements regarding presumptions of abuse at paragraph 60. If, as the first sentence postulates, certain exclusionary conduct "is clearly not competition on the merits," "clearly creates no efficiencies" and "only raises obstacles to residual competition,"[18] such conduct will almost certainly be abusive and we cannot imagine why a "presumption" is necessary. If, however, this statement is meant to signal that the Commission intends to look to the *form* of challenged conduct in making an initial assessment of abuse, and that it will then fall to the dominant undertaking to rebut that presumption through factual evidence, we would disagree with this approach for the reasons already noted and described in more detail below. Also, we would note that, in the interests of legal certainty and business guidance, it would be more helpful if the Discussion Paper were to set out circumstances in which abuse cannot be found, rather than, as in paragraph 60, cases in which the Commission will necessarily assume that an exclusionary abuse has occurred.

In sum, we would recommend that any final Article 82 guidelines move even further away from the more traditional focus on protecting competitors and instead assess whether the conduct is likely to promote or impede efficiency and benefit or harm consumers.

2. Greater reliance on economics-based approach

In the past, EU competition policy has been criticised for focusing more on the form of unilateral conduct than on its actual effects in the marketplace. As we noted in our December 2005 Comments, there is broad consensus among economists that (unilateral) price- and non-price conduct of dominant undertakings may produce both pro- and anti-competitive effects. The ambiguous nature of conduct of dominant undertakings militates in favour of a full appreciation of the (positive and negative) effects on consumers. It is therefore vital that the framework for analysis under Article 82 provides for a rigorous, economics-based examination of the market context in which unilateral conduct occurs.

[17] *Ibid.*, paragraphs 91-92.

[18] *Ibid.*, paragraph 60.

For instance, the Commission should clarify that, despite the references to the "form and nature" of conduct in the general discussion of exclusionary abuses,[19] whether market foreclosure will be found to exist will ultimately turn on the likely or actual effects of the conduct in the marketplace. Also, while we commend the Commission for placing less reliance on per se rules and irrebutable presumptions of market foreclosure and abuse, the Discussion Paper retains elements of this approach. For example, in several places, certain forms of conduct or market shares will make it "highly unlikely" that some legal determination will result.[20] We would urge the Commission to lessen its reliance even on these quasi-per se rules and to adopt a more thoroughgoing, economics- and effects-based analysis that focuses on increasing consumer welfare and is based on sound economic theory of the behaviour of market leaders and on solid empirical analysis.[21]

Furthermore, we are not persuaded that an approach based on the weighing of pro- and anti-competitive effects will decrease legal certainty. As we noted in our December 2005 Comments, 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.

In sum, we would urge the Commission to make it clear that unilateral conduct whose benefits to efficiency or consumers outweigh its negative impact on competitors is not an abuse, whatever its form and regardless of the degree of market power of the undertaking concerned.

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[19] *Ibid.*, paragraphs 58, 59.

[20] *See, e.g., ibid*, paragraphs 30, 90-91**.**

[21] The recent DG Competition's study on Article 82 (Rey et al., *Report by the EAGCP 'An Economic Approach to Article 82,'*" July 2005) correctly emphasizes the need of solid theoretical and empirical foundations in the antitrust procedure: "a natural process would consist of asking the competition authority to first identify a consistent story of competitive harm, identifying the economic theory or theories on which the story is based, as well as the facts which support the theory as opposed to competing theories. Next, the firm should have the opportunity to present its defense, presumably to provide a counter-story indicating that the practice in question is not anti-competitive, but is in fact a legitimate, perhaps even pro-competitive business practice."

3. Expand opportunities to take account of efficiencies

Unilateral conduct that enables an undertaking to operate more efficiently normally results in direct consumer benefits because it allows the undertaking to increase output and/or lower its prices. Unilateral conduct can also promote dynamic efficiency by freeing up resources for increased research and innovation, or to develop improved methods of production and distribution. Indeed, the consideration of efficiencies in the assessment of conduct under Article 82 reflects the role of undistorted competition as a means towards the achievement of the broader Treaty objectives set out in Article 2.

For these reasons, conduct that generates efficiencies should not, in our view, be deemed abusive unless it is demonstrated that the impact of this conduct on competition will result in consumer harm outweighing these efficiencies. While the Discussion Paper acknowledges that promoting efficiency is one of the primary objectives of Article 82,[22] the framework for analysis itself actually provides relatively limited scope for taking efficiencies into account. This manifests itself in a variety of ways:

- ***Burden of proof.*** The Discussion Paper indicates that, consistent with existing practice, it will fall on dominant undertakings to prove the extent to which their conduct was justified on grounds of efficiency.[23] As noted in our December 2005 Comments, the final burden of proving efficiencies should be placed on the authority investigating the alleged abuse because, in stark contrast to the bifurcated approach under Article 81, the assessment of efficiencies is an integral part of the assessment whether any given conduct amounts to "abuse" under Article 82. More importantly, bringing efficiencies into the analysis only as an affirmative defence will send the wrong signal to the business community. It means that investigations will often have moved quite far along before efficiency considerations fully come into play. Placing the burden of proof on competition authorities, by contrast, makes more sense as they are likely to be in a better position to obtain relevant evidence from the dominant undertaking as well as other market participants (such as consumer organizations) on whether challenged conduct promotes efficiency—and have the expertise and resources to undertake such an inquiry. Accordingly, we believe it is for the authority investigating an alleged infringement of Article 82 to support any finding of abuse by evidence that the conduct at issue is not justified by efficiencies, in particular in those instances where the dominant undertaking proposes a prima facie efficiency justification.[24] The legal burden of proving an infringement of Article 82 must always rest on the authority or party alleging the infringement, in line with the legal framework of Article 82 (which differs from Article 81) and the express wording of Article 2 of Regulation 1/2003. There is a need to distinguish between the legal burden of proof and the evidentiary burden. Only the latter may shift to the dominant company once the party or the authority alleging the infringement has proved its existence to the required legal standard.

[22] *See, e.g.*, *ibid*, paragraph 4 ("With regard to exclusionary abuses the objective of Article 82 is the protection of competition on the market as a means of enhancing consumer welfare *and of ensuring an efficient allocation of resources*.") (emphasis added).
[23] *Ibid.*, paragraphs 77, 79.

[24] See footnote 20.

- ***Narrow scope of efficiency defence.*** To assert a successful efficiency defence under the proposed analytic framework, dominant undertakings will be required to show that their conduct was "indispensable" in order to achieve the resulting efficiencies and that "competition in respect of a substantial portion of the products concerned [was] not eliminated."[25] To meet the first of these conditions, the defendant must "demonstrate that there are no other economically practicable and less anti-competitive alternatives to achieve the claimed efficiencies."[26] This condition means that liability could be imposed even on conduct whose efficiency and consumer benefits far outweigh its adverse effect on competitors simply because there exists an alternative that would have disadvantaged rivals less. We wonder whether such rule would have any economic justification and any basis in commercial reality. Wouldn't it at most, merely provide an excuse for rivals to second-guess the business decisions of their dominant competitors? The second condition is equally troubling. There seems to be an inherent contradiction between the "no-elimination-of-competition" prong of the analysis, which is taken from Article 81(3), and the very concept of dominance. As a result, would efficiency claims by dominant undertakings, particularly those with high market shares, not be systematically given short shrift because of the difficulty of satisfying this condition? In essence, would dominant undertakings not be effectively required to place the interests of competitors and the competitive process over the interests of efficiency and consumer welfare?

- ***Virtual exclusion of efficiency defence for monopolies.*** The Discussion Paper seems to suggest that, where a dominant undertaking holds a market share above 75%, the protection of competitors will be given priority over efficiency. In our view, efficiencies should be assessed in the same manner in all cases, regardless of the defendant's market share. Under the Treaty, and consistent with the goals of Article 82 as described by Commissioner Kroes, undertakings that generate pro-competitive efficiencies that benefit consumers should not be penalised regardless of the level of market share or potential impact on less efficient competitors. Moreover, the Discussion Paper introduces a concept of market position "approaching that of a monopoly" (paragraph 92), for market shares above 75%, for which no economic analysis is presented. Moreover, does economic analysis justify any separate treatment for undertakings with high market shares? As shown by the modern economic theory, market leaders tend to have higher market shares exactly when they face effective competitive pressure which induces them to adopt aggressive (pricing and investment) strategies and hence to expand their market shares in a pro-competitive way[27]. Under these conditions, exceptionally high market shares (but not monopolistic ones) can be due to relevant scale economies or to the existence of "learning by doing" or network effects. The existence of these high market shares should not exclude the undertaking from using the efficiency defence.

[25] *Ibid.*, paragraph 84.

[26] *Ibid.*, paragraph 86.

[27] See the discussion on Dominance, above.

In conclusion, we would urge the Commission to clarify that conduct by a dominant undertaking, regardless of its form and irrespective of the undertaking's market share, could be deemed abusive only if the efficiency gains or consumer benefits generated by such conduct were outweighed by the negative effects of such conduct on the competitive process and consumer welfare.

Section 6: Predatory pricing

Predatory pricing is defined in the Discussion Paper as "the practice where a dominant company lowers its prices and thereby deliberately incurs losses or foregoes profits in the short run so as to eliminate or discipline one or more rivals or to prevent entry by one or more potential rivals thereby hindering the maintenance or the degree of competition still existing in the market or the growth of that competition" (paragraph 93). The Discussion Paper uses a number of cost benchmarks in order to assess whether "predatory pricing" by a dominant undertaking has actually taken place.

Pricing below average avoidable cost ("AAC") gives rise to a rebuttable presumption that the pricing is "predatory". Average avoidable cost is the average of the costs that could have been avoided if the undertaking had not produced a discrete amount of extra output (this extra output is usually the amount allegedly subject to abusive conduct). Apparently, this principle is supported by the idea that pricing below marginal cost could only have a predatory purpose, but the concept of marginal cost is difficult to measure. This is in line with the standard economic theory and antitrust doctrine coming from Areeda and Turner (who noticed that "the incremental cost of making and selling the last unit cannot readily be inferred from conventional business accounts, which typically go no further than showing observed average variable cost ("AVC"). Consequently it may well be necessary to use the latter as an indicator of marginal cost"). [28] However, the Discussion Paper substitutes the standard *Areeda-Turner test* based on AVC with the AAC, a sort of average marginal (or incremental) cost of the extra output to serve the predatory sales. Unfortunately, the AAC can be higher than the right theoretical concept whenever it accounts for fixed costs. Moreover, the AAC can be much more difficult to measure than the AVC since it is almost always impossible to precisely define which costs are sustained for a given output and isolate the extra output (supposedly the predatory output) from total output. Finally, there are well known conditions, as in presence of network externalities, under which pricing below marginal cost is a normal competitive strategy for a market leader. Hence it would be better to substitute the concept of AAC with that of average variable cost, in line with the traditional economic interpretations of the *Areeda-Turner test.*

According to the Discussion Paper, where pricing is above AAC, but below average total cost ("ATC"), predation cannot be presumed. ATC is the average of the variable and fixed costs incurred by a company. Pricing above ATC is in general not considered predatory, but according to the virtually unanimous economic literature, it would be better to state explicitly that pricing above ATC is *never* predatory since it cannot lead to foreclosure of 'as efficient' competitors.

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[28] See Phillip Areeda and Donald Turner (1975), "Predatory Pricing and Related Practices under Section 2 of the Sherman Act", *Harvard Law Review*, 88, pp. 637-733. See also F. Etro (2006), "Competition Policy: Toward a New Approach", *European Competition Journal*, Vol. 2, April, in press.

In certain sectors, the Commission uses a long-run average incremental cost benchmark ("LAIC"), instead of AAC. This is usually the case in industries where fixed costs are high and variable costs very low. In these cases, the LAIC benchmark is used as the benchmark below which predation is presumed. The same considerations as above hold also here: there are not economic justifications for a change of standard from AVC to LAIC. Moreover, we believe that the LAIC standard is inconsistent with business reality because it requires companies to price to cover average sunk fixed costs that are unrecoverable: this approach ignores the economic reality that, when businesses decide how to price a product, they do not consider costs that are "sunk" or "unrecoverable," even if not a single product is sold.

In the Discussion Paper, a dominant undertaking may, even if the price is below the relevant cost benchmark, rebut a finding of predatory pricing by providing a "justification" for its pricing behaviour (this is a departure from earlier case-law, where pricing below AVC was considered to be abusive *per se*). The Discussion Paper lists several examples of possible justifications (paragraph 131), including an issue of re-start up costs or strong learning effects, the need to sell off perishable or obsolete stock and the justification that the low price is a short-run loss minimising response to changing conditions in the market (including those resulting from a dramatic fall in demand leading to excess capacity). We suggest that besides learning effects, the proposed guidelines should include network effects, whose theoretical role in justifying aggressive pricing is very similar to that of learning by doing and is recognized by standard economic theory.

Finally, the scope of objective justifications should not be unduly restricted to few "acceptable" justifications in terms of productive efficiency. The possibility should be left to provide any objective justification satisfying the necessity and proportionality requirements.

Dominance itself should not be sufficient to establish the likelihood of recoupment, particularly in technology markets. For example, looking forward one or two years in the dominance inquiry is not sufficient to undertake a proper assessment of recoupment where significant uncertainty abounds regarding not only cost and demand but the existence of potential entrants. It is entirely possible that a firm may be dominant in the sale and/or distribution of a given product, yet be constrained by entrants with highly disruptive technologies which require greater than one or two years to mature and be successfully commercialised.

Section 7: Single branding and rebates

Overall, the Commission's approach seems more flexible than in the past. It appears to depart from a *per se* prohibition and make assessment of rebates conditional on the existence/likelihood of foreclosure effects. In principle, the Commission intends to conduct an analysis of the market conditions in order to show that foreclosure effects are at least likely. ICC also welcomes the introduction of an efficiency defence that dominant undertakings can use in order to justify their rebate systems. This is an improvement to the "old" position where the only possible efficiency defence consisted of economies of scale linked to the adoption of volume rebates.

However, several passages in the Discussion Paper cast doubts on a genuine change of approach. The introductory chapter contains several 'statements of principle' about potential 'negative' effects of rebates that seem more in line with the 'old' approach of a *per se* prohibition. At paragraphs 148 and 149, the Commission alleges that "the dominant position already enables the dominant company to prevent effective competition to be maintained or to emerge in the market and it thus becomes particularly important to protect the limited degree of competition still existing in the market and the growth of residual competition… Where the dominant company applies a single branding obligation to a good part of its buyers and this obligation therefore affects, if not most, at least a substantial part of market demand, the Commission is likely to conclude that the obligation has a market distorting foreclosure effect and thus constitutes an abuse of the dominant position." At paragraph 139, the Commission also mentions that rebates are likely to foreclose competitors when they maintain or strengthen the dominant undertaking's position thereby "hindering the maintenance of growth of residual or potential competition." Later on, the Discussion Paper is even clearer when mentioning at paragraph 158 that "[i]n case the threshold(s) are formulated on terms of percentage of total requirements of the buyer or an individualized volume target, the Commission will normally presume that they are set at that level to hinder customers to switch and purchase additional amounts and thus to enhance loyalty."

Article 82 pre-supposes the existence of a dominant undertaking. By essence, the adoption of rebate systems by dominant undertakings will likely have a 'distorting' effect on competitors, at least in the short-term, and will likely impact on limited residual competition. Under the above-mentioned principles, most rebates applied by dominant undertakings will be deemed abusive without the need of much further market analysis. At paragraph 146, the Discussion Paper gives examples of situations where rebates are unlikely to have foreclosure effect. However, it is difficult to understand how these markets could give rise to dominance issues in the first place. The paragraph mentions that rebates will not have foreclosure effects if "competitors are competing on equal terms for all the customers" One may wonder how this statement may be reconciled with the necessary prerequisite of dominance that supposes the dominant undertaking's 'power to behave independently of competitors.'

ICC would like to stress the following points:

- First, 'distorting' effect on competitors does not necessarily mean 'abusive'. Findings of abuse should be based on a longer-term market assessment that should take into account competitors' likely response to the rebate system, customers' ability to switch and long-term benefits for end-users. The Discussion Paper refers to some of these factors but fails to give sufficient guidance on how it intends to apply them.

- Second, ICC has problems understanding why it would be abusive for dominant undertakings to try to 'maintain or strengthen' market shares through the adoption of rebates. There is a fundamental ambiguity throughout the Discussion Paper in admitting that dominant undertakings are allowed to compete (even aggressively) and, at the same time, considering that dominant undertaking's strategies to maintain or gain market share are likely to be abusive. Competition is generally about increasing market shares to the detriment of competitors. The Discussion Paper seems to assume that, once in a dominant

position, undertakings should stop expanding and 'freeze' their commercial behaviour to whatever is strictly necessary to meet competition. This is difficult to reconcile with a right to aggressively compete. In addition, such a position is highly unrealistic. The Discussion Paper should clarify that, in principle, dominant undertakings should be allowed to compete aggressively on rebates since this may lead to long-term aggressive price competition. Rebates would become abusive in limited defined circumstances when competitive strategies are not 'on the merits' or involve predatory or other anti-competitive behaviour resulting in likely foreclosure effects, for example, "full line forcing".

- Third, the Commission should give some benchmark on the size of the tied market that is likely to involve negative effects. In addition, the Discussion Paper mentions that one way for dominant undertakings to avoid tying a significant part of the demand is to selectively apply the rebates to some customers. However, in that case, dominant undertakings may be caught between a rock and a hard place, on one end the loyalty-enhancing effect of fidelity rebates, on the other the risk of price discrimination. In this respect, ICC welcomes comments recently made by a Commission official that 'real' price discrimination cases should be limited to wide price differences with significant distorting effect and would appreciate if the draft guidelines could include and clarify that aspect.

1. Conditional rebates on all purchases

ICC is not certain that the Commission's approach in assessing the likelihood of an abuse is based on a well-structured operational test. The Discussion Paper mentions that rebates are likely to be abusive when:

(i) they apply to all purchases (including past purchases) made within the reference period;

(ii) the threshold is set at a level that induces switching customers to buy additional quantities from the dominant undertaking;

(iii) competitors' required share exceeds the commercially viable amount per customer, as calculated by the Commission on the basis of the dominant undertaking's ATC and the effective price of the last slice of the rebate, as follows. If the basic price of the dominant undertaking is p, the percentage rebate is r, total sales are $S+X$, of which S is the threshold above which rebates start and X are the extra sales beyond the threshold, then the effective price for the same extra fraction of sales is given by the difference between total price with the rebate $p(1-r)(S+X)$ and the total price of the threshold quantity without rebates pS, divided by the extra quantity X:

$$EP = \frac{p(1-r)(S+X) - pS}{X} = p\left(1 - \frac{r(S+X)}{X}\right) = p\left(1 - \frac{r}{x}\right)$$

where we define $x=X/(S+X)$ as the fraction of extra sales. When this average price is below the average total cost ATC entry is foreclosed. Assuming that ATC is constant and equal to c, the necessary condition can be easily derived. A competitor with the same average total cost of the dominant undertaking could profitably enter only selling at least the fraction:

$$\hat{x} = \frac{pr}{p-c}$$

which is defined as the required share.

(iv) the rebate system ties a significant part of buyers; and

(v) there is no clear indications of significant entry or customers' switching.

As a general comment, ICC considers that the system proposed by the Commission is far too complex and seems to leave room for a large margin of error and uncertainty. ICC considers that only factors (iv) and (v) are reliable indicators of the existence of foreclosure effects. However, although the Discussion Paper refers to these elements in several passages, it does not give much guidance on how the Commission intends to apply them. ICC would welcome some examples/benchmark in order to help companies to quantify the degree of foreclosure that is likely to be held abusive (notably when the Discussion Paper specifies that "*a significant part"* of customers should be tied by the rebates). On the other hand, factors under (i), (ii) and (iii) seem highly unreliable for the following reasons:

- They seem to be based on three artificial assumptions: (i) a dominant undertaking's demand is automatically divided between an inelastic and elastic part (ii) buyers automatically switch once the tied market share is exceeded; and (iii) buyers are automatically 'sucked in' the rebate system once they get close to the threshold. These assumptions are artificial because they suppose that buyers always react in the same way to price variations without taking into account competitors' response or demand fluctuations. In addition, the Discussion Paper focuses on buyer's reactions to prices *only* without taking account of their reactions to competition on quality and innovation.

- The rebates under discussion are substantially equivalent to a simple quantity discount, which, as is well known, has a welfare enhancing role. [29] The implication is that similar rebates should never be considered abusive when the percentage rebate is small enough since they have similar effects to simple quantity discounts.

- Any kind of fidelity rebate can have a pro-competitive role in the sense that it creates a further dimension of competition (the non-linear price schedule) and it can represent a more aggressive pricing strategy: hence an additional minimal condition for rebates to be abusive should be that competitors are not able to propose similar rebates or different ones (with different thresholds),[30] but this issue is absent from the list of conditions.

- It also seems questionable from an economic point of view to calculate the effective price on the last slice of the rebate since one may argue that the threshold is exceeded by all the customers' purchases, and not only by the last slice.

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[29] For instance see Massimo Motta, *Competition Policy. Theory and Practice*, Cambridge: Cambridge University Press, 2004 (Chapter 7).

[30] This requirement is also strengthened by the general statement for which "only conduct which would exclude a hypothetical 'as efficient' competitor is abusive" (paragraph 63).

- The theoretical formulation of point (iii) is largely unrelated or inconsistent with standard economic theory and it is affected by a dangerous theoretical problem. The derivation of the formula for the required share is valid assuming that the ATC is constant. However, in general the average total cost is not constant and typically U-shaped, so that undertakings producing different amounts have different ATCs and there is usually a minimum ATC associated with a certain scale of production. Suppose that ATC depends on the fraction of sales *x* according to a general relation c*(x)* – the particular case where this is constant is assumed by the Discussion Paper.[31] Now, according to the reasoning of the Discussion Paper, foreclosure would require:

  $$EP = p\left(1-\frac{r}{x}\right) < c(x)$$

  In general, this is not equivalent to a cut-off rule for which the competitors' required share exceeds the commercially viable amount per customer. For instance, if we are in the range for which ATC is increasing (which is likely to be the relevant one if we are referring to a dominant firm with a large market share), we actually have the opposite result.[32] In general, applying mechanically the cut-off rule suggested in the Discussion Paper is theoretically inconsistent and can lead to completely ineffective conclusions whenever the market is characterized by a minimum efficient scale.[33]

- The calculation method proposed by the Discussion Paper is far too complex to be applied by business people in their daily practice. When negotiating rebates with customers, one may wonder how dominant undertakings could reasonably project whether or not the last slice of the rebate will exceed their ATC at the particular point in time when the customer precisely buys the last slice. In most cases, dominant undertakings will not be able to determine whether their ATC is below the effective price because they will lack information on their competitors' "commercially viable shares/ required shares". As a result, dominant firms wishing to ensure compliance with Article 82 may elect not to make use of conditional rebate programmes even when they would enhance consumer welfare.

- The calculation method also opens the door to legal uncertainty. According to the Commission, calculating the competitors' "commercially viable test" is the crucial element of the equation. If the CVT is inaccurate, would the whole equation have any value in terms of assessing potential abusive conduct or foreclosure effect? In several parts of the Discussion Paper, the Commission seems to admit that it is extremely difficult to calculate CVT with accuracy. (Paragraph 157 refers to the need of 'revising' the CVT, paragraph 163 admits that there must be cases where "entry or expansion of competitors is in effect not

[31] This relation is motivated as follows. What is behind the discussion on rebates is a market with many customers each one buying a number of products. As long as the total number of customers is given and they have similar demand, x is directly related to total demand, on which a proper average cost function depends.

[32] Formally if *c(x)* is U-shaped, the relation holds for required shares within a closed set and not above a threshold. Hence a mechanic application of the formula may lead to derive the upper bound of the set rather than its lower bound, leading to completely wrong conclusions in every case!

[33] Or whenever the market is not a natural monopoly, that is, in every relevant case for our purposes.

limited to the amount assessed by the Commission as the commercially viable share."; paragraph 164 mentions that "where it is not possible to establish accurately the required share…., the Commission may use cost data of apparently efficient competitors".) This raises a number of questions. In most cases, it will be difficult for the Commission to find competitors as efficient as the dominant undertaking. In the alternative, the Discussion Paper does not specify on what criteria these competitors will be considered "as efficient". Last, the reference to competitors that are "as *apparently* efficient" leaves significant room for discretion and flexibility and thus legal uncertainty.

- There is a risk that the selected operational test may tip the burden of proof quite heavily against the dominant undertaking. Under the "new approach", presumed abusive and foreclosure effects will be mathematically calculated by the Commission on the basis of an equation, the main parameters of which (required share, commercially viable share and sometimes ATC) will be unknown to or difficult to establish by the dominant undertaking (see paragraph 163.)

The Commission should also clarify in what order it intends to apply the above listed tests. At paragraph 164, the Discussion Paper suggests that the Commission will investigate the performance of the dominant undertaking and competitors when information on costs is not available. ICC believes that this comparison should be done before any cost calculation is made since it may be a more reliable indicator of the existence of foreclosure effects. In general, ICC suggests that, before entering into a cost analysis, a more pragmatic approach could be for the Commission to identify whether the rebate system involves some significant foreclosure effects, e.g., by comparing the evolution of the dominant undertaking's market share and competitors' market shares before and after the adoption of the rebate system, determining the percentage of total customers tied by the rebate, and identifying customers' switching ability.

This is particularly troubling in innovative markets and even more so in so-called "pure-play" innovation companies (companies that engage in research and development activities but neither produce nor distribute the resulting products). It is critical for these companies to find ways to incentivise their downstream partners to grow the market for the technology in question, solve potential underinvestment problems resulting from the inability to appropriate the know-how typically transferred to manufacturers and distributors to cover the fixed costs of their investments in research and development.

Loyalty rebates are particularly important to a pure-play innovation company and ultimately for end-consumers. Consumers may benefit, for example, from a manufacturer having a low marginal input cost, when that low cost is passed on to the consumers. This in turn will provide the manufacturer with an incentive to expand sales by competing on price. Additionally, loyalty rebates may facilitate efficient recovery of fixed costs. In general, consumers will face higher prices where an innovator needs to charge higher prices – resulting in lower volume – in order to recover fixed research and development costs. A loyalty rebate scheme allows the innovator to charge a relatively high price for the non-contestable share of the market, where demand is relatively inelastic, while charging a lower price (after loyalty rebates) for the contestable part of the market, where demand elasticity is higher. The company can simultaneously profit from a higher margin on the infra-marginal units without losing volume at the margins.

2. Conditional rebates on incremental purchases

ICC would welcome some specific examples or guidance showing in practice how this type of rebates is likely to have foreclosure effect. The wording of the Discussion Paper is vague and would leave significant flexibility in assessment. It should be kept in mind that conditional rebates on incremental purchases are exactly equivalent to quantity discounts whose welfare enhancing role is well known in economic theory.[34]

For example, if the threshold is set in terms of a percentage of total requirements or individualized volume targets, the Discussion Paper refers to a presumption of abuse when the resulting price is predatory (however, predation in that case is not based on AAC but on ATC) and the tied demand is *important enough* to create a foreclosure effect. If the threshold is set in terms of a standardized volume target, the rebate system will normally not have a loyalty-inducing effect with some exceptions, *e.g.*, when it targets customers that are *of particular importance* for the possibilities and expansion of competitors.

None of these concepts are quantified or illustrated by examples. Therefore, they remain highly subjective. In particular, importance of customers is a flexible concept that varies from one customer to the next.

3. Unconditional rebates

ICC understands that this type of rebates is generally unproblematic except if the dominant undertaking targets some important customers. As mentioned above, ICC considers that the 'importance' of customers is a subjective concept, which should be clarified. Otherwise, it will give competitors significant flexibility to argue that unconditional rebates are abusive by targeting an 'important' customer.

4. Efficiencies

Although ICC welcomes the introduction of an efficiency defence in the context of Article 82, the examples contained in paragraphs 172-176 seem to introduce a very limited defence. As regards the first example, it is extremely difficult for dominant undertakings to quantify which amount of cost efficiencies is specifically linked to a specific percentage of the rebate grid. The two other examples (rebates applied to large retailers and relationship-specific-investment) refer to specific situations and offer limited guidance in practice.

[34] Again, see Motta (2004, Chapter 7).

Section 8: Tying and bundling

We welcome the Discussion Paper's recognition that tying and bundling are often pro-competitive and its movement away from the *per se* approach to these practices reflected in prior case law. Indeed, economists today generally acknowledge that tying often produces positive efficiencies and consumer benefits.[35] The pro-competitive effects of tying are particularly pronounced in the case of technical tying (when companies innovate by linking formerly separate technologies or products, efficiencies often emerge through improved performance and quality), but they also emerge because tying is often used as an aggressive strategy which leads to lower prices.[36]

While the Discussion Paper purports to adopt a more balanced approach that takes into account that tying and bundling can be pro-competitive, we are concerned that this approach is not carried through into the details of the analysis. A close reading suggests that certain older presumptions against tying remain embedded in the analysis, which, taken together, risk perpetuating the current situation in which tying and bundling are viewed as suspect unless proven otherwise. In our view, this would be a mistake, and we urge the Commission instead to adopt an approach that would better reflect that basic principle that tying is generally pro-competitive.

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

[35] DG Competition's own study on Article 82 notes that cases of anti-competitive tying are "relatively scarce." *See* Rey et al. , *Report by the EAGCP 'An Economic Approach to Article 82,'* July 2005, at 39.

[36] The Chicago school has advanced efficiency rationales in favour of bundling with positive (or at worst ambiguous) consequences on welfare, including production or distribution cost savings, reduction in transaction costs for the customers, protection of intellectual property, product improvements, quality assurance and legitimate price responses. The post Chicago approach has shown that, when the bundling firm has some market power, bundles can have a predatory purpose (Michael Whinston, 1990, "Tying, Foreclosure and Exclusion", *American Economic Review*, 80, pp. 837-59), but in general, tying should be submitted to a rule-of-reason standard. However, more recently, the modern theory of market leaders has emphasized that bundling by the incumbent 1) is just an aggressive (pro-competitive) strategy of the incumbent for a competitive tied product market, 2) may not have a specific entry deterrence purpose, and 3) may increase welfare even without taking efficiency reasons into account. Technically, bundling works as a commitment device to be aggressive, that is to produce more for the secondary market and hence to be able to adopt a lower price. As a consequence, the leader can exploit larger scale economies, reduce the average price level for the consumers and hence increase welfare (see Etro, 2006).

1. Distinct Products Test

While we fully agree with the Discussion Paper's emphasis on consumer demand (and independent supply to the extent that it reflects that demand) in assessing whether a tying arrangement might be abusive, we are concerned that the Discussion Paper places too much emphasis on consumer demand for the tied product. Such demand does not shed light on whether there exist distinct products for the purposes of tying analysis, which uses the distinct products test as a proxy for determining whether the tying arrangement produces efficiencies. In other words, while there is clearly consumer demand for shoelaces, this should not mean that shoes and shoelaces are distinct products for the purposes of tying analysis. This issue can only be addressed by asking whether there is consumer demand for shoes without shoelaces.[37] In sum, whether or not consumer demand exists for the tied product is the wrong question; the correct question is whether there is any significant consumer demand for the tying product *without* the tied product. Unless the analysis focuses on this question, there is a danger that the mere existence of consumer demand for the tied product may prevent the emergence of efficient tying arrangements and end up protecting suppliers of tied products at the expense of consumers and innovation.

We are also concerned that, in the case of technical integration of two products that were previously distinct, the distinct products test itself may not be helpful for understanding market dynamics because, by definition, this test is backward-looking. As a result, the Discussion Paper's proposal that consumer demand be considered in such cases is particularly troubling.[38] A better approach in these cases would be simply to ask whether the undertaking integrating the previously distinct products can make a plausible showing of efficiency gains. Since technical tying is normally efficient, market-leading undertakings would be able to continue producing innovative products benefiting consumers without running afoul of the prohibitions on tying.

2. Market Foreclosure Effect

a. In General

The Discussion Paper also provides that a tying arrangement would be prohibited if it "is likely to have a market distorting foreclosure effect that would result in harm to consumers."[39] Yet the description of what constitutes such foreclosure is vague. Market foreclosure effects are described as conduct that has "the capability, by its nature, to foreclose competitors from the market." Total foreclosure is not necessary -- it is enough if competitors are "disadvantaged."[40] The Discussion Paper goes on to state that a tying practice will be presumed to result in market-distorting foreclosure where it ties a "sufficient part" of the market, but fails to provide guidance as to the meaning of "sufficient."[41]

[37] See Commission notice - Guidelines on Vertical Restraints, paragraph 216.

[38] *Ibid.*, paragraph 187 (noting that analysis will consider "whether consumer demand has shifted as a consequence of the product integration so that there is no more independent demand for the tied product").

[39] *Ibid.*, paragraph 183.

[40] *Ibid.*, paragraph 58.

[41] *Ibid.*, paragraph 188.

Under this vague foreclosure standard, any tying arrangement that has the effect of reducing demand for a competitor's product could be deemed to have a prohibited foreclosure effect, irrespective of the benefits to consumers or whether these effects are solely the result of competition on the merits. Unless clearer guidance is provided on the degree of foreclosure that is presumed to give rise to anti-competitive effects, undertakings will be left in a state of uncertainty in assessing tying arrangements. To give undertakings as much concrete guidance as possible, it would be helpful to have more precise indication of the degree of foreclosure that is considered to be abusive.

The Discussion Paper fails to provide clear guidance on the effect of bundling by competitors of the dominant undertaking on the analysis of market foreclosure. At one point, it suggests that bundling is less problematic if competitors also offer bundles.[42] At another point, it indicates that the foreclosure effect might be greater if others in the industry also bundle.[43] We believe this inconsistency should be resolved in favor of the former position: the fact that other undertakings in the market also offer bundles is a presumption that bundling generates efficiencies and meets consumer demand – if not, bundling by the dominant undertaking would provide competitors with a great opportunity to differentiate their offerings and make them more attractive to consumers. Additionally, the dominant undertaking ought to be able to compete with bundles offered by its competitors.

Finally, the Discussion Paper's treatment of "commercial usage" in the context of market foreclosure does not reflect the economics of tying. According to the Discussion Paper, the sale of a tied product by a dominant undertaking may be an abuse, even when it is standard commercial practice.[44] Furthermore, the fact that a competitor ties may add to the foreclosure effect.[45] As mentioned above, the Discussion Paper overlooks that in practice the customary nature of bundling is evidence that such tying generates efficiencies, or that there is no demand for the unbundled product. If there were sufficient customer demand to make the supply of the unbundled product profitable, competitors of the dominant undertaking would most likely avail themselves of this business opportunity.

b. Foreclosure by Mixed Bundling

While we agree with the Discussion Paper's general approach to determining when a discounted or "mixed" bundle might give rise to foreclosure, we disagree with the specific test proposed. The Discussion Paper provides the following guidance on the point at which a mixed bundle might give rise to foreclosure: "[c]ompetitors are foreclosed if the discount is so large that efficient competitors offering only some but not all of the components, cannot compete against the discounted bundle."[46] The Discussion Paper then indicates that such foreclosure will exist unless "[t]he incremental price that customers pay for each of the dominant company's products in the bundle … cover[s] the

[42] *Ibid.*, paragraphs 195, 202.
[43] *Ibid.*, paragraph 197.
[44] *Ibid.*, paragraph 182.
[45] *Ibid.*, paragraph 197.
[46] *Ibid.*, paragraph 189.

long run incremental costs of the dominant company of including this product in the bundle."[47]

We believe that the long-run incremental costs standard is inconsistent with business reality because it requires companies to price bundles to cover sunk fixed costs that are unrecoverable. This approach ignores the economic reality that, when businesses decide how to price a product, they do not consider costs that are "sunk" or "unrecoverable," even if not a single product is sold.

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

We believe that a more appropriate cost standard in this case would be marginal costs ("MC") or at least Average Avoidable Costs ("AAC"). When business people decide whether or not to make a marginal sale at a particular price, they generally consider the marginal cost of making that sale. We note that the Discussion Paper uses AAC as the appropriate measure of cost in its predatory pricing guidelines[48] and that same reasoning supports AAC as the appropriate measure of cost in the mixed bundling context. Indeed, the only time the Discussion Paper uses the long-run average incremental cost measure in the predatory pricing context is when addressing pricing by monopolies that are (or were) established by law.[49]

c. *Standard of Proof*

We are concerned that the standard of proof the Commission is required to meet to establish harmful foreclosure effects is too low, particularly in light of the fact that the analysis of foreclosure effects can be speculative in nature. In the case of tying, actual market foreclosure effects are not required by the Discussion Paper – it is enough that such effects are "likely"[50] to occur. In other words, the mere risk of foreclosure can result in a finding against a dominant undertaking. In merger cases, the European Court of Justice ("ECJ") has held that the Commission must put forward convincing evidence to block a merger, as the Commission is trying to predict the future effects of the merger on a market.[51] As the analysis of market foreclosure effect under Article 82 will often entail a prediction of future effects, the Commission should set a similarly high standard of proof for tying cases.

[47] *Ibid.*, paragraph 190.
[48] *Ibid.*, paragraph 108.
[49] *Ibid.*, paragraphs 124-26.
[50] *Ibid.*, paragraph 183.
[51] Case C-12/03, *Commission v. Tetra Laval,* Judgment of 15 Feb. 2005 (not yet reported).

In establishing foreclosure in a tying case, the Commission must address a chain of causation that is similar to that involved in a conglomerate merger case, which, in the words of the ECJ, are "dimly discernable, uncertain and difficult to establish."[52] Establishing foreclosure not only requires the Commission to predict what will happen in the future if the tying practice continues, but requires it to establish that the dominant firm has the ability and the incentive to leverage its dominant position on the tying product's market to foreclose competition on the tied product's market. A standard of proof that requires convincing evidence will help ensure that companies will not be deterred from bringing new products to market as a result of concerns about remote, potential foreclosure effects.

3. Efficiencies

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

We are also concerned that the Discussion Paper fails to acknowledge that bundling can be used to create value for consumers in markets that experience network effects or in multi-sided markets. In fact, with regard to network effects, the Discussion Paper indicates that foreclosure effects of a bundle may be greater when there are network effects.[53] In such markets, bundling is a valuable strategy to gain broader distribution of the products or service that is subject to network effects. And the broader the distribution, the greater the value produced for all consumers. This is particularly true when the product or service in question has a low (or no) marginal costs, because the supplier can costlessly include the product or service in bundles with other products. In this respect, the Discussion Paper appears to advocate an interpretation of Article 82 outlawing business practices that create wealth for society and large consumer benefits.

Similarly, we believe that it should be acknowledged that bundling can generate efficiencies in multi-sided markets, i.e. markets where products or service must be matched with other products or service to have value. Newspapers exist in multi-sided markets. Newspapers are sold to readers, but they also sell advertising space to advertisers. The reader is not only a "customer" of the newspaper, the reader is also a supplier of "eyes" that the newspaper sells to advertisers. The complex business models resulting from multi-sided markets often require bundling practices because the consumption on one side of the market is being "sold" on the other side of the market, and piece-meal consumption on one side of the market breaks down the interdependent ecosystem.

In conclusion, while we recognize and welcome the shift in the Discussion Paper away from rigid, per se rules and presumptions, we would urge the Commission to pursue this further, including by more fully taking account of the pro-competitive benefits of tying and bundling and by expanding the avenues through which these benefits may inform the analysis.

[52] *Discussion Paper*, paragraph 44.
[53] Paragraph 199.

Section 9: Refusal to supply

The Discussion Paper distinguishes between termination of an existing supply relationship and *de novo* refusals to start supplying an input.

The European Commission would introduce a rebuttable presumption that continuing a supply relationship is pro-competitive (paragraph 217). Four conditions are set out for an abuse to occur in case of termination of an existing supply relationship:

- The behaviour must amount to termination (including delaying tactics, excessive pricing, unfair terms, margin squeeze);
- Dominance must be established in an "upstream" input market (but it could also be a distinct market where access is needed to link with another market, e.g., to interface information);
- There must be a likely market distorting foreclosure effect; and
- There are no objective justifications and no efficiencies (for example, lack of commercial assurances to fulfill obligations or plans to integrate downstream).

The threshold is higher for an abuse to occur in cases of *de novo* refusals to start supplying an input. The following five conditions need to be met:

- Behaviour is a refusal to supply (incl. delaying tactics, excessive pricing, unfair terms);
- Dominance must be established in an "upstream" input market (but it may also be a captive, potential or hypothetical market);
- <u>The input is indispensable</u> (in the sense that there are no real or potential substitutes in the market and it is impossible or extremely difficult or expensive for competing companies to duplicate the input);
- There must be a likely market distorting foreclosure effect; and
- There are no objective justifications and no efficiencies (for example, no commercial assurances to fulfill obligations, lack of capacity constraints, unreasonable cost increase in access).

Controversial Issues

The Section of the Discussion Paper on Refusal to Supply seems to start from the existing case-law, but still raises many controversial policy issues that ICC submits warrant further consideration by the European Commission:

- *Necessary or sufficient conditions*: It is not clear whether the conditions for finding an abuse are necessary or simply sufficient. The Discussion Paper qualifies that "<u>normally</u>" those conditions must be fulfilled; therefore, it seems to leave open the possibility that on a case-by-case basis the Commission could identify other criteria beyond those listed above. This significantly undermines legal certainty and potentially leads to open-ended cases of intervention.

- *Different thresholds*: The Discussion Paper does not explain the basis for the view that, in general, continuing a supply relationship should be presumed to be pro-competitive. We consider that this should be the result of a case-by-case assessment of the economic circumstances of each case and not the subject of a legal presumption. Several Member States have specific provisions on issues of economic dependency outside the scope of competition law; any concerns arising out of the termination of existing supply relationships could be adequately dealt with in that context rather than reversing the burden of proof by introducing a pro-competitive presumption and lowering the threshold for competition law intervention. We submit that the threshold for intervention should be the same as for cases of *de novo* refusals to supply and, therefore, the requirement that the input is indispensable should also be added for termination of existing supply relationships.

- *Objective justifications*: In paragraph 224, the Commission states, in the context of an objective justification for a termination of a supply relationship, that "the dominant company may also argue that it is terminating the supply relationship because it wants to integrate downstream and itself perform the downstream activities. In such a situation it falls upon the dominant company to show that consumers are better off with the supply relationship terminated". This presumption the Commission stipulates can hardly be reconciled with established principles of competition law. In a market system of free competition, even a dominant company must, at least in principle, be allowed to freely decide upon its sales strategy and distribution system. If it decides to change its distribution policy, e.g., to terminate existing distribution contracts and to establish a direct sales organisation, it is its own choice for which it bears responsibility[54]. Competition law is not meant to guarantee an existing distributor relationship once and for all. As long as the supplier does not act in order to discipline a specific distributor and as long as the necessary termination periods are observed (depending on the given set of facts, the length may vary), there is no reason to intervene by means of Article 82. Therefore, it should not "fall upon the dominant company to show that consumers are better off with the supply relationship terminated" as the Commission proposes. If there be a presumption at all, it should be in favor of the company's freedom to decide upon its distribution strategy. Only in the case where the terminated dealer can show that he was disciplined or discriminated, the supplier might be required to justify the termination.

- *Indispensable input*: The definition of the indispensable input does not address the necessary economic analysis that should be carried out to decide whether duplication of the input is impossible, difficult or expensive for any competitor or for "*as efficient*" competitors. ICC submits that the Commission should clarify that the focus of the analysis should be on whether a second, substitute product can be created by "*as efficient*" competitors, rather than whether any competitors will in fact make the investment to create it. This approach would be consistent with the *Oscar Bronner* case and with the Commission's objective of protecting competition on the merits.

[54] Langen, Bunte, *European Competition Law*, 10th Edition 2006, note 168 to Article 82.

- *Foreclosure effect*: The standard for intervention by the Commission is not fully developed. In particular, the Discussion Paper does not give sufficient guidance on the degree of the likely anti-competitive foreclosure effects in the market. It states that the market distorting foreclosure effect should not be understood to mean the complete elimination of all competition, but it does not specify to what extent competition in the downstream market should be affected for an abuse to be found. Furthermore, there is no mention of the economic analysis that should be carried out of the effects of the abuse, in particular to assess the degree of efficiency of excluded competitors. ICC therefore submits that the Commission should clarify that the foreclosure effect should be substantial and at least amount to the creation of dominance in the downstream market (in terms of price increases or output reduction) resulting from the exclusion of "as efficient" competitors.

- Finally, the thresholds to argue efficiencies and objective justifications seem to be too high to be realistically successful in practice. Furthermore, the Discussion Paper fails to acknowledge that an input may become indispensable simply as a result of a company's superior business performance. ICC submits that a duty to deal/supply should not be imposed simply because consumers prefer the dominant undertaking products.

Refusal to Licence IPRs

Compulsory licensing of intellectual property rights is a very sensitive and controversial area under Article 82 and, therefore, deserves particular attention. As already explained in ICC's comments submitted to the European Commission on 12 December 2005, ICC believes it is important to preserve companies' incentives to engage in research and development and other ventures aimed at generating innovative products and services. ICC welcomes a number of pronouncements in the Discussion Paper that appreciate the benefits of the IPR regime and IPR protection. The European Commission acknowledges that:

- The indispensable input is often the result of substantial investments enabling significant risks (paragraph 235);
- In order to maintain the incentive to invest and innovate, the dominant company must not be unduly restricted (paragraph 235);
- There is no general obligation for the IPR holder to license the IPR (paragraph 238);
- The very aim of the exclusive right is to prevent third parties from using the IPR without consent (paragraph 238); and
- Refusal to license an IPR does not in itself constitute an abuse (paragraph 239).

In setting out the exceptional circumstances where refusal to license an IPR may constitute an abuse, the Discussion Paper starts from the principles and approach well-established in the case-law of the Court of Justice (notably and most recently, *IMS Health*). However, it then fails to give guidance on some key issues still left open by *IMS Health* and, in some instances, expands the scope of potential compulsory licensing to cover cases beyond the requirements of exceptional circumstances set out in *IMS Health*, thus potentially having a chilling effect on incentives to invest and innovate.

1. Exceptional Circumstances

The Discussion Paper sets out that the refusal by a dominant company to license access to an IPR could be considered abusive when the five conditions for *de novo* refusal to start supplying an input are satisfied, AND "the refusal to grant a licence prevents the development of the market for which the licence is an indispensable input, to the detriment of consumers". The threshold for intervention in cases of refusals to license IPRs is therefore higher than in other cases of refusals to supply. In summary, the conditions under the Discussion Paper are as follows:

- The behaviour can be properly characterised as a refusal (again, including cases of constructive refusals such as delaying tactics in supplying, imposing unfair trading conditions, or charging excessive prices for the input);
- The company refusing to license must be dominant in the market where input is provided;
- The input must be indispensable (i.e., it must not be possible to turn to any workable alternative technology or to "invent around" the IPR – the Discussion Paper mentions as examples cases where the technology has become the standard or where interoperability is necessary);
- The refusal is likely to have a negative effect on competition;
- There is no objective justification; **AND**
- The additional condition is that the refusal prevents the development of new goods or services and for which there is a potential consumer demand.

2. Unresolved Issues

The Discussion Paper does not give guidance on some of the key issues left open by *IMS Health*:

- *Dominance in an upstream market*: The dominance requirement as set out in paragraph 227 of the Discussion Paper broadens the scope of potential reach of compulsory licenses for IPRs that have no commercial or independent use (i.e. that are not marketed separately), but are only used as an input in other commercial products or services. Under *IMS Health*, there must be two identifiable markets as a necessary condition for IPR compulsory licensing. The Discussion Paper states that it is sufficient to identify a "captive", "potential" or even a "hypothetical" upstream market, and that "such is the case where there is actual demand for the input on the part of the undertakings seeking to carry out the activity for which the input is indispensable" . This broad construction can lead to a greater number of compulsory licensing of IPRs (provided the other conditions are met) by covering IPRs that are only used as an input without the need to identify a distinct product or service that would be sold or licensed separately. Furthermore, there is no reference or explanation in the Discussion Paper of the qualification given by the Court of Justice in *IMS Health* that the potential market must at least correspond to an identifiable "stage of production". Finally, there is no economic assessment of the conditions under which holding an IPR could amount to market power, which should be the correct framework of analysis without any presumption that holding an IPR may

automatically give rise to market power. ICC submits that without further qualification, such a potentially broad application of Article 82 could have a negative impact on incentives to invest in developing IPRs and investing in new production processes and research.

- *"New product" requirement*: There is no explanation of the requirement that the refusal to license must prevent the appearance of new goods or services. The Discussion Paper says that the company requesting the licence should not limit itself to the duplication of goods/services already offered. However, it does not provide any guidance on the criteria to identify or define a "new" product. ICC submits that the Commission should clearly specify that it must be a new kind of product (rather than just an incremental or minor improvement of an existing product) that must expand the market rather than steal sales. In this respect, it would helpful to clarify, consistently with *IMS Health*, that the new product should satisfy consumer demand that is not satisfied by existing products.

3. Concerns

Despite having some deference for IPRs in a number of welcome pronouncements as explained above, the Discussion Paper does not fully carry them through and goes significantly beyond the exceptional circumstances for compulsory licensing set out in *IMS Health*. For example, the Discussion Paper advocates the position that a refusal to license is abusive if it is likely to have a negative effect on competition, while in *IMS Health*, the ECJ required an elimination of competition. ICC is concerned about the following sections that may carry the risk of reducing the incentives to invest and innovate in the long term:

- For follow-on innovations, the additional condition that the refusal prevents the development of new goods or services is not necessary. Paragraph 240 of the Discussion Paper states that "a refusal to licence an IPR protected technology which is indispensable as a basis for follow-on innovation by competitors may be abusive even if the licence is not sought to directly incorporate the technology in clearly identifiable new goods and services. The refusal of licensing an IPR protected technology should not impair consumers' ability to benefit from innovation brought about by the dominant undertaking's competitors." This goes much further than the exceptional circumstances set out in IMS Health and the statements of principle in the Discussion Paper. This would be a worrying departure from the established principles of the European case-law, because it effectively means the introduction of open compulsory licensing to competitors for a myriad of IPRs. Furthermore, the Discussion Paper does not define what could amount to "follow-on innovation" and does not explain why intervention is required in this area to bring benefits to consumers. Finally, inefficient competitors may effectively have the possibility to free-ride on the investments and risks taken by a dominant undertaking. For all these reasons, companies may be deterred from investing and innovating in the first place, with a potential much bigger negative impact on consumers in the medium-long term.

- For refusal to supply information needed for interoperability, the Discussion Paper (paragraphs 241-242) says that (a) leveraging market power from one market to another may be an abuse of a dominant position and (b) it may not be appropriate to apply the same high standards for intervention even if such information may be considered a trade secret. The Commission does not develop the framework for assessing where/how such leveraging may occur, nor does it substantiate why trade secrets do not deserve the same high standards for protection. Again, such a broad policy intervention could have chilling effects on incentives to invest and innovate and could ultimately end up protecting inefficient competitors that may free ride on the risks and investments of the dominant undertaking, therefore in contradiction with the Commission's objective of protecting competition on the merits.

Section 10: Aftermarkets

We recall the comments we made in our submission dated 12 December regarding aftermarkets[55]. In particular, we suggest that the Commission examine the competitive links between products and systems at the stage of market definition. The Commission would thus recognize, 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 other systems against which they are in competition, constitute a single relevant product market.

As the Discussion Paper notes, it is common for the supplier of such equipment to have "a very strong position" in the sale of "secondary" products and services used with its own brand of equipment (paragraph 253). Indeed, undertakings with smaller positions in the primary equipment market may have even larger shares of their brand's aftermarket because third-party suppliers and other primary market firms typically focus on the most successful equipment brands since those brands provide the largest aftermarket revenue opportunity. As a result, there is a risk that undertakings with quite modest positions in the primary market would be viewed as dominant in the aftermarket if the assessment were to be focused only on an aftermarket consisting of products and services for their individual brand of equipment.

We believe that the Discussion Paper is correct in emphasizing that the "secondary markets" should not be viewed in isolation since "the actual degree of market power of the supplier [in the aftermarket] … may be constrained by competition in the primary market." (paragraph 246). As the Discussion Paper explains, "competition in the primary market may make price increases in the aftermarket unprofitable due to its impact on sales in the primary market, unless prices in the primary market are lowered to offset the higher aftermarket prices." (paragraph 246). This fundamental insight regarding the key relationship between the primary market and any related aftermarkets means that a separate examination of a single brand aftermarket under Article 82 is rarely, if ever, appropriate.

[55] Pages 9 -11.

The Discussion Paper appears to accept this conclusion for "customers who may buy the primary product in the future" since competition in the primary market will protect such customers (paragraphs 254-259)[56]. However, the Discussion Paper draws a distinction between "future customers" and "prior purchasers" on the basis that "competition in the primary market does not protect customers who have already bought the primary product." (paragraph 254). We believe that the distinction in the Discussion Paper between "future customers" and "prior purchasers" is misguided[57]. Since every "prior purchaser" was, by definition, a "future customer" before it acquired the primary product, competition in the primary product market also protects this subset of customers. In addition, as noted in the Discussion Paper, the "prior purchasers" are also protected by the supplier's interest in its reputation with respect to its aftermarket pricing and practices because its reputation will affect its future sales of the primary product as well as its future sales of other equipment that requires aftermarket products and services (paragraph 262).

We believe that the complex, multi-step analysis of aftermarkets set forth in the Discussion Paper[58] is both unnecessary and counterproductive. The Discussion Paper appears to acknowledge that harm to customers through actions by a supplier of aftermarket products and

[56] Customers can protect themselves by comparing the lifecycle costs of the products thereby taking into account both the initial cost of the primary product and the anticipated aftermarket costs over the useful life of the product. Often customers use long-term maintenance contracts or other contractual guarantees regarding the lifecycle cost of the product to protect themselves against the impact of subsequent changes in aftermarket prices or policies. Sophisticated customers [referred to in the Discussion Paper as "professional buyers" (paragraph 258)] are more likely to engage in this practice than individual consumers. However, consumers may use extended warranties or other contractual arrangements to protect themselves. Even where customers lack information or sophistication to compare lifecycle costs or to negotiate contractual protections, competition among suppliers will normally protect purchasers. Since suppliers can be expected to understand the long-term revenue opportunity flowing from the sale of the primary product, they are likely to compete aggressively in pricing their primary products in the expectation of obtaining a stream of aftermarket revenues from the primary equipment sale. See paragraph 259.

[57] Of course, many customers are repeat purchasers of the primary product and thus are both "prior purchasers" and potential "future customers". A customer may well be able to protect itself with respect to the impact of "policy changes" with respect to its prior purchases when it negotiates for its next purchase of the primary product. See paragraph 254, footnote 146.

[58] The first step in the approach set forth in the Discussion Paper is to determine whether there is a separate single-brand aftermarket. This focuses only on customers that have already purchased the primary product and asks whether it is possible for such customers (1) to switch to the secondary products provided by other primary market suppliers or (2) to switch to another brand of the primary product in order to defeat an attempt by the supplier of the primary product to increase prices of its secondary products or services. In many cases, this step will lead to defining a single-brand aftermarket. Only in the second step of the proposed approach – determining "dominance" in the single-brand aftermarket -- is the impact of competition in the primary market taken into account. Here, the Discussion Paper appears to require a separate assessment be made of "customers who have already bought the primary product" (paragraph 254) and appears to treat ease of entry as the only factor that would keep a supplier with a "very strong position on the aftermarket" for its own brand of equipment from being viewed as "dominant" for this group of customers. While suggesting that "the weaker the position of the supplier in question on [the primary] market" the "less likely it is that the supplier in question can be considered dominant on the aftermarket" for its brand of equipment (paragraph 260), in fact the analysis in the Discussion Paper leaves such suppliers exposed to a finding of dominance and of abuse of dominance if they "decide to change policy and raise prices in the aftermarket or restrict the possibilities of other suppliers in the aftermarket." (paragraph 261). In sum once such a supplier has begun to deal with others in connection with the aftermarket for its brand of equipment, the analysis in the Discussion Paper indicates that any attempt to "change policy" will expose the supplier to Article 82 claims.

services is a limited concern. The only example provided is one in which a supplier adopts a "policy change" with respect to aftermarket products or services (paragraphs 261-262).

However, such a change is likely to take place only in very unusual circumstances – where both (1) the entire primary market is declining or the particular supplier has decided to exit or is losing market share and (2) the relevant supplier is not engaged in other equipment markets and thus would not be deterred by the impact of the "policy change" on its reputation (paragraph 262). Even in those very limited situations, there would be no harm to customers if the customers utilized the primary market competition to protect themselves by contract when they purchased the equipment (paragraph 263). We submit that it is preferable to address this limited concern regarding "installed based opportunism" through private contracts rather than by attempting to apply Article 82 to single-brand aftermarkets and treating a "policy change" as a potential abuse of dominance[59]. Otherwise, there is a risk that suppliers will be deterred from adopting more open and flexible aftermarket policies in the first place if future changes in those policies will subject them to a risk of costly investigations, fines, and private damages actions for violation of Article 82[60] .

There is a risk that the Discussion Paper's focus (for example, paragraph 247) on customers who have already purchased the primary product will lead to an over-restrictive analysis on the basis of alleged "lock-in". First, the supplier would need to be able to discriminate against the so-called "locked-in" customers so as not to prejudice sales in the primary market. Secondly, the practical possibility of switching to a different "system" would need to be analysed and not just by reference to up-front purchase costs. This latter point is relevant, for example, in markets where the customer already owns and uses different (competing) systems, for example machinery used with consumable products, and can switch between them whenever the price of the consumables for one system is increased without the need to make a further capital investment (which may be significant in comparison with the increase in the price of the consumables) (see paragraph 249).

Moreover, the supplier risks losing sales in the primary market going forward if, having acquired a sufficiently large "installed base" to make discrimination worthwhile, it then increases prices in the secondary market to customers who genuinely are locked-in, for example because switching costs are too high. The supplier may, however, then suffer reputation damage which reduces future demand in the primary market. This point appears to be missing from the discussion in paragraph 254 -- see also paragraph 261 which postulates a change in policy by the supplier --

[59] See Carlton, "A General Analysis of Exclusionary Conduct and Refusal to Deal – Why Aspen and Kodak Are Misguided," 69 Antitrust L.J. 659, 679-680 & fn 39 (2001); Klein, "Market Power in Antitrust: Economic Analysis After Kodak," 3 Sup. Ct. Econ. Rev. 43, 47-63 (1993).

[60] For example, a supplier might be willing to supply parts to third-party service firms or to train their personnel in order to make its primary products more attractive to customers because of the presence of a number of service alternatives, including alternatives located close to potential customers. Such an approach might assist a small supplier in entering the primary market or in expanding its sales in the primary market. However, if taking such an approach to aftermarket parts and training could not be altered in the future without violating Article 82, it is possible that the supplier would be deterred from pursuing that approach. The concern that efficient conduct that benefits consumers will be deterred by an analysis that places importance on "policy changes" is similar to the problem noted with the different standards set forth in the Discussion Paper for "termination of an existing supply relationship" and "refusal to start to supply".

albeit that it is raised in paragraph 262 in the more limited circumstances of a supplier with declining sales and poor market prospects or of a supplier who has to exit the market. The same reputation point can be made in relation to the possibility of the supplier lowering quality once the customer is locked-in (see paragraph 254), as can the point that the supplier would need the ability to discriminate. In other words, it is appropriate to consider all of the factors which may exercise a constraining influence on the future conduct of the supplier.

The Commission should recognize that the holding of a dominant position in an aftermarket is not abusive *per se* even in the market for consumable of a durable good. Given the typically pro-competitive nature of tying and bundling practices, abuse cannot be established without rigorous economic analysis and a careful balancing of the pro-and anti-competitive aspects of the challenged practice.

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We hope that our comments on the Discussion Paper will be helpful. We welcome the opportunity to expand upon our comments, if necessary.

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