

NOTA DI LAVORO

65.2009

Article 82 EC – The Problems and The Solution

By **John Temple Lang**, Cleary Gottlieb
Steen and Hamilton, Brussels and
London LLP, Trinity College, Dublin and
Senior Visiting Research Fellow, Oxford

INSTITUTIONS AND MARKETS Series

Editor: Fausto Panunzi

Article 82 EC – The Problems and The Solution

By John Temple Lang, Cleary Gottlieb Steen and Hamilton, Brussels and London LLP, Trinity College, Dublin and Senior Visiting Research Fellow, Oxford

Summary

The Commission's Guidance paper on exclusionary abuse under Article 82 EC is open to three fundamental criticisms. First, it leads to less legal certainty, because the rules suggested are vague and imprecise, because dominant companies will not have the information needed to apply them, and because the Commission is trying to change the law, which it has no power to do. Second, it would lead to some anticompetitive effects, because in practice it discourages price competition, by discouraging individualised price negotiations and retroactive rebates, and by suggesting that the Commission will protect not-yet-as-efficient competitors from price competition. Third, it leads to too many "*false positives*", *i.e.*, findings of exclusionary abuse that are not justified in economics or law. The solution is to return to the test in the Treaty as interpreted by the Court of Justice: an exclusionary abuse must involve limiting the production, marketing or technical development of competitors of the dominant company, if harm is caused to consumers.

Keywords: Article 82EC, Competition, Abuse

JEL Classification: K21

This paper was presented at the Conference "Ten years of Mercato Concorrenza Regole", Milan, 30 June 2009

Address for correspondence:

John Temple Lang
Cleary Gottlieb Steen & Hamilton LLP
Rue de la Loi 57
1040 Brussels
Belgium
Phone: +32 2 287 2000
Fax: +32 2 231 1661
E-mail: jtemplelang@cgsh.com

Article 82 EC – The Problems and The Solution

by
Dr. John Temple Lang

Abstract

The Commission's Guidance paper on exclusionary abuse under Article 82 EC is open to three fundamental criticisms. First, it leads to less legal certainty, because the rules suggested are vague and imprecise, because dominant companies will not have the information needed to apply them, and because the Commission is trying to change the law, which it has no power to do.

Second, it would lead to some anticompetitive effects, because in practice it discourages price competition, by discouraging individualised price negotiations and retroactive rebates, and by suggesting that the Commission will protect not-yet-as-efficient competitors from price competition.

Third, it leads to too many "*false positives*", i.e., findings of exclusionary abuse that are not justified in economics or law.

The solution is to return to the test in the Treaty as interpreted by the Court of Justice: an exclusionary abuse must involve limiting the production, marketing or technical development of competitors of the dominant company, if harm is caused to consumers.

This paper was presented at the Conference "Ten years of Mercato Concorrenza Regole", Milan, 30 June 2009.

Keywords: Article 82EC, Competition, Abuse

Jel: K21

Article 82 EC – The Problems and The Solution

by
Dr. John Temple Lang¹

“ EC competition law is not always disciplined in application, nor adequately informed by economics, especially in relation to the analysis of abuse of dominance” – Sir John Vickers²

¹ Cleary Gottlieb Steen and Hamilton, Brussels and London LLP; Professor, Trinity College, Dublin; Senior Visiting Research Fellow, Oxford.

See generally Temple Lang, The requirements for a Commission Notice on the concept of abuse under Article 82 EC, (2007) Finnish Competition Law Yearbook 271-306 and Centre for European Policy Studies Special Report (2008); Hawk, Conduct Element in Abuse of Dominant Position, in Monti, Von Liechtenstein, Vesterdorf, Westbrook & Wildhaber (eds.), Economic law and justice in times of globalisation, Festschrift for Carl Baudenbacher (2007, Nomos, Baden-Baden) 393-403; O'Donoghue & Padilla, The Law and Economics of Article 82 EC (2006, Hart); Giorgio Monti, EC Competition Law (2007) ch. 6, 7; Vickers, Abuse of Market Power, 115 The Economic Journal (2005) F244-F261.

Certain sections of this paper are being included, with modifications, in a Report on the Treatment of Exclusionary Abuses under Article 82 being published by CEPS, the Centre for European Policy Studies in 2009. My views on Article 82 have been clarified by the discussions in the CEPS Task Force, but I am solely responsible for the views expressed here.

² Vickers, Competition Policy and Property Rights, Department of Economics Discussion Paper Series No. 436 (Oxford, May 2009) p. 24.

PART I

The problems faced by the Commission

When the Commission decided that some clarification of the law under Article 82 was necessary, it faced several problems.

No definition of abuse, no policy thinking:

There was no definition of "abuse" in the Treaty. No official effort had been made to say what the underlying or unifying principles might be. The only "strategic" thinking about Article 82 had concerned the question whether it could apply to mergers by dominant companies.

*Continental Can*³ and *Commercial Solvents*⁴ showed that conduct not expressly envisaged by the words of Article 82 can be illegal. *Continental Can* also showed that exclusionary abuse can be committed without using or taking advantage of market power. So the concept of abuse seemed open-ended.

Article 82(b), which prohibits limiting production, marketing or technical development to the prejudice of consumers, had already been held by the Court to prohibit conduct limiting the activities of competitors, in 1975 (*SZV* case, in the *Sugar Cartel* judgment).⁵ But this was not widely seen as a comprehensive definition of exclusionary abuse.

The Commission did not even officially use the long-established classification of abuses (exploitative, exclusionary, discriminatory, and reprisal) until 1999.⁶

Too few cases:

There had been few Article 82 cases.

Article 82 cases had been limited to some Article 234 cases referred by national courts, *United Brands*, some copyright society cases, some "loyalty rebate" cases, the *AKZO* case on predatory pricing, and a couple of cases on excessive prices for compliance certificates for motor vehicles.⁷

Three cases involving intellectual property rights (the *Magill* television programmes case, *IMS Health*, and *Microsoft*) had caused controversy, some of it artificially generated.⁸

³ Case 6/72, *Continental Can* [1973] ECR 215.

⁴ Cases 6 and 7/73, *Commercial Solvents* [1974] ECR 223.

⁵ Joined Cases 40/73 and others, [1975] ECR 1663 at paras. 399, 482-483, 523-527.

⁶ The definition of abuse in Case 85/76, *Hoffmann-La Roche* [1979] ECR 461 para. 91 is a definition only of exclusionary or anticompetitive abuse. It requires distinguishing "normal competition" and "methods different from those which condition normal competition" but does not define either.

⁷ Case 27/76, *United Brands* [1978] ECR 207; Case C-62/86, *Akzo* [1991] ECR I-3359.

⁸ Cases C-241 and 242/91P, *RTE and ITP*, [1995] ECR I-743; Case C-418/01, *IMS Health v. NDC* [2004] ECR I-5039; Case T-201/04 *Microsoft* [2007] ECR II-3601.

In short, the Commission had been opportunistic, and neglected Article 82.⁹

The need to change or clarify the Courts' case law, which the Commission itself has contributed to

The Commission has no power to make or to change the law. The most serious problems concerned pricing, and on pricing issues the Commission had persuaded the Community Courts to accept statements that were widely criticised by economists. So the Commission really needs to change or at least to clarify the Courts' case law, which the Commission has no power to do, as well as its own practice.

The EAGCP economists' paper and the Commission officials' Discussion Paper¹⁰ (both in 2005, both on exclusionary abuses) tried to move in the right direction, but neither was considered satisfactory. There were a large number of comments, not all of them constructive.

It seems that the Commission's own lawyers and economists have been unable to agree on clear statements of what the law is, or what it ought to be. So instead the Commission decided in 2008, in its "Guidance", merely to state its own "enforcement priorities". This led to one of the flaws in the paper: by definition a description of enforcement priorities does not describe "safe harbours", but the opposite. So it is helpful to competition authorities, but less helpful for companies.

⁹ There have been several Article 82 cases decided since the Commission's Discussion Paper was published in 2005:

Case T-170/06 *Alrosa* [2007] ECR II-2601 (now appealed); Case T-340/03 *France Télécom* [2007] ECR II-107; Case T-151/01 *Duales System Deutschland* [2007] ECR II-1607; Case T-201/04 *Microsoft* [2007] ECR II-3601; Joined Cases C-468/06 to C-478/06 *GlaxoSmithKline* [2008] ECR I-____ Sept. 16; Case T-271/03 *Deutsche Telekom* [2008] ECR II-477; Case C-52/07, *Kanal 5* [2008] ECR I-____ Dec. 11. A Swedish court has referred a margin squeeze case involving TeliaSonera to the Court of Justice under Art. 234.

Commission decisions:

Case COMP/38.784, *Wanadoo España v Telefónica*, OJ C 83/05, July 4, 2007 (now appealed); Case COMP/E-1/38.113, *Prokent v Tomra*, OJ C 219/12, March 29, 2006 (now appealed); Case COMP/B-1/37.966, *Distrigaz*, OJ C 9/05, Oct. 11, 2007. The most recent Commission decision is *Intel* (May 2009, against which there will certainly be an appeal).

Commission cases initiated:

Electricité de France, *RWE* (commitments), *Alcan*, *Microsoft* (tying web browser), *Standard & Poor* (tying of licensing fees), *Rambus*.

In addition there are an increasing number of national competition authority decisions in Article 82 cases including excessive prices cases.

¹⁰ DG Competition Discussion Paper on the application of Article 82 of the Treaty to exclusionary abuses (December 2005).

Report by the EAGCP, An economic approach to Article 82 (July 2005).

The Guidance Paper is so different from the previous papers that it is unfortunate that it was not published as a draft for comments.

Discrimination - unanswered questions

As well as the absence of any comprehensive definition of exclusionary abuse, several basic questions about discrimination remain unanswered.¹¹ These questions are relevant to the cases of exclusionary abuse, discussed in the Commission's Guidance Paper.

- Is harm to consumers necessary for discrimination to be illegal? (*Almost certainly*).¹² Mere differences in prices are not likely to harm either competition or consumers.
- Is there a stricter rule against discrimination in favour of the dominant company's own operations than against discrimination between non-associated companies? (*Apparently*).
- May a dominant company justify different treatment based on the other party's situation (*i.e.*, behave as a discriminating monopolist, for example to aid new entrants) even if the transactions are exactly the same as far as the dominant company is concerned? (*Almost certainly*).
- Is it important to make it clear that the rules against discrimination do not prohibit individualised prices? (*Certainly*).
- When is discrimination unlawful if it is neither exclusionary, exploitative, or a reprisal? (*Rarely, see below*).

Reasons for the demand for reform

Apart from these specific problems, the Commission needed to bear in mind a large number of reasons for the demand for reform:

- a) Article 82 was the only competition law area conspicuously uninfluenced by economics.
- b) The risks of discouraging legitimate competition were slowly being understood.
- c) It had become increasingly difficult to give clear and reasonable (that is, not excessively cautious) advice, on pricing and selective rebates.

¹¹ In regulated or recently liberalized sectors, new entrants are often in a different situation from incumbent operators, and this may need to be recognized.

Case C-462/99, *Connect Austria* [2003] ECR I-5197, para. 94; Case C-544/03, *Mobistar v. Commune de Fiéron* [2005] ECR I-7723, para. 49; Case T-475/04 *Bouygues v. Commission* [2007] ECR II-2097, para. 109; Case C-327/03 *ISIS Multimedia and Firma*, [2005] ECR I-8877, paras 45-46; Case C-109/03, *KPN Telecom v. OPTA*, [2004] ECR II-273, Opinion of Advocate General Maduro at para. 41; Case T-328/03 *O2 (Germany)*, [2006] ECR II-1231, para. 107; Case T-271/03 *Deutsche Telekom* [2008] ECR I-477, para. 199.

So little attention has been paid to discrimination under Article 82 until O'Donoghue & Padilla, *The Law and Economics of Article 82 EC*, that "discrimination" does not appear in the index of Giorgio Monti, *EC Competition Law* (2007).

¹² Temple Lang, *Anticompetitive non-pricing abuses under European and national antitrust law*, in Hawk (ed.), 2003 Fordham Corporate Law Institute (2004) 235-340 at pp. 245, 250-253.

- d) Commission statements, and Commission arguments in Community Courts, had become less and less clear.
- e) Decentralisation under Regulation 1/2003 imposed on national antitrust authorities the duty to apply Article 82. Guidelines were needed to coordinate (now) national authorities in twenty-seven Member States (plus the three EEA States).
- f) European lawyers and economists were reading the recent US literature on Section 2, Sherman Act (exclusionary abuses, “monopolization”).
- g) The Commission’s *IMS Health* interim measures decision [2001] suggested that there was a duty to licence, even if there was no conduct other than the refusal to licence, merely because there would otherwise be no competition downstream.
- h) The second *Michelin* case¹³ appeared to say that selective rebates were illegal unless justified by reduced costs. The *British Airways* decision of the Commission in 1999 also seemed to prohibit common practices. (The Commission admitted to the Court in *British Airways* that Article 82 was due for reconsideration).¹⁴
- i) The *Microsoft* case prompted public discussion on Article 82 questions, and comparisons with US law.
- j) Economists argued that the effects of practices on the market should be assessed, and not merely their formal legal nature.
- k) Reg. 1/2003 ended the Commission’s duty to deal with notifications, and left it free to choose its priorities (Article 82 cases had never been notified).
- l) National competition authorities had published notices or guidelines on the interpretation of the national equivalents of Article 82, which were useful and showed that it could be done.¹⁵
- m) DG Competition appointed a Chief Economist to advise, with his own staff.
- n) Increasingly it was understood that some practices previously assumed to be exclusionary could lead to “efficiencies”, that is, are procompetitive, and that the law as the Commission seemed to understand it discouraged desirable competition, in particular price competition.
- o) It was increasingly realised that even the most law-abiding companies are dissatisfied when the law is unclear and appears to be irrational and anticompetitive, in the sense that it discourages competition that is generally considered to be legitimate and desirable.

¹³ Case T-203/09, *Michelin* [2003] ECR II-4071.

¹⁴ Case C-95/04P, *British Airways* [2007] ECR I-____.

¹⁵ See for example the UK Office of Fair Trading publications *The Chapter 11 Prohibition* (Chapter 11 of the UK legislation corresponds to Article 82 EC), and *Assessment of Individual Agreements and Conduct*.

Part II

Introductory comments on the Commission's Guidance document

The Commission's Guidance document discusses only exclusionary abuses, and not exploitative abuses, discrimination, or reprisals. The omission of discrimination and reprisals, both of which are related to exclusionary abuses, is unfortunate. The omission of exploitative abuses was understandable.

On a number of specific points, discussed below from an essentially practical viewpoint, several criticisms of the Guidance Paper are necessary.

1. No limiting principles. The document does not show any awareness of the need to state limiting principles, either to clarify the ideas being described, or to prevent them being taken too far and giving rise to anticompetitive results. If no limiting principles were added or imposed, the effect of the Guidance Paper would be significantly anticompetitive in a number of ways.
2. No comprehensive concept of foreclosure. It does not suggest any comprehensive concept of "foreclosure" or "exclusionary abuse". In places it refers to "foreclosure" without making it clear whether foreclosure due to illegal conduct is referred to, and without recognising that a less efficient competitor may be lawfully and legitimately "foreclosed" and pushed out of the market by normal competition, that is, as a result of the dominant company offering better products or lower prices. So limiting principles are clearly needed. (Para. 19 does not define anticompetitive foreclosure adequately).¹⁶
3. No guidance on new kinds of conduct. The Guidance Paper discusses only well-recognised kinds of exclusionary abuse, and does nothing to help to deal with new or unusual kinds of conduct, for which guidance would be most needed.
4. No reliance on legal principles. The text is economic, and non-legal. (The reader's clear impression is that legal footnotes were added afterwards). No effort is made to base what is said on the express words of Article 82, which is the legal basis. The paper makes no visible effort to get the Community Courts to accept the theories suggested. It does not seem to be written with the Community Courts in mind. Judgments are cited, when they seem to illustrate or resemble the statements made, but the statements do not seem to build on or draw conclusions from the judgments. The paper does not indicate when the Commission believes that it is stating existing law, or when (as it certainly is in some cases) it is going significantly further, or suggesting changes in the law. Nor does it expressly correct any of the much-criticised features in the existing law of pricing. There is no legal analysis.

¹⁶ Vickers, Abuse of Market Power, 115 The Economic Journal (2005), F244-F261, says that without underlying substantive principles "there would be a danger that competition law towards abuse of dominance could become a set of ad hoc and unpredictable rules that are consistent neither with each other nor with the policy goals of the law" (F247). See Rey & Tirole, A Primer on Foreclosure, in Armstrong & Porter (eds.), Handbook of Industrial Organisation, Vol. III (2005).

5. Too much reliance on companies' intentions. The Guidance Paper relies too much on the subjective intention or strategy of the dominant company, in spite of the fact that abuse has been repeatedly said to be an objective concept.¹⁷ It is clear from *e.g.*, the Commission's Preliminary Report on its sector enquiry into the pharmaceutical industry, that this is undesirable, among other reasons because it leads the Commission to attribute importance to aggressive statements instead of considering whether the conduct of the dominant company was inherently or objectively exclusionary or anticompetitive.

6. The dominant company cannot be expected to apply some of the suggested rules, since it cannot be expected to have the information needed to apply them. This is contrary to the principle of legal certainty,¹⁸ and is clearly unrealistic and unwise policy. For corresponding reasons the Guidance Paper is unsatisfactory also because it suggests that various kinds of conduct are illegal, apparently without considering how the Commission could write a remedy. How, for example, could the Commission define not-yet-as-efficient competitors which might need to be protected against competition?

7. Efficiencies. Since the document proposes wide concepts of abuse in various respects, it would be better balanced if it also said more about defences and efficiencies, *e.g.*, in connection with below-cost prices. At present it is unbalanced, in particular because it does not say enough about the need to prove harm to consumers. It does not even say whether meeting competition is a defence (an issue not resolved in the *Wanadoo/France Télécom* case).¹⁹
 For example, it would be useful to say that in markets where demand is elastic, it may be procompetitive to reduce prices to encourage buying. It would also be useful to say that if conduct has *e.g.*, desirable externality effects on public health or the environment, these will be taken into consideration.
 The discussion of efficiencies relies too much on the analogy with Article 81(3). Because Article 81(3) does not allow competition to be eliminated by agreement, this purely legal analogy has led the Commission to the conclusion that if an efficiency is so great that it leads to the dominant company obtaining a monopoly, the conduct causing the efficiency should be illegal. This would deprive consumers of the benefit of an efficiency when it is important enough,

¹⁷ O'Donoghue & Padilla, *The Law and Economics of Article 82 EC* (2006), pp. 225-227; Case T-279/02, *Degussa* [2006] ECR II-897, paras. 35 and 66; Case 169/80, *Gondrand Frères*, [1981] ECR 1931 para. 17; Case 137/85, *Maizena*, [1987] ECR 4587, para. 15; Case C-143/93, *van Es Douane Agenten* [1996] ECR I-431, para. 27; Case C-129/95, *X* [1996] ECR I-6609, para. 25.

Temple Lang, *Legal Certainty and Legitimate Expectations as General Principles of Law*, in Bernitz & Nergelius (eds.), *General Principles of European Community Law* (Kluwer, 2000), 163-184; Tridimas, *The General Principles of EU Law* (2nd ed., 2006) ch. 6, pp. 244-246. Of course the larger the fines imposed for breaches of Art. 82, the greater the need for legal certainty in the definition of exclusionary abuse.

¹⁸ Case T-271/03 *Deutsche Telekom* [2008] ECR II-477 at para. 192. Commission officials admit that "*the enforcement system must be designed in a way that guarantees coherence and predictability for business*": Lowe, *The design of competition policy institutions for the 21st century*, 2008 Competition Policy Newsletter (No. 3) 1-11 (emphasis in original). As explained below in the text, a dominant company cannot be expected to know with confidence and precision what its customers' purchasing plans are, to calculate what rebates are lawful.

¹⁹ Case T-340/03, *France Telecom* [2007] ECR II-107, para. 187.

which is absurd, would prevent the emergence of natural monopolies, and would prevent or interfere with competition “for the market”.²⁰ In short, it is an effort to prohibit “tipping effects”. It would limit the ability of dominant companies to become more efficient.

8. *Too many presumptions.* The Guidance Paper relies too much on presumptions, not all of which are justifiable. These presumptions, because they throw the burden of proof onto the dominant companies, make it particularly unfortunate that the discussion of efficiencies is incomplete and unsatisfactory.

These flaws are all the result, directly or indirectly, of not having a single comprehensive principle on exclusionary abuses, and they would be resolved by adopting a general legal principle, if it was a sound one. None of these flaws are due to any lack of clarity in the case law of the Community Courts. They are due to a theoretical and regulatory approach.

Pricing

The most important weaknesses in the Guidance Paper concern pricing and refusal to contract. Pricing is something that every dominant or potentially dominant company has to do, so the omissions and defects in what is said about pricing are serious. They are particularly serious because the rules on pricing were the most unsatisfactory aspect of the case law before the Commission’s papers were published,²¹ and the Guidance Paper has certainly not reduced or resolved the problems.

(i) Pricing – omission of Article 82(c) on discrimination

The Guidance Paper discusses only exclusionary abuses, and not discrimination. But a paper that discusses foreclosure in pricing without considering discrimination is seriously incomplete. In particular, the Guidance Paper does not say that in most cases price rebates and other differential prices that are permitted as non-exclusionary under the Guidance Paper are also legal under Article 82(c).

More seriously, para. 20 even says that if a practice is applied selectively, only to selected customers or input suppliers which may be particularly important for competitors, that may increase the likelihood of anticompetitive foreclosure. This clearly fails to distinguish legitimate from undesirable competition.²² Para. 45 also suggests that individualised rebates are likely to be unlawful (presumably, because they are thought to lead to exclusive dealing, and not because they are discriminatory). It should be said that if a

²⁰ Temple Lang, Efficiencies in European competition law, in Baudenbacher (ed.), Current developments in European and international competition law: 14th St. Gallen International Competition Law Forum 2007 (2008) 45-76, pp. 58-62.

²¹ Temple Lang and O’Donoghue, Defining legitimate competition: How to clarify pricing abuses under Article 82 EC, 26 Fordham International Law Journal (2002) 83-162.

²² This is a question which certainly needs to be clarified, since Case T-228/97, *Irish Sugar* [1999] ECR II-2969 appears to suggest that selectively matching competitors’ prices above LRAIC can be illegal, which would be anticompetitive if it were the law.

rebate is equally available to all buyers, the fact that only some will qualify for it does not make it illegal.²³

In general, different treatment that is neither exploitative nor exclusionary nor a reprisal, and which involves prices above cost, should be considered legal.

However: -

- Discrimination on the basis of nationality, even *de facto*, is apparently illegal, even if it is neither exclusionary nor exploitative.
- Discrimination may be illegal if it is linked with some other conduct that is contrary to Article 82, if that is made possible or made more serious by the discrimination, or if the discrimination takes advantage of the other conduct.
- Discrimination is illegal if the market power of the dominant company is due to a patent pool, a joint venture, or a standard-setting agreement, the existence of which would seriously handicap outsiders unless they were given non-discriminatory access (*IGR Stereo Television - Salora*).²⁴ (This is a result of both Article 81 and Article 82).
- Some kinds of non-price discrimination are illegal.

Targeted discrimination can also be illegal if it is a reprisal.

(ii) Pricing - "Not yet as efficient" competitors

The Commission begins by saying that it will “normally” intervene where the conduct is capable of hampering competition from competitors which are as efficient as the dominant company. That principle has been developed by some economists to provide a rule for predatory pricing (prices below an appropriate measure of cost). It is also applicable to margin squeeze cases. It is a clear and sensible approach, and if it was followed consistently it would be better than the existing case law. It has the important advantage that it enables the dominant company to assess the lawfulness of its conduct on the basis of information that it has or can obtain.

But the Guidance Paper shows that the Commission does not plan always to follow the “as efficient competitor” approach. The Commission goes on (paras. 24-25) to indicate that it will also act in other pricing cases, (that is, it will stop conduct that harms competitors that are “not yet as efficient as” the dominant company), without saying when or why. Even if this were legitimate in principle, it is not workable in practice, in pricing cases (it might perhaps be useful in some non-pricing cases). Competition law is not supposed to provide protection for inefficient firms against legitimate above-cost price competition.

²³ See however Case C-163/99, the *Portuguese airport charges* case [2001] ECR I-2613.

²⁴ Eleventh Report on Competition Policy (1981), pp. 63-64 (a case based only on Article 81, but the result would be the same under Art. 82). See Temple Lang, *International Joint Ventures under Community Law*, in Hawk (ed.), 1999 Fordham Corporate Law Institute (2000) 381-464, pp. 447-450.

This suggestion represents an attempt to change the law as it has been generally understood.

The dominant company has no way of knowing when the Commission would do this, or which company might be thought likely to become as efficient, or how much of a price umbrella to provide, or for how long. (The Commission merely says that “*a competitor ... may benefit from demand-related advantages, such as network or learning effects, which will tend to enhance its efficiency*”: para. 24).²⁵ The dominant company would need to raise its prices to all its customers, since it would not know which customer the not-yet-efficient rival was trying to sell to, or what the rival’s break-even point would be at any time.

In short, the “not yet as efficient” competitor test is impractical (there is no way to know when it would apply, or what the consequences should be), undesirable (it would protect inefficient competitors at the expense of consumers), and illegal (competition law is not intended to protect the inefficient from competition). It would encourage illegal contacts between the dominant company and new entrants, to see how much of a price umbrella they would need. It would also encourage inefficient market entry, and reduce the incentives for new firms to become efficient. It would also be impossible to administer: how many inefficient competitors should be protected? Should new inefficient entrants be protected, if some inefficient entrants have already been protected for several years? In the context of refusal to supply cases and margin squeeze cases, it has always been accepted that a dominant company has no duty to subsidise a competitor.

It is also unsatisfactory because it is said that anticompetitive foreclosure is more likely where competitors are not able to compete “on equal terms” (para. 39). The Guidance never says whether the Commission thinks that *e.g.*, a competitor with fewer economies of scale is “on equal terms” with, or as efficient as, the dominant company, a crucial question.²⁶

²⁵ Curiously, the Commission does not mention the desirability of competition in product variety. That would not lead to a practical criterion (how could a dominant company know which of its competitors was likely to produce new varieties of products or services?) but it would indicate what the Commission might have in mind.

²⁶ A dominant company by definition is dominant because it has advantages not enjoyed, or not enjoyed to the same extent, by its competitors. These may be economies of scale or scope, network effects, large portfolios of products or services, larger customer bases which make differential pricing possible, or simply the fact that the company or its products are well-known. It would be impossible to distinguish, even if it was legally permissible to do so, between advantages from which a dominant company could legitimately benefit and those from which it could not. It would also be impossible to calculate precisely how much each of these elements contributed to reducing the dominant company’s costs. If the Commission were to act on this basis, it would therefore have to impose an essentially arbitrary minimum price or price umbrella on the dominant company, to protect the less efficient competitors. This would be price regulation, not competition law. It would also deprive consumers of the benefits of the dominant company’s greater efficiency. In the long term, if a dominant company was not allowed to compete, its dominant position would be eroded, which would clearly be illegal. It is hard to believe that the Commission has given this sufficient consideration. (Of course insofar as a dominant company’s competitive advantage is due to its illegal conduct, the advantage may be neutralized if that is possible). In Case T-170/06 *Alrosa* [2007] ECR II-2601, para. 146, the Court of First Instance said: “*Since the object of Article 82 EC is not to prohibit the holding of dominant positions but solely to put an end to their abuse, the Commission cannot require an undertaking in a dominant position to refrain from making purchases which allow it to maintain or to strengthen its position on the market, if that undertaking does not, in so doing, resort to methods which are incompatible with the competition rules. While special responsibilities are incumbent on an undertaking which occupies such a position (Michelin v. Commission, paragraph 57), they cannot amount to a requirement that the very existence of the dominant position be called into question.*”

Dominant companies must be encouraged to seek greater efficiency, and they cannot be encouraged to do so unless they are allowed to keep the benefit for themselves. This is so even when it might be said that overall market efficiency might be improved if a competitor remained in the market. In theory, this is when the gain in allocative efficiency through lower prices can outweigh the loss in productive efficiency through higher costs. But competition authorities and courts cannot reliably decide when this might ultimately prove to be so, and it would be contrary to the principle of legal certainty to require dominant companies to assess, in advance, how competition authorities might ultimately decide. The economic theory that says that a less efficient competitor may sometimes have a beneficial effect on the market is not capable of being made into an operational legal principle in competition law.²⁷ (It can sometimes be used in a regulatory context, for measures to operate *ex nunc*).

If the Commission really intends to insist, even occasionally, on dominant companies providing price umbrellas for rivals with less economies of scale, the effect would be very anti-competitive.

"Not yet as efficient" competitors and reprisal abuses

The Commission's concern is reasonable in one specific type of situation, but one which is not clearly envisaged in the Guidance Paper.²⁸ Competitors that are aggressive, but not yet efficient, might provoke a targeted reaction from the dominant firm, so in situations in which the Commission might try to protect a not-yet-as-efficient competitor, the conduct of the dominant company would be specifically aimed at the competitor in question. In that situation the Commission should instead rely on the principle, of which the Commission is not sufficiently aware, that prohibits "reprisal" abuses. Illegal "reprisals" include conduct aimed at an aggressive competitor and intended to warn it to compete less vigorously. That would be a very much more sound and justifiable approach than the not-yet-as-efficient theory, and a much more practical one.²⁹

²⁷ See Elhauge, Why above-cost price cuts to drive out entrants are not predatory, 112(4) Yale Law Journal (2003) 681-828.

²⁸ It is mentioned in para. 77.

²⁹ Some Commission officials believe that when a company is "super dominant" (undefined), it is appropriate to protect less efficient competitors, to prevent complete monopolization, or as a supplement to regulatory measures. This seems to be a regulatory approach not based on competition law.

On reprisals see Temple Lang, Reprisals and overreaction by dominant companies as an anti-competitive abuse under Article 82(b), 29 European Competition Law Review (2008) 11-15; Case 27/76 *United Brands*, [1978] ECR 207, at paras. 189-191; Case T-65/89 *British Gypsum* [1993] ECR II 389 at p. 418; joined cases T-24/93, *Compagnie Maritime Belge* [1996] ECR II 1201 at p. 1243 and 1252; Case T-133/95 *International Express Carriers Conference*, [1998] ECR II 3645; Case T-111/96, *ITT Promedia*, [1998] ECR II 2937 para. 60; Case T-5/97, *Industrie des Poudres Sphériques*, [2000] ECR II 3755 paras. 211-218; see also Case T-228/97, *Irish Sugar*, [1999] ECR II-2965; Case T-210/01, *General Electric v. Commission*, [2005] ECR II 5575 para. 306; Case C-52/07, *Kanal 5* [2008] ECR I-____ Dec. 11; Joined Cases C-468/06 to C-478/06, *GlaxoSmithKline* [2008] ECR I-____ Sept. 16 paras. 50, 69-71, 76. A reprisal is illegal if it is intended as a punishment or a warning, even if the conduct is not otherwise exploitative or exclusionary.

The Commission's Discussion Paper para. 208 referred to this case law, but said that it is "best viewed" as concerning refusals to supply as an instrument to achieve *e.g.*, exclusive dealing, which is too narrow an understanding of the cases, and disregards the fact that the principle has been repeatedly stated in cases not concerned with exclusive dealing. The Guidance Paper (para. 77) also says that

Reprisal abuses can, of course, be committed against companies that are as efficient as (or more competitive than) the dominant company. The prohibition of reprisals is broader in scope, and more important, than the question of not-yet-as-efficient rivals. Also, reprisals can be committed against customers and suppliers which complain to competition authorities, as well as against competitors.

It is hard to assess how much under-enforcement has resulted from the fact that the Commission has never made a public statement that reprisals are illegal (and the Commission seems not to understand the need to say this), but it is certainly significant.

(iii) Foreclosure, anticompetitive foreclosure, and "loyalty-inducing" conduct

The Guidance Paper says that there is a distinction between “anticompetitive foreclosure” and foreclosure due to legitimate competition. This distinction is certainly crucial, but it is not made clearly. For example, para. 20 says that there may be evidence of actual foreclosure if competitors have left the market. But one cannot judge from the fact that they left the market whether the dominant company’s conduct was legal or illegal. These are not mere drafting defects: the whole document is ambiguous on this fundamental question.

The section on anticompetitive foreclosure (paras. 19-21) is also unsatisfactory because most of the “factors” listed as relevant are structural, not behavioural, and so they are relevant to dominance rather than abuse. (The only behavioural factors are the “extent” of the conduct in question, which proves nothing about whether it is anticompetitive or not, and evidence of exclusionary strategy, which proves nothing about whether the means used were anticompetitive). The apparent implication is that if a company is dominant and its competitors leave the market, there must have been abuse. That is clearly wrong.³⁰

Rebates

Rebates are discussed in the Guidance Paper under the heading “exclusive dealing”.³¹ This is understandable where a rebate is given on condition that the buyer buys, during the relevant period, exclusively or almost exclusively from the dominant company, because that imposes a financial penalty for even a small purchase from a rival. However, the Guidance discusses rebates that are said to “have actual or potential foreclosure effects similar to exclusive purchasing obligations” (para. 36). This is ambiguous. A rebate may legitimately lead to a buyer buying all its requirements from the dominant company, because the dominant company offers the lowest price or the best value. The Commission has previously used the phrase “loyalty-inducing”, which is equally ambiguous. The phrases quoted do not make this important distinction, and if the Guidance Paper was acted on, it would lead to Commission decisions with clearly anticompetitive effects.

refusals to supply, to punish customers for dealing with competitors, will be examined on the basis of the principles on exclusive dealing, tying and bundling.

³⁰ A better approach to anticompetitive foreclosure would look for proof of substantial market foreclosure (including the proportion of the market in fact foreclosed), proof that the degree of foreclosure significantly reduced the competitiveness of competitors (did it prevent them obtaining necessary economies of scale?), and proof that the reduced competitiveness would affect prices or output.

³¹ See OECD Roundtable on Loyalty and Fidelity Discounts and Rebates, 29 May 2002.

On the basis of Article 82(b), a rebate should be illegal only if it (1) leads to an effective price below cost or (2) is conditional on exclusivity, that is, the rebate already obtained is lost, and the buyer suffers a penalty by losing a reduction already obtained, if it buys from a rival. (It is the condition that is illegal, not the rebate). Rebates given on condition that the buyer limits purchases from its competitors give the dominant company market share by handicapping competitors and limiting their efficiency without increasing the efficiency of the dominant company. But even in this second case it can be procompetitive to allow dominant companies the right to bid for exclusivity, and some important buyers insist on this, to get the lowest prices, or because they are more efficient if they deal with a single supplier. Where exclusivity gives sufficient benefits to the buyer, (or to the dominant company, *e.g.*, if it needs a guarantee of exclusivity to justify customer-specific investment),³² they may outweigh the restriction on competition. But the case law of the Community Courts does not recognise this yet, and the Guidance Paper does not state it clearly, although it is recognised by economic theory.³³ It is also well known in various sectors of industry, in particular in connection with capital equipment that requires regular maintenance and servicing, *e.g.*, engines of aircraft.

Incremental and retroactive rebates

Rebates may be “incremental” (given only on purchases above a threshold) or “retroactive” (given on all previous purchases made during the period, after the threshold is reached). The effect of what the Commission said, (para. 42), for incremental rebates, is that the net or effective price resulting from the rebate must be above the dominant company's Long Run Average Incremental Cost (LRAIC) of producing the quantity above the threshold. This is clear and understandable.

All the Commission needed to say about retroactive rebates is that the effective price, for the quantity that gives rise to the rebate plus one unit, must be above LRAIC. That would have been clear and intelligible.

But that is not what the Guidance Paper says.

The Commission intends to estimate what price a rival would have to offer to compensate the buyer for the loss of the rebate, if the buyer changed suppliers. For incremental rebates, one must look at the price that the rival must offer to match the nominal or net price resulting from the rebate, for the increased purchases above the threshold. If that price is above the LRAIC of the dominant company, it is “normally” not capable of foreclosing (the word “normally” is not explained).

In the case of incremental rates, looking at what the rival needs to offer, rather than looking at the dominant company's net price, is an unnecessary complication. For retroactive rebates, what the Commission says is far more complicated.

³² Elhauge, Why above-cost price cuts to drive out entrants are not predatory – and the implications for defining costs and market power, 112 Yale Law Journal 681 (2003).

³³ See para. 46 of the Guidance Paper. In other respects the Commission has made use of economic theory when it leads to stricter requirements for dominant companies, but not always when equally well-established theories suggest efficiency defences.

(iv) **Pricing - retroactive rebates and the “relevant range”**

A major flaw in the Guidance Paper concerns the calculation for retroactive rebates.

First, the Commission says that one must estimate how much of the buyer's purchase requirements could realistically be switched to a rival (the “contestable share”: para. 42). This presumably depends on both the buyer and the rival, and would be different for different buyers, and for different rivals (for example, it would depend on their long-term contracts). The dominant firm cannot estimate any of these quantities with precision or confidence, without confidential information about both its customers and its rivals that it cannot be expected to have.³⁴

Then one must estimate the part of the demand that the buyer is likely to switch (“the relevant range” para. 40) or the proportion that the rival might offer to supply of the tranche offered by the dominant company subject to the rebate. This is not the same as the contestable share (para. 41). It is a subjective matter, very much within the discretion of the buyers, and not (except by coincidence) the same for all buyers, or for a given buyer at different times.

One must then estimate, for the “relevant range”, the price that the rival would have to offer to compensate the buyer for the loss of the rebate, if the buyer switched that quantity (para. 40). The dominant firm must estimate the price that the rival would have to offer, for the “relevant range”, to match the dominant firm's “effective” price after deducting the rebate. The “effective” price is the nominal price of the tranche subject to the rebate, minus the rebate given on earlier purchases. Because the rival must offer, for that quantity, a price that is less than the dominant firm's nominal price for the “relevant range” part of that tranche (because the rival also has to match the amount of the rebate on previous purchases), the dominant firm must ensure that its “effective price” (that is, its price after deducting the rebate for previous purchases: paras. 41-44) for the “relevant range” is above its LRAIC.

The Commission does not suggest how a dominant company could calculate the “relevant range” (or even the “contestable share”, although that might be easier) with anything approaching precision. In fact, this approach could be used only with hindsight and access to confidential information.

The objections to the concept of the “Relevant range” for retroactive rebates

There are a number of fundamental objections to this complicated “relevant range” approach for retroactive rebates.

1. It requires dominant firms to keep their prices up, and competition law is intended in general to bring them down, except in cases of clear below-cost pricing.
2. The dominant firm cannot make the calculations needed. It is unworkable in practice, too complicated, and the “relevant range” is imprecise and

³⁴ Calculating the contestable share may also be difficult or impossible, at least with precision, for other reasons. If there are sub-markets, some of them may be contestable and some may not. Whether a market is effectively contestable for a given competitor may depend on whether it has some experience, on capacity constraints, economies of scale and scope.

subjective, and cannot be precisely known to the dominant company. This is inconsistent with the principle of legal certainty.

3. It would be arbitrary, because the “contestable share” and the “relevant range” may be different for different buyers, and different rivals. There is no rational way of deciding whose share or range should be used. The Commission’s description does not envisage situations with more than one competitor or with more than one buyer. For a cautious dominant company, the effect would presumably be to raise the company’s price to the highest of the alternative levels.
4. If the “relevant range” (the part of its demand that the buyer is likely in practice to switch) is small, then the dominant company’s “effective price” for that quantity will be lower (because the retroactive rebate on purchases below the threshold is spread over a smaller quantity) and so it is more likely that its effective price will be illegal. This means that the smaller the quantity likely to be bought from rivals, the higher the dominant firm must raise its effective price, to provide a price umbrella for potential suppliers of that quantity. This is an irrational and absurd consequence of the “relevant range” concept.
5. It draws an unjustified distinction between incremental and retroactive rebates. The latter are not inherently more likely to lead to prices below the dominant company’s costs than incremental rebates. It all depends on the size of the rebates.
6. The Commission treats the loss of a chance to get a price reduction (lost if the buyer chooses to switch) as if it was a penalty paid by the buyer for switching. The Paper should consider the possibly anticompetitive nature of the conduct, not its possible effect on the buyer’s purchases.
7. It is unjustifiably regulatory, because it gives the Commission the task of managing the dominant company’s price, on the basis of an artificial calculation, to protect rivals from price competition.
8. It is unreasonable to say that the pricing obligations of a dominant company vary according to the wishes of any one of its potential customers.
9. It disregards the possibility, mentioned above, that buyers may be more efficient if they deal exclusively with one supplier, and that they should be allowed to make suppliers bid for that position.
10. The approach is even more uncertain than the above description suggests, because the Commission adds more qualifications, not already mentioned:

The Commission may look at “other factors” if the dominant company’s price is between average avoidable cost (AAC) and LRAIC (para. 44). The Commission will decide whether the threshold is individualised (para. 45). However, even a standard quantity discount may be illegal if it “approximates [to] the requirements of an appreciable proportion of customers” (para. 45). No indication is given of what “approximates” and “appreciable proportion” mean, and even a dominant company does not necessarily know what its customers’ total requirements are. The Commission will see if “realistic and effective counterstrategies” are available to rivals (para. 44). Last, the dominant firm may justify a given price by reference to efficiencies (para. 46).

The “contestable” share

The idea of a contestable share is open to many (though not all) of the same objections as the “relevant range”. The share of one buyer’s requirements that is contestable is not necessarily the same, in absolute or percentage terms, as the share of another’s. The proportion of all buyers’ requirements that are contestable by one competitor is not necessarily the same as the proportion that is contestable by other competitors. Apart from the fact that the dominant company is unlikely to know these figures, it is not clear what it is supposed to do if all these figures differ. Product differentiation, quality differences, differences in production capacity, and many other factors might have to be taken into account. The concept of contestable shares, while no doubt theoretically valid, is unworkable in all but the simplest cases. If taken seriously by a cautious dominant firm, it would seriously discourage price competition, as well as greatly increasing transaction costs by involving cost accountants, economists, industry experts (to estimate production capacities) and lawyers.

Retroactive rebates: The practical effects, and the alternative solution

The effect of all this will be to discourage dominant companies from giving retroactive rebates, or to cause them to give small rebates, an anticompetitive result that could not have been intended by the Commission.

In practice, if both the concepts of contestable share and relevant range were abandoned, the final result would apparently be to require the net effective price for the threshold quantity plus one, after granting the rebate, to be above LRAIC. That would be a simple, clear, and justified rule, would provide a safe harbour, and make the rules on both kinds of rebates consistent.³⁵ But that is not what the Guidance Paper says.

³⁵ The relevant range is the part of the buyer's demand that is likely to be switched (paras. 40, 41), and the question is the price the rival needs to offer for that quantity. One should not assume that the competitor's offer is made precisely at a time when the buyer is just below the threshold quantity, and the buyer is choosing which to buy from. (Para 39 of the Guidance says that this is not the right approach). That is not a consequence of either the contestable share idea or the relevant range concept. But if the maximum quantity that the buyer can buy (contestable) or is likely to buy (relevant range) from the rival is small, the buyer will have to decide whether to buy it at all, if that would jeopardise its chances of getting the retroactive rebate. That decision, of course, can be taken at any time. But it is an important decision only if the quantity involved is or will be crucial to whether the buyer reaches the threshold or not. So, in effect, the rival might be competing for the minimum quantity that would make the difference.

That might occur if the contestable share is very small. But it is not likely to occur because the relevant range is very small, (although the relevant range must be equal to or less than the contestable share, assuming for simplicity that there is only one rival and only one buyer). The buyer is not likely knowingly to choose to buy a quantity that is likely to cause it to lose the rebate. So a cautious buyer who wants or needs the rebate will buy only from the dominant company until it has got the rebate, and will only then consider buying elsewhere.

In that situation, the relevant range is only the quantity above the threshold that the buyer may find itself able to buy. Therefore, if the price for the minimum quantity above the threshold is above LRAIC, it seems that in practice there is a safe harbour.

In other words, the assumption that the relevant range, which is entirely within the buyer's discretion, might be both (i) small and (ii) crucial, is unrealistic. Also, the approach in the Guidance Paper implicitly assumes that the threshold is close to the quantity that most buyers buy. If it is well above that quantity, or well below it, it can hardly have a foreclosure effect.

(v) Pricing below cost and “sacrifice” of profits

In the *AKZO* case³⁶ the Court stated two rules. First, it is illegal to charge prices below average variable cost (usually equivalent to average avoidable cost). Second, it is illegal to charge prices below average total cost if there is evidence that this was part of a plan to force a competitor out of the market. That was clear.

The Guidance Paper goes much further. The Commission is, clearly, trying to change the law, (not merely to describe a situation coming under the second *AKZO* rule). “Deliberately foregoing profits in the short term, to foreclose a competitor” (referred to as “profit sacrifice”) is said to be illegal. It is illegal if the conduct “led in the short term to net revenues lower than could have been expected from a reasonable alternative conduct, *i.e.*, whether the dominant undertaking incurred a loss that it could have avoided” (paras. 63-65).

This suggestion:

- Is not limited to prices below average total costs.
- Is therefore clearly not intended merely to describe a possible strategy of the kind mentioned in *AKZO*.
- Is inconsistent with the Commission’s own basic as-efficient-competitor principle.
- Is extremely vague and difficult to apply (what alternatives were reasonable, at the time when the conduct began? Why did the company choose a course of action that has turned out to be less profitable than another which it might have chosen?)
- Does not distinguish between foreclosure that is legitimate and lawful (due to offering better value), and foreclosure that is unlawful (because the means used are anticompetitive for some identifiable reason). In other words, the serious ambiguity in what the Commission says about rebates is also a flaw in what it says about “profit sacrifice”.
- The “profit sacrifice” concept does not explain why it is thought likely to be anticompetitive (rather than procompetitive) to charge a lower price than might have been charged, and if this concept was applied to prices above average total costs, it would be inexplicable. A dominant company should not be told that it must always charge as high a price as it can. It certainly should not have to justify *e.g.*, charging a lower price to promote more widespread use of its products, or offering a cheap version as well as an expensive version of its products, since both practices, like almost all “profit sacrifices”, clearly benefit consumers.

³⁶ Case C-62/86, *AKZO* [1991] ECR I-3359.

It is hard to imagine that any “profit sacrifice” test could be applied unless there was clear evidence that the dominant company had considered two courses of action and deliberately chosen the less profitable one, primarily in order to foreclose a competitor, and without an economic reason. As an intention to foreclose competitors (in some sense) is relevant under both the *AKZO* principles and the suggested new “profit sacrifice” test, surprise inspections may be needed with either test.

If this suggestion were upheld by the Community Courts (which is doubtful because it is plainly contrary to the *AKZO* judgment, and without any obvious reason or justification), it would be so broad that defences would have to be very clearly recognised. The Commission is clearly reluctant to accept efficiency defences in below-cost pricing cases, and it only says that efficiencies to achieve economies of scale or “related to expanding the market” will be considered. This suggests that the Commission has not given the question much thought. Defences should be clearly accepted at least for:

- Meeting competition, at least above average avoidable cost.
- Promotional expenditure and loss-leading.
- Reaching economies of scale in network industries.
- Start-up of big investments.
- Excess capacity in a recession.³⁷

The Commission should alter the Guidance Paper to refer to profit sacrifice only as a possible example of the second *Akzo* rule.

(vi) **Margin squeezes**

The Guidance paper treats margin squeezes as examples of refusal to contract. This does not make the law clear. It is not even clear whether a margin squeeze can be illegal only when a refusal to contract would be illegal under Article 82, (or whether the Commission believes that this is so), and the circumstances in which a refusal to contract is illegal are not clear either. As margin squeezes are arising more often, in particular in telecommunications, this basic uncertainty is serious. Faced with a supposed margin squeeze case, does one need to go through the whole list of issues in connection with refusal to contract, before one begins to analyse the two price levels? This has not been the practice of the Commission in margin squeeze cases.

In a margin squeeze, the downstream competitors are buying the input from the dominant company at the non-discriminatory price at which (at least in theory) it is sold to the dominant company's downstream operations. The dominant company controls the retail

³⁷ In a recession, capacity utilization is likely to fall and unit costs to rise, and they may rise above the previous price level, which the company may be unable to increase. Since in such circumstances the situation is not the result of anything done by the company, there should clearly be no abuse. It is curious and unfortunate that the Commission has apparently not considered such well-known situations as this and the others listed in the text.

price. If, on the basis of this wholesale price, the dominant company's downstream operations are losing money, there is an illegal squeeze.

This comparison between the wholesale price of the input and the retail price of the final product assumes (and can be meaningful only in) the relatively simple case in which both the dominant company and its downstream competitors have the same business model and both use the input in the same proportions in their final products. Also, there can be an illegal squeeze only if the wholesale price of the input is a substantial proportion of the costs of downstream operations.³⁸ If these assumptions are not true, no conclusion about the effect for competitors can be drawn from the fact that the dominant company's downstream operations are loss-making on the basis of its price for the input, even if that is shown. The as-efficient-competitor test necessitates similar operations.³⁹

It is now established that the test is whether the dominant company's own downstream operations are or would be profitable if they paid the input price charged to the downstream competitors. The test is not whether the competitors are profitable on the basis of that price. This was clearly decided in *Deutsche Telekom*,⁴⁰ and is clearly correct, because it is only on this basis that the dominant company can tell whether its prices are lawful or not.

In theory, the upstream or wholesale price might be excessive (and contrary to Article 82(a)), or the retail price might be below cost. The assumption is, however, that a margin squeeze can be illegal in other circumstances (otherwise no separate discussion, and no reference to the duty to contract, would be needed). On this basis, a margin squeeze would be contrary to Article 82(b) (limiting the marketing and production of competitors, if there is harm to consumers). It may be possible to regard a high input price as exclusionary as well as exploitative, but that does not seem to add much to the analysis.

Clearly there are differences between a margin squeeze and a below-cost retail price:

- In a margin squeeze, the vertically-integrated dominant company is not necessarily losing money overall. It might merely be taking its profit upstream.
- In a below-cost selling case, the remedy is to increase the price. In a margin squeeze case, the dominant company may either reduce its upstream price, or raise its retail price, or do both. It follows that in a margin squeeze case the arguments against giving a remedy are not as strong as they are in a refusal to supply case, in which any remedy is likely to have some effect of lessening the value of the dominant company's investment in its asset or infrastructure.

Margin squeezes involve special difficulties where, as is often the case, the vertically integrated dominant company has invested in a large network or infrastructure which cannot be expected to make a profit overall in its first years. In such situations the company will be trying to attract customers to its downstream operations, and therefore to the whole network.

³⁸ Even if the input price is small, there may still be illegal discrimination under Art. 82(b) or (c), although it might not create a competitive disadvantage.

³⁹ See Temple Lang, Anticompetitive non-pricing abuses under European and national antitrust law, in Hawk (ed.), 2003 Fordham Corporate Law Institute (2004) 235-340 at pp. 275-282.

⁴⁰ [2008] ECR II-477 at para. 192.

Such start-up situations may also give rise to cases of first refusal to contract, if there is no duty to contract under national law.

Margin squeeze cases also raise the issue, mentioned above in connection with foreclosure, whether the Commission believes that it is improper for a dominant company to take advantage of economies of scale or scope, resulting from its network or infrastructure, that are not, or are not yet, obtained by its competitors.

The comparison with refusals to contract

The Guidance Paper is unsatisfactory because it treats margin squeeze cases as if they were refusal to contract cases, without discussing whether that view is correct, and without explaining its implications. In other respects the section of the Guidance paper is inadequate, rather than positively wrong.

A situation in which there is a refusal to make the first contract, and there is no relevant downstream competition, is obviously different from a situation in which the dominant company has been supplying an input to independent buyers, and the prices are said to be illegal. (If the refusal concerns a second or later contract, discrimination questions may arise). If there is downstream competition, there will be evidence showing how much scope there is for value added competition in that market, and how much harm to consumers, if any, would result from downstream competitors withdrawing or being forced out of the market. In the case of a first refusal, by definition there can be no such evidence. It is therefore uninformative to treat a margin squeeze case as if it was a case of first refusal to contract, with no explanation.

It is clear that the non-discrimination rule prohibits a vertically integrated company from discriminating in favour of its own downstream operations, and that rule is not limited to situations in which there would be an obligation to contract. Since discrimination in favour of its own downstream operations would create, and might be substantially equivalent to, a margin squeeze, there is no obvious reason for saying that a "pure" margin squeeze can be illegal only if there would be a duty to contract.

Where there is downstream competition between companies buying the input from the dominant company, some of the capacity needed to compete downstream is being provided by the competitors. In a refusal to contract case, it would be illegal to refuse to contract if the dominant company could not meet the downstream demand (the *Höfner* judgment⁴¹ shows this). It would also be illegal for the dominant company to squeeze the downstream competitors so that it could take them over cheaply (*Commercial Solvents*).

The Guidance paper approach fails to discuss the distinction, which may be important, between a duty to contract under Article 82 and a duty to contract imposed by national regulatory legislation (whether or not the legislation is based on EU directives). Para. 82 merely says that if the dominant company has a duty to contract under national regulation, or if it previously had a statutory monopoly or was financed by the State, imposing a duty to contract under Article 82 would not discourage the company from investment or innovation.

⁴¹ Case C-41/90, *Höfner and Elser v. Microtron* [1991] ECR I-1979.

Since margin squeeze cases have already arisen in the telecommunications industry where network operators already have duties to contract, this comment is insufficient. If the implication is that there might be a duty under Article 82 that was wider or more onerous than the duty under national law, the comment is incorrect. If the duty under Article 82 was the same as the duty under national law, there would be no apparent reason for applying Article 82 at all.

(vii) **Refusal to contract and stifling “follow-on innovation”**

The Guidance Paper section on refusal to contract is vaguely drafted, and goes further than the existing case law. No explanation is given, and it is not clear whether the Commission realised the implications of what is said. It is not made clear, as it should be, that there can be a duty to contract only if refusal is illegal for some specific and identifiable reason, and not merely because a contract would lead to more competition in the short term. In several respects the Guidance Paper needs clear limiting principles, in particular because it does not even say that there is a duty to contract only in “exceptional circumstances”, an important if imprecise phrase used by the Community Courts. It does not even say that there must be two markets, and dominance in the downstream market, nor does it say that there must be sufficient scope for added-value competition in the downstream market (if there is no scope for added value competition, consumers cannot be harmed by a refusal to contract). There can never be a duty to supply the dominant company’s final product to its competitors.

- Since the mere refusal to licence an intellectual property right can never be in itself an abuse, there must be some other identifiable abuse, for which the duty to contract is the appropriate remedy.⁴²
- The Guidance Paper says a “potential market” for the input may be enough. But the mere existence of demand for the input cannot create a duty to supply. That would create a greater duty to share more valuable inventions, which would be absurd. There can only be a duty if it would be economically rational for the owner to contract.
- The Court in *Microsoft* said that the test under the *Magill* judgment, usually summarised by saying that there must be a “new kind of product for which there is a clear and unsatisfied demand”, is only one example of the harm to consumers which is required by Article 82(b). But the mere fact that production, marketing or technical development of competitors is limited is not enough to cause harm to consumers, (Article 82(b) makes that clear), so limiting principles are needed. If competitors are only copying the dominant company, there is no justification for a duty to supply under Article 82(b) (because copying is not added-value

⁴² Temple Lang, European Competition Law and Compulsory Licensing of Intellectual Property Rights – A Comprehensive Principle, 4 *Europarättslig Tidskrift* (2004) 558-588; Temple Lang, Anticompetitive Abuses under Article 82 involving Intellectual Property Rights, in Ehlermann & Atanasiu (eds.), *European Competition Law Annual 2003: What is an Abuse of a Dominant Position?* (Hart, 2006) 589-658.

See generally Vickers, *Competition Policy and Property Rights*, Department of Economics Discussion Paper Series No. 436 (Oxford, May 2009), where the complexities of “follow-on innovation” are discussed.

competition, and the slight short-term benefit to consumers could not outweigh the harm done to incentives to invest).⁴³

Remember that the Guidance Paper does not discuss discrimination, and so does not discuss discriminatory refusal to contract, although many EC refusal to contract cases are really discrimination cases, and should be analysed in that way.⁴⁴ Adding one more competitor is not a justification for imposing a duty to contract.

- If an otherwise illegal refusal to contract is said to be justified by efficiencies, but the efficiencies could be obtained without causing the exclusionary effects, there is a duty to avoid those effects. (For example, a genuine improvement in one of two products that must work together may make it incompatible with competitors' versions of the other product. In this situation there may be a duty to provide the information needed by competitors).

One of the unsatisfactory features of the Guidance Paper (para. 87) in this respect says that consumers may be harmed if the refusal to contract is likely to stifle follow-on innovation. This statement is not qualified by reference to any circumstances such as those in the *Microsoft* case, and as expressed it is both too vague and too broad. It is obviously incorrect to suggest that there can be a duty to contract merely to enable a competitor to copy or improve on or add to a product already made by the dominant company. Nothing is said in Guidance to suggest that even this approach would apply only in "exceptional circumstances". This is insufficiently-considered drafting.

A rational and more correctly expressed principle based on Article 82(b) would say in effect that a refusal to contract may be an abuse, because it interferes with the dynamic process of competition, if:

- (a) sufficient harm to consumers is shown,⁴⁵ and
- (b) the refusal will eliminate or permanently handicap competition and create or maintain dominance in a new or developing market for a new or improved product that competitors were producing, (or would produce, if the evidence that they would do so is strong enough), and would be under competitive pressure to produce,⁴⁶ and

⁴³ The *IMS Health* interim measures decision of the Commission involved a single market, and would have allowed competitors to use IMS Health's principal competitive advantage to produce identical products.

⁴⁴ Treating refusal to contract cases as discriminatory abuses whenever possible often solves the problem of deciding the price at which the dominant company should be required to contract. The Commission presumably would have understood this if it had analysed the refusal to contract cases under Article 82(c), which it apparently chose not to do.

⁴⁵ Proof of harm to consumers is required by Article 82(b), and the Commission says that it accepts this. However, in the context of refusal to contract it is essential to know what this means. Ordering a dominant company to supply an input always creates at least some competition in the downstream market in the short term. It is essential that this is not considered a sufficient reason for imposing a duty to contract. The harm to consumers must be something more than the absence of competitors which might provide little or no added-value competition.

⁴⁶ This requirement means that both the dominant company and its competitors continue to be under competitive pressure to develop better products, an essential objective of any rule designed to promote dynamic competition.

- (c) the duty to contract would provide an essential input otherwise unobtainable without giving competitors all or most of the dominant company's competitive advantage or depriving it of the incentive to invest further. (As long as the dominant company retains its main competitive advantage exclusively, it has an incentive to invest).

If the input in question is essential but is not the dominant company's main competitive advantage (the information needed merely for interoperability, if it is really essential, is the simplest example), the price (if any) to be paid for it is obviously less, and so is more easily determined.

A principle on these lines would be a reasonable summary of what may be deduced about refusal to contract from the *Microsoft* judgment, but without listing all the special features of that case which, cumulatively, led to the conclusion that its conduct was illegal.⁴⁷ It would also largely avoid the need for balancing or weighing up benefits against disadvantages, which is difficult and unsatisfactory, and which the Court in *Microsoft* did not do.

⁴⁷ Special features of the Microsoft interoperability case that individually or cumulatively seem to have been significant were:

- Network effects.
- Exceptional extent and duration of dominance.
- The benefits relied on could have been obtained without the conduct in question (Judgment, para. 1154).
- A pattern of exclusionary conduct.
- Interoperability had been practiced in the industry, and by Microsoft itself.
- There was no risk that interoperability could lead to mere copying of the whole product.
- Because of time lag and disadvantages, competitors would always need to do more than merely provide interoperability.

Also there were high market shares in the downstream market, and Microsoft was not capacity constrained in that market. A high proportion of competitors in that market were affected. Microsoft's refusal was part of an exclusionary strategy.

- Disclosure would encourage innovation in the whole industry, including Microsoft.
- Reduction of innovation harms consumers through reduced choice and lock-in of users.

The Guidance Paper was unwise to try to state a general principle on the basis of the *Microsoft* judgment without referring to the special facts of the case.

In any refusal to contract case it may be necessary to balance short-term effects of promoting competition against long-term effects of reducing incentives to invest. This problem is not the result of the specific phrase used by the Commission. This is distinct from the problem of balancing the short-term procompetitive and anticompetitive effects of the conduct in question.

Part III

The comprehensive solution that should be adopted by the Community Courts

It will be seen that insofar as the Guidance Paper tries to modify or extend the law, most of the statements made are open to serious criticism, either for unnecessary complexity, vagueness, anticompetitive effects, or difficulty of application.

But it will also be seen that each of the unsatisfactory proposals in the Guidance Paper can be adjusted or corrected in a way that makes it reasonable.

I hope that the Commission will have the good sense not to adopt decisions protecting not-yet-as-efficient rivals (except in reprisal cases), or prohibiting "loyalty-inducing" rebates, or rebates based on the "relevant range", or less profitable pricing, and that these ideas will be dropped from the future revisions of the Guidance Paper that clearly will be necessary.

However, it is to be expected that the Commission will act on these ideas, or will use them to defend its actions under Article 82. If the Commission does act on these ideas, the companies involved will certainly challenge them before the Community Courts, as legally unjustified. What is the Court of First Instance likely to do?

One should begin by saying clearly that although on certain issues the case law of the Community Courts is not clear, and needs to be clarified, the confused state of the law under Article 82 is due primarily to the Commission's statements, rather than the Courts' case law. Therefore, if the Community Courts base their future judgments on their own case law and not on the Commission's Guidance Paper, the law will become clear progressively.

The CFI will be well aware that the Commission is now asking the Courts to have confidence that its new policy is better than its old one, which the Commission unfortunately got the Courts to accept. So the CFI will be cautious, and critical. The CFI must know that the law under Article 82 is widely regarded by both economists and lawyers as unsatisfactory, and the Court will be determined not to add to the uncertainty, even if only the Court of Justice can now resolve the problems. Much will depend on the Advocates General in the next Article 82 cases to reach the Court of Justice, whether they reach the Court on appeal or under Article 234. (If an important Article 82 case comes before the CFI, it would be appropriate for the Court to appoint one of the judges to act as an Advocate General for the purposes of the case. This has been done in several cases involving less important and less difficult issues in the past).⁴⁸ Advocates General are free, if they take the time to study all the cases, to advise the Court when the whole case law is unclear or unsatisfactory, in particular when the Commission is not in a position to point this out. The CFI will probably ask the Commission what clause in Article 82 (or what other legal principle) it is relying on. The Commission could refer to Article 82(b), "limiting the production, marketing or technical development" (of competitors). The Commission will not be able to point to any other legal

⁴⁸ Case T-24/90, *Automec II* [1992] ECR II-2223 and Case T-28/90 [1992] ECR II-2285; see Greaves, Judge Edward Acting as Advocate General, in Hoskins & Robinson (eds.), *A True European: Essays for Judge David Edward* (Hart, 2003), 91-98.

basis for exclusionary abuses, since there is none.⁴⁹ It is not possible to state a meaningful fifth rule, or fifth kind of abuse (in addition to the four rules on exploitative, exclusionary, discriminatory, and reprisal abuses). So the CFI will have to decide whether to accept the Commission's new economic theories, which do not inspire complete confidence for the reasons outlined above.

The CFI will want to decide on the basis of legal principles that the Court of Justice will ultimately accept, since all these issues will certainly be appealed to the Court of Justice. The Courts are not likely to accept an economic theory, however fashionable. Faced with a choice between Article 82(b) and an economic theory without a legal basis, and conscious of the overriding need for legal certainty, the CFI is likely to rely on Article 82(b), and on the well-established case law that says that Article 82(b) prohibits "limiting" the possibilities open to competitors of the dominant company.⁵⁰

⁴⁹ In case C-95/04 P, *British Airways* [2007] ECR I-2331 para. 64, the Court spoke of the "underlying factors" that have guided the case law of the Courts, but gave no indication of what these underlying factors might be. Neither did the Advocate General (para. 41 of the Conclusions). The least that can be said about unknown "underlying factors" is that they are contrary to the well-established principle of legal certainty. There is nothing in Article 82 or the case law to support *e.g.*, the suggestion that the dominant company has a legal duty not to behave unreasonably, or not to make life unduly difficult for its competitors. Any such suggestion would be unacceptably vague, and would have no basis anywhere in the Treaty. It would also be inconsistent with the Commission's repeated statements that competition law protects competition and consumers, and not competitors. If it amounted to saying that a dominant company is not free to compete normally, it would imply that a dominant company might be obliged to allow its dominance to be taken away by competition, or was not free to take advantage of any improvements it could make in its own efficiency. That could not be suggested, since the existence of dominance is clearly legal, as is its maintenance by all legal means: Case T-170/06, *Alrosa* [2007] ECR II-___ para. 146. In Case T-191/98, *Atlantic Container* [2003] ECR II-3275 para. 1460, the Court of First Instance said that the "special responsibility" of dominant companies means only that they are subject to Art. 82 and non-dominant companies are not. The underlying factors might be the equally efficient competitor principle, but the *British Airways* judgment does not seem compatible with that principle.

⁵⁰ The case law has made it clear that Art. 82(b) applies to limiting the production, marketing or technical development of competitors, and not merely to limiting the dominant company's own activities. Joined Cases 40/73 and others, *Sugar Cartel – SZV*, [1975] ECR 1663, paras. 399, 482-83, 523-527 ("*the system complained of was likely to limit markets to the prejudice of consumers within the measure of Article [82](b) because it gave other producers ... no chance or restricted their opportunities of competing with sugar sold by SZV*": para. 526); Case 41/83 *Italy v. Commission (British Telecommunications)*, [1985] ECR 873; Case 311/84, *Telemarketing CBEM*, [1985] ECR 3261, para. 26; Case 53/87, *CICR v. Renault*, [1988] ECR 6039; Case 238/87, *Volvo v. Veng*, [1988] 6211; Joined Cases C-241/91P, *RTE and ITP ("Magill")*, [1995] ECR I-743 at para. 54 ("*The applicants' refusal to provide basic information by relying on national copyright provisions thus prevented the appearance of a new product, a comprehensive weekly guide to television programmes, which the applicants did not offer and for which there was a potential consumer demand. Such refusal constitutes an abuse under heading (b) of the second paragraph of Article [82] of the Treaty.*"); Case C-41/90, *Höfner and Elsnner*, [1991] ECR I-1979 at 2017-2018 ("*Pursuant to Article [82](b), such an abuse may in particular consist in limiting the provision of a service, to the prejudice of those seeking to avail of it*": para. 30; Case C-55/96, *Job Centre*, [1997] ECR I-7119 at 7149-7150; Case C-258/98 *Carra*, [2000] ECR I-4217; Case T-201/04, *Microsoft*, [2007] ECR I-3601 para. 643-648 ("*The circumstance relating to the appearance of a new product, as envisaged in Magill and IMS Health ... cannot be the only parameter which determines whether a refusal to licence an intellectual property right is capable of causing prejudice to consumers within the meaning of Article 82(b) EC. As that provision states, such prejudice may also arise where there is a limitation not only of production or markets, but also of technical development*": para. 647). Bellamy & Child, *European Community Law of Competition* (6th ed., 2008) pp. 1025-1026; Commission Decision, *P&I Clubs*, OJ No. L-125/12, May 19, 1999, paras. 128-133.

The CFI may need to indicate that it does not know any “underlying factors”⁵¹ in the Courts’ case law other than the words of the Treaty themselves. This would greatly clarify the law, and do much to end the present legal uncertainty that the *British Airways* judgment has contributed to.

There are obvious advantages in applying a principle that:

- Is based on the words of the Treaty, and well-established case law.
- Is unambiguous.
- Cannot lead to results contrary to competition principles (*e.g.*, does not protect inefficient competitors from above-cost price competition).
- Includes the limiting principles that are clearly needed.
- Can be applied and acted on by dominant companies on the basis of information that they can be expected to have or to be able to obtain.
- Is entirely consistent with the need for legal certainty.
- Requires consumer harm to be proved in all exclusionary abuse cases (ensuring that the law protects consumers and not competitors).
- Does not involve a search for “underlying factors” which have never previously been mentioned and which are difficult to express.
- Discourages misuse of competition law for regulatory objectives.
- Involves reversing only one judgment (*British Airways*), and some *dicta*.
- Seems broadly similar to the law in the USA.

But it would be much better if the Commission came to this conclusion itself.

See Elhauge, Defining Better Monopolisation Standards, 56 Stanford Law Review (2003) 253; Temple Lang, Anticompetitive Non-Pricing Abuses under European and National Antitrust Law, in Hawk (ed.), 2003 Fordham Corporate Law Institute (2004) 235-340; Temple Lang, The Requirements for a Commission Notice on the Concept of Abuse under Article 82 EC, 2007 Finnish Competition Law Yearbook 271-306 and Centre for European Policy Studies Special Report (2008); O’Donoghue & Padilla, The Law and Economics of Article 82 (2006) Ch. 4; O’Donoghue, Verbalizing a general test for exclusionary conduct under Article 82 EC, in Ehlermann & Marquis, European Competition Law Annual 2007: A Reformed Approach to Article 82 (Hart, 2008); Vickers, Abuse of Market Power, Vol. 115 (6) The Economic Journal (2005) 244 (who discusses three tests, on sacrifice, as-efficient-competitors, and consumer welfare). Other tests suggested have included no-economic-sense test, consumer surplus test).

⁵¹ Case C-95/04P, *British Airways* [2007] ECR I-2331 para. 64. See footnote 49 above.

Comments on Article 82(b)

Dominant companies must be free to compete by legitimate means, even if that results in increased dominance. (If they were not free to compete legitimately, that would ultimately erode dominance and in effect make it illegal, which is clearly not the legal position).

If a dominant company offers a better product at a lower price, that does not “limit” the ability of rivals to make similar offers, and it certainly cannot harm consumers.

“Limiting” production, marketing or technical development means creating or imposing a handicap or difficulty on competitors to which they would not otherwise be subject (other than by offering a better bargain). The key question is: does the conduct offer consumers something better or different, or does it interfere with competitors’ ability to offer their products or services?

Since dominant companies are free to compete legitimately, they may *e.g.*, obtain patents for their inventions (although that “limits” the possibilities of rivals in the short term), because obtaining patents for one’s own inventions is considered procompetitive in the long term by patent law. (But it is illegal for a dominant company to acquire the only alternative to its own technology: *Tetra Pak-BTG Licence*, 1988). In short, it is procompetitive for them to develop their own patents or essential facilities, but it may “limit” the possibilities of rivals if the dominant company acquires exclusive rights to crucial inputs from other companies.

One important problem in applying Article 82(b) arises when a genuine procompetitive improvement of a product or service in one market unavoidably involves anticompetitive effects in another market,⁵² or where improving the dominant company’s efficiency necessarily reduces the efficiency of its competitors. In such cases it may be necessary to weigh the effects against one another. This weighing process seems essential in such circumstances, whatever legal test of foreclosure is being used.

But if the anticompetitive effects caused incidentally by procompetitive conduct can be avoided or reduced, there may be a duty to avoid or reduce them. For example, if the anticompetitive effect of an improvement in one of two products is to make it incompatible with competitors’ version of the other product, there may be a duty to provide the information needed for interoperability. Providing the information would also show that there was no anticompetitive intent. It would reduce or end the competition-reducing effect without inhibiting the dominant company’s freedom to make improvements. This is a broader principle than refusal to contract, but it seems reasonable in all situations.

The need for one comprehensive concept of exclusionary abuse

A comprehensive concept of exclusionary abuse will be needed:

⁵²

In the case of two products that must be used together, a genuine improvement in one product may make it incompatible with competitors’ versions of the other product. If this is done deliberately (and in particular if there is no real improvement) without any disclosure of the technical information needed, the conduct is illegal (*Decca Navigator System*, 1989 OJ L-43/27) because it limits the marketing of competitors’ versions of the second product.

- to assess what the Commission is saying in the Guidance Paper, and in future decisions;
- to distinguish between legitimate and anticompetitive foreclosure, which the Guidance Paper seems to confuse; and
- to deal with other kinds of supposedly “abusive” conduct.

For example, in the first Report on the Pharmaceutical Sector the Commission lists a long series of different kinds of unilateral conduct. If any of these are illegal, they can only be exclusionary abuses. But none of them fall into any recognised category of exclusionary abuse.

Final General Comments

To what extent is there an alternative legal view?

1. It should be said that some lawyers have criticised the approach of the Commission as set out in the Discussion Paper and in the Guidance paper, on several grounds different from those explained here. They can be summarised, very briefly, as follows.⁵³

First, the economic or effects-based approach represents a significant change from the previous practice of the Commission and the previous case law of the Community Courts, and the Commission has no power to change the law.

In response, it must be admitted that the Commission is trying to change the law, as far as it is able to do so, because the previous law was seen to be unsatisfactory (although the Commission cannot say so frankly, since it was largely responsible for the defects). Unfortunately some of the changes that the Commission wishes to see would make the law worse rather than better.

Second, the critics point out that the Treaty does not clearly say that protection of consumers is the principal or the only test of exclusionary abuse. They say that Article 82 has been understood to provide some protection, never clearly defined or explained, for small enterprises against large enterprises.

- In response, it should first be said that Article 82(b), which is the only clause in Article 82 that appears to apply to exclusionary abuses, states explicitly that there is an abuse only if there is harm to consumers.
- Second, there are strong arguments, referred to above, for saying that harm to consumers should be understood to be an essential element in all kinds of abuse under Article 82. Harm to consumers is expressly mentioned in Article 81(3), and it would be irrational and anomalous if

⁵³ See generally Gormsen, *The Conflict between Economic Freedom and Consumer Welfare in the Modernisation of Article 82 EC*, 3 *European Competition Journal* (2007) 329-344; Parret, *Do we (still) know what we are protecting?* Tilec Discussion Paper (April 2009, Tilbury University); M. Motta, *Competition Policy, Theory and Practice* (Cambridge U.P., 2004).

harm to consumers was necessary for any infringement of Article 81 but not under some clauses of Article 82.

- Third, protection for competitors against competition must always ultimately be, directly or indirectly, at the expense of consumers. Where unilateral conduct has both exclusionary and efficiency consequences, it may be necessary to balance one against the other. But where the primary or only economic effect of the conduct is procompetitive, at least in the long term, there is nothing in the Treaty that clearly requires the law to constrain the freedom of the dominant company to compete, by requiring it to limit the effects of its actions on competitors. The phrase "the structure of competition" is often used to describe something that a dominant company may not interfere with or eliminate, but like most metaphors the meaning of the phrase is unclear. It could of course be an imprecise way of saying that the dominant company may not create obstacles or handicaps for competitors, and this is of course correct, under Article 82(b). If it goes further, and implies that a dominant company has a legal duty not to make life unreasonably difficult for its competitors, *e.g.*, by taking advantage of its economies of scale, then it has to be said that such an approach is regulatory, and that there is no basis in the Treaty for suggesting that dominant companies are not free to compete legitimately.

It may well be that the critics of the Commission's approach are unduly concerned with conceptual issues, and that the consequences of their criticisms are not significantly different from the consequences of the Commission's new approach.

The Guidance Paper does not merely describe the Commission's priorities

2. The Guidance Paper is not correctly described as stating the Commission's enforcement priorities.⁵⁴ The paper tries to extend the existing case law under Article 82 in several ways – by proposing presumptions that dominant companies need to rebut, altering the burden of proof, by trying to protect not-yet-as-efficient competitors, by introducing the concepts of "relevant range" and profit sacrifice, and by some parts of what is said about refusal to contract. The overall effect would be to make the rules on exclusionary abuse stricter on dominant companies, and this effect is not counterbalanced by what is said about efficiencies, which is brief and superficial, and omits several obvious and common types of efficiency. It is not even counterbalanced by pointing out, as the Commission is now apparently willing to say elsewhere, that the Commission no longer believes that quantity rebates must be cost-justified, one of the most obviously unrealistic and anticompetitive statements made repeatedly on behalf of the Commission in recent years.

⁵⁴ Except in the unfortunate sense that parts of it are too much based on one or two current cases, instead of more general principles.

Parts of the Guidance paper are based on particular cases

3. The Guidance paper, like the Discussion paper, suffers from a defect which is serious, but may not be obvious. Parts of the paper have been written apparently in general terms, but in fact with the specific circumstances of one or two particular cases in mind. Whatever the merits of those decisions may be, this practice is unsatisfactory for several reasons.
- The text is too much adapted to the special circumstances of the case that the Commission has in mind, and is not written in the objective and general terms that would be appropriate to a general rule.
 - The implications of what is written have not been fully and carefully considered. Generalisations are made, without the limiting principles that are needed, and without the balance that is necessary in any "general" principle. Extremely complex kinds of cases are approached in an over-simplified and over-confident way, because other similar situations have not been considered.
 - It is unwise for the Commission to try to make general statements on the basis of an individual case before the Commission's decision in that case has been considered by the Community Courts. The Commission should not be trying to build a legal theory for a decision that it has not yet adopted, or which the Courts have not had an opportunity to consider.
 - The Commission used to have a policy that it would not publish a Notice or propose a group exemption until the Commission had experience of dealing with a sufficient number of different cases to enable the Commission to see all the principal aspects of the problem. This cautious policy is particularly necessary in complex legal situations in high technology industries. It is a pity that it has not been followed in the Guidance Paper. It is unwise to try to state a general rule on the basis of one or two individual cases, particularly if they are unrepresentative.

Judicial review of "effects-based" decisions

4. The Commission claims that its future decisions in Article 82 cases will be "effects based", that is, will be based on consideration of the exclusionary effects of the conduct in question in the context of the facts of the individual case. This is in contrast to the "form-based" approach under which the Commission looked only or primarily at the nature of the conduct, and did not consider what economic consequences the conduct was likely to have, in the circumstances of each case, or what justifications there might be for the conduct.

This change is desirable in principle, and there is certainly no objection to it. However, it raises the important question of the extent to which the Court of First Instance will review the findings of fact made by the Commission in reaching its conclusions, and the deductions drawn by the Commission from those facts. Because the lawfulness or unlawfulness of any given course of conduct will now depend primarily on its economic effects, (and because the

dominant company must be able to judge in advance whether its conduct would be inherently lawful or not), the judgments of the Court of First Instance cannot depend merely on what actually happened. In other words, the adoption of an "effects-based" approach needs to lead to more intensive judicial review of the economic facts and the conclusions drawn by the Commission, rather than a lessening of the judicial review by the Court of First Instance. Presumably the new approach will make less difference in the Court of Justice, where the Court is not supposed to make findings of fact, and because the Court of Justice has been more reluctant to become involved in economic issues.

Lack of legal certainty, and discouraging legitimate competition

5. To summarise, it will be seen that in this paper the criticisms of the Commission's Guidance paper are based on (i) the regrettable lack of legal certainty that it has created and (ii) the clearly anticompetitive implications of some of the suggestions made. These criticisms are not based on conceptual issues. This is the most practical approach to the serious difficulties that now exist in the law under Article 82. They will not be resolved by conceptual arguments, or by ascribing particular views to "ordoliberalism" or to "Chicago school" thinking. They are too serious, and too practical, for that.

The Guidance Paper and competition authorities

6. The defects in the Guidance Paper are serious for several additional reasons not already mentioned. First, it is likely to be regarded in practice by national competition authorities as correctly stating the law, and they will act on it. National courts may act on it uncritically, without referring cases to the Court of Justice under Article 234. In any case, Article 234 allows the Court to consider only legal questions. To correct the flaws in the Guidance Paper, the Court will probably need to consider economic arguments, which it has unfortunately been reluctant to do.

Second, within the Commission the same individuals (few of whom have been trained as judges, and some of whom have no special knowledge of competition law or economics), investigate the case, write the Statement of Objections, and draft the decision. The result is that there is no sufficient objective independent assessment of the soundness of a Commission decision until it is challenged in the Court of First Instance. In view of the huge fines now being imposed by the Commission under Article 82, the absence of independent scrutiny within the Commission is no longer acceptable. This means that irrational results caused by the Guidance Paper are not likely to be seen clearly until the judges examine the decision in question, a year or two later.

The crucial attitude of the Community Courts

7. Inevitably, the future is now largely in the hands of the Community Courts. We cannot rely on the Commission to correct its own errors. If the Community Courts accept the Guidance Paper uncritically, many anticompetitive effects will follow. If they look at the Guidance Paper critically, the Commission's errors can be corrected. There are not so many of them, although the results appear in several places. All that is needed to correct them are the principle of legal certainty, the as-efficient-competitor rule,⁵⁵ which the Commission has accepted in theory, and Article 82(b), which provides the legal definition of foreclosure which is strikingly absent from the Guidance Paper and its predecessors. If the Court of First Instance appoints an Advocate General for one or more of those cases, a sound and comprehensive solution can be obtained.

⁵⁵ In case T-271/03, *Deutsche Telekom* [2008] ECR II-477, at para. 237, the Court approved the as-efficient-competitor test, at least in the context of that case (a margin squeeze case). O'Donoghue & Padilla, *The Law and Economics of Article 82 EC* (2006) conclude (p. 191) "*the equally efficient competitor test ... offers perhaps the most promising basic economic test for exclusionary conduct.*" It is entirely consistent with Article 82(b), which prohibits making competitors less efficient. It is also consistent with the principle of "*equality of opportunity*" (*Deutsche Telekom*, para. 199) to say that a dominant company must not limit or interfere with the opportunities of its competitors. See also Case C-462/99, *Connect Austria*, [2003] ECR I-5197, paras. 82-83.

NOTE DI LAVORO DELLA FONDAZIONE ENI ENRICO MATTEI

Fondazione Eni Enrico Mattei Working Paper Series

Our Note di Lavoro are available on the Internet at the following addresses:

<http://www.feem.it/Feem/Pub/Publications/WPapers/default.htm>

<http://www.ssrn.com/link/feem.html>

<http://www.repec.org>

<http://agecon.lib.umn.edu>

<http://www.bepress.com/feem/>

NOTE DI LAVORO PUBLISHED IN 2009

SD	1.2009	Michael Hoel: Bush Meets Hotelling: Effects of Improved Renewable Energy Technology on Greenhouse Gas Emissions
SD	2.2009	Abay Mulatu, Reyer Gerlagh, Dan Rigby and Ada Wossink: Environmental Regulation and Industry Location
SD	3.2009	Anna Alberini, Stefania Tonin and Margherita Turvani: Rates of Time Preferences for Saving Lives in the Hazardous Waste Site Context
SD	4.2009	Elena Ojea, Paulo A.L.D. Nunes and Maria Loureiro: Mapping of Forest Biodiversity Values: A Plural Perspective
SD	5.2009	Xavier Pautrel : Macroeconomic Implications of Demography for the Environment: A Life-Cycle Perspective
IM	6.2009	Andrew Ellul, Marco Pagano and Fausto Panunzi: Inheritance Law and Investment in Family Firms
IM	7.2009	Luigi Zingales: The Future of Securities Regulation
SD	8.2009	Carlo Carraro, Emanuele Massetti and Lea Nicita: How Does Climate Policy Affect Technical Change? An Analysis of the Direction and Pace of Technical Progress in a Climate-Economy Model
SD	9.2009	William K. Jaeger: The Welfare Effects of Environmental Taxation
SD	10.2009	Aude Pommeret and Fabien Prieur: Double Irreversibility and Environmental Policy Design
SD	11.2009	Massimiliano Mazzanti and Anna Montini: Regional and Sector Environmental Efficiency Empirical Evidence from Structural Shift-share Analysis of NAMEA data
SD	12.2009	A. Chiabai, C. M. Travisi, H. Ding, A. Markandya and P.A.L.D Nunes: Economic Valuation of Forest Ecosystem Services: Methodology and Monetary Estimates
SD	13.2009	Andrea Bigano, Mariaester Cassinelli, Fabio Sfera, Lisa Guarrera, Sohbeth Karbuz, Manfred Hafner, Anil Markandya and Ståle Navrud: The External Cost of European Crude Oil Imports
SD	14.2009	Valentina Bosetti, Carlo Carraro, Romain Duval, Alessandra Sgobbi and Massimo Tavoni: The Role of R&D and Technology Diffusion in Climate Change Mitigation: New Perspectives Using the Witch Model
IM	15.2009	Andrea Beltratti, Marianna Caccavaio and Bernardo Bortolotti: Stock Prices in a Speculative Market: The Chinese Split-Share Reform
GC	16.2009	Angelo Antoci, Fabio Sabatini and Mauro Sodini: The Fragility of Social Capital
SD	17.2009	Alexander Golub, Sabine Fuss, Jana Szolgayova and Michael Obersteiner: Effects of Low-cost Offsets on Energy Investment – New Perspectives on REDD –
SD	18.2009	Enrica De Cian: Factor-Augmenting Technical Change: An Empirical Assessment
SD	19.2009	Irene Valsecchi: Non-Uniqueness of Equilibria in One-Shot Games of Strategic Communication
SD	20.2009	Dimitra Vouvakis and Anastasios Xepapadeas: Total Factor Productivity Growth when Factors of Production Generate Environmental Externalities
SD	21.2009	Giulia Macagno, Maria Loureiro, Paulo A.L.D. Nunes and Richard Tol: Assessing the Impact of Biodiversity on Tourism Flows: A model for Tourist Behaviour and its Policy Implications
IM	22.2009	Bernardo Bortolotti, Veljko Fotak, William Megginson and William Miracky: Sovereign Wealth Fund Investment Patterns and Performance
IM	23.2009	Cesare Dosi and Michele Moretto: Auctioning Monopoly Franchises: Award Criteria and Service Launch Requirements
SD	24.2009	Andrea Bastianin: Modelling Asymmetric Dependence Using Copula Functions: An application to Value-at-Risk in the Energy Sector
IM	25.2009	Shai Bernstein, Josh Lerner and Antoinette Schoar: The Investment Strategies of Sovereign Wealth Funds
SD	26.2009	Marc Germain, Henry Tulkens and Alphonse Magnus: Dynamic Core-Theoretic Cooperation in a Two-Dimensional International Environmental Model
IM	27.2009	Frank Partnoy: Overdependence on Credit Ratings Was a Primary Cause of the Crisis
SD	28.2009	Frank H. Page Jr and Myrna H. Wooders (lxxxv): Endogenous Network Dynamics
SD	29.2009	Caterina Calsamiglia, Guillaume Haeringer and Flip Klijn (lxxxv): Constrained School Choice: An Experimental Study
SD	30.2009	Gilles Grandjean, Ana Mauleon and Vincent Vannetelbosch (lxxxv): Connections Among Farsighted Agents
SD	31.2009	Antonio Nicoló and Carmelo Rodríguez Álvarez (lxxxv): Feasibility Constraints and Protective Behavior in Efficient Kidney Exchange
SD	32.2009	Rahmi İlkiliç (lxxxv): Cournot Competition on a Network of Markets and Firms
SD	33.2009	Luca Dall'Asta, Paolo Pin and Abolfazl Ramezani (lxxxv): Optimal Equilibria of the Best Shot Game
SD	34.2009	Edoardo Gallo (lxxxv): Small World Networks with Segregation Patterns and Brokers
SD	35.2009	Benjamin Golub and Matthew O. Jackson (lxxxv): How Homophily Affects Learning and Diffusion in Networks

SD	36.2009	Markus Kinaterer (lxxxv): Team Formation in a Network
SD	37.2009	Constanza Fosco and Friederike Mengel (lxxxv): Cooperation through Imitation and Exclusion in Networks
SD	38.2009	Berno Buechel and Tim Hellmann (lxxxv): Under-connected and Over-connected Networks
SD	39.2009	Alexey Kushnir (lxxxv): Matching Markets with Signals
SD	40.2009	Alessandro Tavoni (lxxxv): Incorporating Fairness Motives into the Impulse Balance Equilibrium and Quantal Response Equilibrium Concepts: An Application to 2x2 Games
SD	41.2009	Steven J. Brams and D. Marc Kilgour (lxxxv): Kingmakers and Leaders in Coalition Formation
SD	42.2009	Dotan Persitz (lxxxv): Power in the Heterogeneous Connections Model: The Emergence of Core-Periphery Networks
SD	43.2009	Fabio Eboli, Ramiro Parrado, Roberto Roson: Climate Change Feedback on Economic Growth: Explorations with a Dynamic General Equilibrium Mode
GC	44.2009	Fabio Sabatini: Does Social Capital Create Trust? Evidence from a Community of Entrepreneurs
SD	45.2009	ZhongXiang Zhang: Is it Fair to Treat China as a Christmas Tree to Hang Everybody's Complaints? Putting its Own Energy Saving into Perspective
SD	46.2009	Eftichios S. Sartzetakis, Anastasios Xepapadeas and Emmanuel Petrakis: The Role of Information Provision as a Policy Instrument to Supplement Environmental Taxes: Empowering Consumers to Choose Optimally
SD	47.2009	Jean-François Caulier, Ana Mauleon and Vincent Vannetelbosch: Contractually Stable Networks
GC	48.2009	Massimiliano Mazzanti, Susanna Mancinelli, Giovanni Ponti and Nora Piva: Education, Reputation or Network? Evidence from Italy on Migrant Workers Employability
SD	49.2009	William Brock and Anastasios Xepapadeas: General Pattern Formation in Recursive Dynamical Systems Models in Economics
SD	50.2009	Giovanni Marin and Massimiliano Mazzanti: Emissions Trends and Labour Productivity Dynamics Sector Analyses of De-coupling/Recoupling on a 1990-2005 Namea
SD	51.2009	Yoshio Kamijo and Ryo Kawasaki (lxxxv): Dynamics, Stability, and Foresight in the Shapley-Scarf Housing Market
IM	52.2009	Laura Poddi and Sergio Vergalli: Does Corporate Social Responsibility Affect the Performance of Firms?
SD	53.2009	Valentina Bosetti, Carlo Carraro and Massimo Tavoni: Climate Change Mitigation Strategies in Fast-Growing Countries: The Benefits of Early Action
GC	54.2009	Alireza Naghavi and Gianmarco I.P. Ottaviano: Firm Heterogeneity, Contract Enforcement, and the Industry Dynamics of Offshoring
IM	55.2009	Giacomo Calzolari and Carlo Scarpa: On Regulation and Competition: Pros and Cons of a Diversified Monopolist
SD	56.2009	Valentina Bosetti, Ruben Lubowski and Alexander Golub and Anil Markandya: Linking Reduced Deforestation and a Global Carbon Market: Impacts on Costs, Financial Flows, and Technological Innovation
IM	57.2009	Emmanuel Farhi and Jean Tirole: Collective Moral Hazard, Maturity Mismatch and Systemic Bailouts
SD	58.2009	Kelly C. de Bruin and Rob B. Dellink: How Harmful are Adaptation Restrictions
SD	59.2009	Rob Dellink, Michel den Elzen, Harry Aiking, Emmy Bergsma, Frans Berkhout, Thijs Dekker, Joyeeta Gupta: Sharing the Burden of Adaptation Financing: An Assessment of the Contributions of Countries
SD	60.2009	Stefania Tonin, Anna Alberini and Margherita Turvani: The Value of Reducing Cancer Risks at Contaminated Sites: Are More Heavily Exposed People Willing to Pay More?
SD	61.2009	Clara Costa Duarte, Maria A. Cunha-e-Sá and Renato Rosa: The Role of Forests as Carbon Sinks: Land-Use and Carbon Accounting
GC	62.2009	Carlo Altomonte and Gabor Békés: Trade Complexity and Productivity
GC	63.2009	Elena Bellini, Gianmarco I.P. Ottaviano, Dino Pinelli and Giovanni Prarolo: Cultural Diversity and Economic Performance: Evidence from European Regions
SD	64.2009	Valentina Bosetti, Carlo Carraro, Enrica De Cian, Romain Duval, Emanuele Massetti and Massimo Tavoni: The Incentives to Participate in, and the Stability of, International Climate Coalitions: A Game-theoretic Analysis Using the Witch Model
IM	65.2009	John Temple Lang: Article 82 EC – The Problems and The Solution

(lxxxv) This paper has been presented at the 14th Coalition Theory Network Workshop held in Maastricht, The Netherlands, on 23-24 January 2009 and organised by the Maastricht University CTN group (Department of Economics, http://www.feem-web.it/ctn/12d_maa.php).