

# **TREATMENT OF EXCLUSIONARY ABUSES UNDER ARTICLE 82 OF THE EC TREATY**

## **COMMENTS ON THE EUROPEAN COMMISSION'S GUIDANCE PAPER**

### **FINAL REPORT OF A CEPS TASK FORCE**

**CHAIRMAN: DR. JOHN TEMPLE LANG**

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

**RAPPORTEUR: PROF. ANDREA RENDA**

Senior Research Fellow, CEPS

**CENTRE FOR EUROPEAN POLICY STUDIES  
BRUSSELS**

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This report is based on discussions in the CEPS Task Force on Treatment of Exclusionary Abuses under Article 82. The members of the Task Force participated in extensive debates in the course of several meetings and submitted comments on earlier drafts of this report. Its contents contain the general tone and direction of the discussion, but its recommendations do not necessarily reflect a full common position reached among all members of the Task Force, nor do they necessarily represent the views of the institutions to which the members belong. A list of participants appears in Annex 1 at the end of this report.

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Centre for European Policy Studies  
Place du Congrès 1, B-1000 Brussels  
Tel: (32.2) 229.39.11 Fax: (32.2) 219.41.51  
E-mail: [info@ceps.eu](mailto:info@ceps.eu)  
Website: <http://www.ceps.eu>

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# **EXECUTIVE SUMMARY AND RECOMMENDATIONS**

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**O**n 3 December 2008, the European Commission issued a Guidance paper setting its enforcement priorities in applying Article 82 to abusive exclusionary conduct (hereinafter, ‘the Guidance paper’). The Guidance paper will become a key reference for market players, judges, competition authorities, practitioners and scholars in the years to come. For this reason, it is of utmost importance that its content and overall approach are expressed and interpreted in a clear and understandable way.

In particular, the Guidance paper will be read and interpreted by market players as containing indications on the types of conduct that will be considered unlawful since they lead to anti-competitive foreclosure, and the conditions that will have to be fulfilled for such a conclusion to be drawn by the Commission, national courts and competition authorities. In our view it is essential that any approach proposed by the Commission for any kind of conduct is capable of being applied by a dominant company before it decides whether to begin the conduct in question. Accordingly, no test or criterion should be proposed or used that depends on information that the dominant company could not reasonably be expected to have or be able to obtain.

The CEPS Task Force welcomes the Commission’s efforts to clarify an area of competition law that is generally considered to be both unclear and unsatisfactory. In particular, we welcome the effort to introduce more economic thinking into the legal rules. However, as will be explained in this report, we consider that the Guidance paper is unclear or expressed too broadly in a number of respects, and that it should be interpreted in certain ways to avoid a number of potential difficulties. The CEPS Task Force is concerned that, if the recommendations contained in this report are not accepted, the Guidance paper will lead to findings of abuse in cases where

the findings are not justified either on economic or legal grounds. On the other hand, we consider that, if our recommendations are adopted, the law would be clearer, companies' costs of compliance would be reduced, pro-competitive conduct would not be discouraged and the law would be regarded as more reasonable and rational.

The main recommendations contained in this report are listed below.

## I. Recommendations on the general approach to exclusionary abuses

### 1. *The definition of dominance*

- Para. 11 of the Guidance paper should either be removed or at least amended to specify that a finding of dominance requires significant market power, as opposed to an unspecified degree.
- Given the function of the notion of dominance in an effects-based approach to Article 82 EC, we recommend raising the market share indicator to 50%, as this threshold is more in line with theory and practice than the current 40% indicator identified in para. 14 of the Guidance paper.
- The Commission should acknowledge that, for certain types of abuse, an even higher level of market power might be required than under the general dominance test.
- The Commission should develop the section on countervailing buyer power in line with the corresponding section of the Guidelines on Horizontal Mergers.
- The Commission should refine its definition of barriers to entry and expansion to make it more in line with economic analysis. In particular, it is important to clarify that the factors listed in para. 17 of the Guidance paper become relevant as barriers to entry or expansion only when they lead – individually or in combination with other factors – to impeding the possibility of likely, timely and sufficient entry.

### 2. *The theory of harm and the list of generally relevant factors*

- Any case alleging anti-competitive foreclosure must be supported by a coherent theory of harm – i.e. an explanation of the anti-competitive benefits that the dominant firm might realise if it were able to

foreclose competition (incentive); and evidence regarding the dominant firm's ability to foreclose and the likelihood of consumer harm.

- The Commission should clarify that none of the seven factors listed in para. 20 can be used in isolation or even together to prove anti-competitive foreclosure. They should always be included in a plausible theory of consumer harm.
- The Commission should consider introducing rules for a structured assessment of the most common practices, able to capture the likely consumer harm and the short- and long-term impact on consumers.

### **3. *Truncated assessments and negative presumptions***

- The circumstances under which the Commission is allowed to avoid a full assessment of anti-competitive foreclosure, including presumptions of illegality with reversal of burden of proof, should be narrowly justified, viewed as strictly exceptional and interpreted accordingly.

### **4. *Protection of 'not-yet-as-efficient' competitors***

- Serious concerns are raised by the suggestion in various places in the Guidance paper that it may be appropriate for the legality of the dominant firm's pricing conduct to be assessed on the basis of not-yet-as efficient (cost) standards. The only situation in which a less efficient competitor might be protected is when: i) the competitor is aggressive, but not yet efficient, and this provokes a reaction from the dominant firm; and ii) the conduct of the dominant company is specifically aimed at the competitor in question. In that situation, the Commission should rely on the principle that prohibits 'reprisal' abuses, rather than the 'not-yet-as-efficient' theory.

### **5. *Cost benchmarks***

- In order to establish whether equally efficient competitors could be foreclosed, the Commission should use two different cost benchmarks for price abuses: i) where prices are below AAC, the Commission may conclude that the contested practice is capable of

foreclosing equally efficient competitors; and ii) where prices are between AAC and LRAIC, the Commission should investigate whether additional factors point to the conclusion that entry or expansion by equally efficient competitors is likely to be affected.

- However, common costs should be taken into account where: i) they are significant relative to total costs; and ii) competitors cannot realise similar scope economies by expanding their product range, so as to cover common costs through the sale of other products. The Commission should accept any cost allocation method for common costs employed by a multi-product company, provided that it is: i) reasonable and normally accepted (e.g., used by cost accountants, economists or regulatory authorities); and ii) is consistently used by the dominant firm itself across its different activities (where applicable).

## 6. *Efficiencies*

- In line with the effects-based approach outlined in para. 19 of the Guidance paper, the consideration of counterbalancing efficiencies should be part of the overall assessment of abuse, rather than left as a defence. However, the defendant should have the initial evidential burden of alleging the efficiency in question, with the burden remaining on a competition authority to show an abuse overall (i.e., including consideration of the efficiencies put forward by the dominant firm).

## 7. *Use of economic evidence*

- The Commission should clarify that in some circumstances economic evidence may create a *prima facie* presumption that the conduct was unlikely to lead to anti-competitive foreclosure. Such evidence may be related, *inter alia*, to market shares, price levels and product quality. Where there is sufficient evidence to establish a *prima facie* presumption of absence of abusive conduct, the conduct should be considered as lawful unless the Commission can provide cogent and verifiable evidence that the observed improvements (such as price reductions, quality increases, etc.) would have occurred on a larger scale in the absence of the conduct of the dominant undertaking.

## II. Recommendations on specific forms of abuse

### 8. Single-product rebates

- The Commission should clarify that: i) it does not mean to suggest that conditional rebates on the part of dominant firms should always be treated as equivalent to exclusive dealing for competition law purposes; and ii) conditional rebates by dominant firms should be assessed according to the same effects-based methods that the Commission will use to assess other forms of potentially exclusionary conduct (e.g. predation).
- According to the majority of the CEPS Task Force members, the Commission should abandon the relevant range concept, and probably also the contestable share test. Instead, the Commission should state clearly that the net effective price for the threshold quantity plus one unit after granting the rebate should be above LRAIC. This should entirely replace the discussion of retroactive rebates.
- Other members of the Task Force argued that any analysis of the exclusionary effects of conditional rebates should consider the extent of the market ‘available’ to rival suppliers without causing customers to lose any retroactive rebates that the customers otherwise would have received from the dominant supplier. If the ‘available market’ so defined is large relative to rivals’ minimum efficient scale, then it is less likely that the dominant firm’s rebate scheme can have anti-competitive foreclosure effects.

### 9. Tying

- The Commission should explain and why the Guidance paper uses a different wording for the distinct product test compared to the case law and should clarify the intended consequences (if any).
- The key question for the distinct product test should be whether, in the absence of tying or bundling, a substantial number of customers would ‘mix and match’ – i.e. purchasing the tying product from the dominant firm while purchasing the tied product from a different supplier.

- Further thought should be given to the statement in the Guidance paper that, in determining whether the distinct product test is satisfied the Commission will consider indirect evidence “such as the presence on the market of undertakings specialised in the manufacture or sale of the tied product without the tying product”. Such evidence may allow the conclusion that products are distinct in some circumstances but not in others.
- The Commission should recognise and confirm that, in applying the distinct product test the evidence that ultimately matters is evidence which answers the key question set out above, namely whether, during the period of the bundling, all but an insubstantial number of customers (at the relevant level of trade) still would have purchased the tying and tied product from the same supplier (i.e. the dominant firm) even if the dominant firm had not engaged in tying or bundling.
- The Commission should clarify that one of the situations in which tying and bundling can have anti-competitive effects is when the tied product is currently a complement to the tying product, but has the potential to evolve into a substitute of the tying product.

#### **10. *Multi-product discount***

- The Commission should clarify that whenever competitors produce (or may reasonably produce) more than one bundled product, the discount should be allocated to a subset including all the bundled products reasonably open to competition, unless it is possible to demonstrate that a different allocation is more appropriate. Allocation to single bundled products, and/or to smaller subsets of the competitive products, may be appropriate only where competitors producing only one product, or a smaller subset of the competitive products, account for a significant share of the competition that the dominant firm faces with respect to these products; and when competitors cannot expand their product range or engage in other effective forms of bundling counter-strategies, so as to offer a subset including all the competitive products.

## 11. *Predation and profit sacrifice*

- The Commission should alter the Guidance paper to refer to profit sacrifice only as a possible *example* of the second *AKZO* rule. It should not be suggested that profit sacrifice is a separate test in itself.
- Furthermore, the Commission should explicitly accept a number of defences against allegations of predatory pricing, including cases where the dominant firm acted for the purpose of meeting competition, engaging in promotional expenditure and loss-leading, achieving economies of scale in network industries, large start-up investments, or when the firm's conduct was justified by excess capacity during a recession period.

## 12. *Refusal to contract*

- The Commission should reconcile its treatment of refusal to contract with existing case law, and in particular with reference to the 'exceptional circumstances'. The Commission should also make sure that its assessment of refusal to contract remains within the boundaries of the 'anticompetitive foreclosure' test that inspires the whole Guidance paper. The Commission should clarify under what conditions the dominant firm will be able to avoid continuation of previous supply.
- The Guidance paper should contain a clearer statement on the fact that only competition by innovation, not competition by imitation, is to be pursued by imposing a duty to contract when the relevant exceptional circumstances are met.
- The Guidance paper should state that the treatment of refusals to contract requires an assessment of the long-term impacts of imposing a duty to contract on all players' incentives to invest and innovate, as well as consumer welfare. Useful criteria can be identified and included in the Guidance, which would add clarity for market players and lead to more easily understandable and applicable rules.
- The Commission should clarify under what (exceptional) circumstances it will protect follow-on innovation by competitors, and why.

### 13. Margin squeeze

- A finding of margin squeeze should always require evidence of actual or likely anti-competitive effects, i.e. harm to consumer welfare in the sense defined in this Report.
- The Commission should be extremely careful before finding a margin squeeze abuse when: i) the dominant firm's wholesale input costs are a small part of rivals' overall costs; ii) the dominant firm's wholesale input is used in variable proportions by rivals; or iii) rivals use the input to provide a range of services (whether or not the dominant firm itself also offers competing services). In these cases, it will usually be far from obvious that a margin squeeze is occurring or that if it is, it has more than *de minimis* effects.
- Margin squeeze imputation tests should normally be based on the dominant firm's own costs. However, in cases such as those identified in the previous bullet point, the Commission should also consider whether the dominant firm priced below its rivals' actual costs before finding an abuse.
- Start-up phases in markets raise significant complexities in margin squeeze cases. The mere fact of the dominant firm's having losses or its failure to pass an as-efficient competitor test should not be sufficient in itself for a finding of abuse. In such cases, the Commission should explain that i) relying on historical costs only will generally be inappropriate; ii) it may make sense to exclude a short start-up phase from the analysis entirely; iii) loss minimisation is an acceptable strategy for a dominant firm in a start-up phase; and iv) failure by the dominant firm to take remedial action once it became apparent that it would not meet the targets would constitute abusive conduct (assuming the other conditions are met).
- Margin squeeze often emerges in regulated markets. In this respect, the Commission should reiterate the fundamental principle that national regulatory authorities (NRAs) should not approve or even encourage measures that are contrary to Article 82 EC; and that in general, if a NRA misapplies Community law, the remedy is an infringement action against the Member State, not a competition investigation by the Commission.
- The Commission should in general only intervene in cases where there is parallel *ex ante* regulation if: i) the regulatory authority lacks

the requisite legal basis or enforcement powers to take effective action; or ii) if there is a ‘lazy’ or ‘captured’ regulator unwilling or unable to apply its own rules. (The Commission could not formally declare that a regulator was lazy or captured, but that would be the clear implication.) In general, in cases where there is parallel *ex ante* regulation by an NRA, it is better to allow the NRA to implement any remedies since it will be closer to the facts and be better able to conduct the detailed monitoring usually required in regulatory cases.

### III. Additional recommendations

#### 14. *Discrimination*

- A section on discrimination should be added in the next revision of the Guidance paper to ensure that the Commission’s views on Article 82(c) and those contained in the Guidance paper are consistent.
- In that section, the Commission should state that, in most cases, price rebates and other differential prices that are non-exclusionary are also legal under Article 82(c). It should also say that if a rebate is equally available to all buyers, the fact that only some will qualify for it does not make it illegal. In general, different treatment that is neither exploitative nor exclusionary is legal (unless it is a reprisal).
- The Commission should also make it clear that even though the price level may sometimes be determined by marginal buyers, it is not necessarily illegal to price-discriminate between marginal and infra-marginal buyers, and so deprive the latter of some of the benefit of competition.

# INTRODUCTION

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**O**n 3 December 2008, the European Commission issued a Guidance paper setting its enforcement priorities in applying Article 82 to abusive exclusionary conduct (hereinafter the Guidance paper).<sup>1</sup> The document had been expected for a long time, especially after the Discussion paper published by the Commission in December 2005, which paved the way towards a more economic approach to the application of Article 82 of the EU Treaty to exclusionary abuses.<sup>2</sup> The new Guidance paper seeks to streamline the antitrust treatment of exclusionary abuses, such as exclusive dealing, refusals to supply, tying, single-product and bundled rebates and predation, by adopting a general concept of ‘anti-competitive foreclosure’, which contains both the elements of actual foreclosure and consumer harm.

This report comments on the Guidance paper and issues recommendations aimed at improving the Commission’s text and the interpretation of some of the rules contained therein. Even if the Commission does not issue a revised version of the Guidance paper, it is hoped that the comments in this report will be useful to the Commission in

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<sup>1</sup> After having undergone legal-linguistic revision, the “Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings”, was adopted in all EU languages on 9 February 2009. See OJ No. C.45/7, February 24, 2009. The document is also available online, at the following website: <http://ec.europa.eu/competition/antitrust/art82/index.html>.

<sup>2</sup> The “Discussion paper on the application of Article 82 of the Treaty to exclusionary abuses”, published in December 2005, is available online at <http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf>.

its application of the principles set out in the Guidance paper and to national courts in their interpretation of the Guidance paper.

The report is the result of a joint effort of academics, practitioners and industry representatives coordinated by the Centre for European Policy Studies and chaired by Dr. John Temple Lang. The group, called the CEPS Task Force on the treatment of exclusionary abuses under Article 82 (CEPS Task Force, for short) met five times in Brussels between February and June 2009, to discuss the Commission's Guidance paper, and also continued the debate on an *ad hoc* online forum created by CEPS.<sup>3</sup> The views expressed in this report have been agreed by a consensus of the Task Force participants, but do not necessarily represent the views of each participant. As will be seen at various places, there was disagreement between participants on a number of issues.

The CEPS Task Force believes that the Guidance paper will become a key reference for market players, judges, competition authorities, practitioners and scholars in the years to come. For this reason, it is of utmost importance that its content and overall approach are expressed and interpreted in a clear and understandable way.

In particular, although the Guidance paper is conceived as setting the enforcement priorities of the Commission, it will *de facto* be considered by national courts and competition authorities as a document containing guidelines on how to apply Article 82 to exclusionary abuses in the years to come.<sup>4</sup> Accordingly, the approach adopted by the Commission should be stated in such a way that judges and competition authorities can apply it as easily as possible, and diverging interpretations throughout the EU27 are kept at a minimum. The Commission should also be mindful in this regard of the distinction between administrative enforcement and private

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<sup>3</sup> See Annex I at the end of this report for a list of the Task Force participants.

<sup>4</sup> In the Guidance paper the Commission specifies that the “document sets out the enforcement priorities that will guide the Commission’s action in applying Article 82 to exclusionary conduct by dominant undertakings ... it is intended to provide greater clarity and predictability as regards the general framework of analysis which the Commission employs in determining whether it should pursue cases concerning various forms of exclusionary conduct and to help undertakings better assess whether certain behaviour is likely to result in intervention by the Commission under Article 82”. See Guidance paper, § 2.

litigation. In particular, while a regulatory body may be entitled to set enforcement priorities (e.g. to protect not-yet-as-efficient competitors in certain circumstances), a national court or arbitral body in general has no such discretion.

Moreover, the Guidance paper will be read and interpreted by market players as containing indications on the types of conduct that will be considered unlawful since they lead to anti-competitive foreclosure, and the conditions that will have to be fulfilled for such a conclusion to be drawn by the Commission, national courts and competition authorities. In our view it is essential that any approach proposed by the Commission for any kind of conduct is capable of being applied by a dominant company before it decides whether to begin the conduct in question. This approach was endorsed also by the Court of First Instance in its *Deutsche Telekom* decision.<sup>5</sup> Accordingly, no test or criterion should be proposed or used, which depends on information that the dominant company could not reasonably be expected to have or to be able to obtain. This is a necessary consequence of the principle of legal certainty and of the fact that the European Union is subject to the rule of law. It is also an obvious practical necessity, since the Community is obliged to rely primarily on voluntary compliance by dominant companies. No company can be expected to obey the law, or to regard the law as reasonable, if it is compelled to decide its conduct on the basis of information that it cannot be expected to have. This is even more obvious when it is remembered that if a dominant company was expected to know information about its rivals' competitively sensitive business in order to decide whether its conduct was lawful, any effort that it made to find out would be clearly contrary to Article 81.

Based on these considerations, the CEPS Task Force analysed and discussed in detail the content and potential impact of the Commission's Guidance paper, with a view to producing constructive comments.

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<sup>5</sup> See Case T-271/03. At §192, the CFI states: "If the lawfulness of the pricing practices of a dominant undertaking depended on the particular situation of competing undertakings, particularly their cost structure – information which is generally not known to the dominant undertaking – the latter would not be in a position to assess the lawfulness of its own activities": The CFI also clarifies, in the same para., that "any other approach could be contrary to the general principle of legal certainty".

- Overall, the CEPS Task Force welcomes the Commission's efforts to clarify an area of competition law that is generally considered to be both unclear and unsatisfactory. In particular, we welcome the effort to introduce more economic thinking into the legal rules. However, as will be explained in the next sections, we consider that in a number of respects the Guidance paper is unclear or expressed too broadly, and that it should be interpreted in certain ways, set out in the next sections, to avoid a number of potential difficulties.
- While the Guidance paper states that the Commission's focus will be on anti-competitive foreclosure and that the Commission recognises that "what really matters is protecting an effective competitive process and not simply protecting competitors",<sup>6</sup> the Guidance paper does not always give enough weight to the need to prove consumer harm as a precondition to any finding of abuse. The Commission is right to distinguish between anti-competitive foreclosure and legitimate foreclosure: however, the distinction is not made clearly enough, and is not applied consistently and clearly throughout the Guidance paper.
- The Commission seems to have described its future approach to some types of conduct with implicit reference to a number of recent (or pending) cases. While it is perfectly understandable that the Commission describes its future approach and enforcement priorities on the basis of its previous experience and decisions, we are concerned that some sections of the Guidance paper could be read as an effort by the Commission to use the Guidance paper to supply authority that the Commission may have felt was missing when it reached certain recent decisions.

We are concerned that, if the recommendations contained in this report are not accepted, the Guidance paper will lead to findings of abuse in cases where the findings are not justified either in economics or in law. This leads to legal uncertainty and might discourage pro-competitive behaviour, so that the widespread and serious disadvantages would greatly outweigh whatever benefits the Commission might hope to obtain. On the other hand, we consider that, if our recommendations are adopted, the law would be much clearer, companies' costs of compliance would be

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<sup>6</sup> See Guidance paper, para. 6.

greatly reduced, pro-competitive conduct would not be discouraged, and the law would be regarded as reasonable and rational.

This report is structured in three main parts. Part 1 contains our assessment of the Commission's general approach to exclusionary conduct and comments in particular on the definition and treatment of dominance and market power, the definition of anti-competitive foreclosure and the treatment of consumer harm. We also comment more specifically on the merits of protecting 'not-yet-as-efficient' competitors, the use of cost benchmarks, the definition of barriers to entry and expansion, the role of efficiency defences and the related problem of truncated analysis, negative presumptions and, more generally, the standard of proof in Article 82 cases. Finally, we provide suggestions on the use of economic evidence in dealing with Article 82 cases, especially when some or all of the likely effects of the alleged exclusionary conduct are supposed to have already materialised when the case is decided. Part 2 deals with specific forms of exclusionary conduct as defined in the Guidance paper, and thus comments on the Commission's approach regarding exclusive dealing, single-product and bundled rebates, tying, predation, refusal to deal and margin squeeze. Part 3 concludes by providing comments on the need to complete the current Guidance paper by adding a section on discrimination.

# **1. THE GENERAL APPROACH TO EXCLUSIONARY ABUSES**

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**A**n important feature of the Guidance paper is the identification of a general approach to be applied to all types of exclusionary conduct.<sup>7</sup> This test leads to challenging a given conduct when the undertaking holds a dominant position in the relevant market and the conduct at hand, “on the basis of cogent and convincing evidence”, is likely to lead to anti-competitive foreclosure of rivals<sup>8</sup>. More precisely, identifying an exclusionary abuse requires a finding that the observed conduct led to (or is likely to lead to):

- Foreclosure of ‘as efficient competitors’ or – under specific circumstances – ‘not yet as efficient competitors’.<sup>9</sup>
- An adverse impact on consumer welfare, “whether in the form of higher price levels than would have otherwise prevailed or in some other form such as limiting quality or reducing consumer choice”.<sup>10</sup>

In this respect, the Commission clarifies that the main goal of the application of Article 82 to exclusionary abuses is indeed the protection of consumers, rather than competitors.<sup>11</sup> Moreover, in the Guidance paper the

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<sup>7</sup> Section III of the Guidance paper.

<sup>8</sup> Ibid., para. 20.

<sup>9</sup> See below, section 1.2.4.

<sup>10</sup> See Guidance paper, para. 19.

<sup>11</sup> Ibid., para. 6, stating: “the Commission is mindful that what really matters is protecting an effective competitive process and not simply protecting competitors. This may well mean that competitors who deliver less to

Commission identifies a number of factors that might be considered relevant in the assessment of dominance;<sup>12</sup> and also factors that may be taken into consideration in assessing the likelihood that an observed conduct by a dominant undertaking is likely to lead to anti-competitive foreclosure.<sup>13</sup>

The Commission puts emphasis on a more sound economic approach to exclusionary abuses. However, the Guidance paper also states that “[t]here may be circumstances where it is not necessary for the Commission to carry out a detailed assessment before concluding that the conduct in question is likely to result in consumer harm”, and that “[i]f it appears that the conduct can only raise obstacles to competition and that it creates no efficiencies, its anti-competitive effect may be inferred”.<sup>14</sup> While, in a narrow set of circumstances, the Commission may find that the facts of the case unequivocally indicate the existence of an infringing conduct even without the need for a full analysis of the effects, we believe that the conditions that have to be met for a truncated assessment to become viable have to be very precisely defined. Otherwise, the standard of proof for a finding of abuse may vary unpredictably. In the next sections, we suggest that the standard of proof envisaged in the Guidance paper is not consistent.

More generally, the concepts of dominance and market power, the theory of harm relevant to the definition of abuse of dominance, the factors relevant to the finding of anti-competitive foreclosure, as well as the

consumers in terms of price, choice, quality and innovation will leave the market”.

<sup>12</sup> Ibid., para. 12. These factors include: i) the market position of the dominant undertaking and its competitors, ii) constraints imposed by the credible threat of future expansion by actual competitors or entry by potential competitors and iii) constraints imposed by the bargaining strength of the undertaking’s customers (countervailing buyer power).

<sup>13</sup> Ibid., para. 20. These factors include: i) the position of the dominant undertaking, ii) the conditions on the relevant market, iii) the position of the dominant undertaking’s competitors, iv) the position of the customers or input suppliers, v) the extent of the allegedly abusive conduct, vi) possible evidence of actual foreclosure and vii) direct evidence of any exclusionary strategy.

<sup>14</sup> Ibid., para. 22.

standard of proof and the role and scope of truncated analysis will play a decisive role for a sound treatment of exclusionary abuses. Accordingly, it is of utmost importance that these concepts are clearly identified and consistently interpreted throughout the Guidance paper. In the next sections, we provide an analysis of the Commission's general approach to exclusionary conduct and provide comments and recommendations for a future revision of the Guidance paper.

## 1.1 Market power and dominance

In the Guidance paper (para. 10), the Commission starts from the classic definition of dominance found in ECJ case law since *United Brands* and *Hoffman-Laroche*, whereby a dominant position is "a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers".<sup>15</sup> In the latter case, the ECJ expanded on its test by adding that "such a position does not preclude some competition... but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions under which that competition will develop, and in any case to act largely in disregard of it so long as such conduct does not operate to its detriment".<sup>16</sup>

One of the key difficulties with the concept of dominance under Article 82 EC is that it works in an either-or fashion – a firm is either dominant or it is not – whereas the underlying economic notion – market power – works on a sliding scale.<sup>17</sup> A firm can have more or less market power: almost all firms hold some measure of market power, while a smaller set of firms hold significant market power. In fact, firms typically gain some market power through product differentiation, thereby enabling

<sup>15</sup> *Chiquita*, OJ 1976 L95/1, confirmed on appeal in case 27/76, *United Brands Company and United Brands Continental BV v. Commission* [1978] ECR 207, para. 65.

<sup>16</sup> See *Vitamins*, OJ 1976 L223/27, confirmed on appeal in case 85/76, *Hoffmann-La Roche & Co AG v. Commission* [1979] ECR461, para. 39.

<sup>17</sup> See, e.g. R. O'Donoghue and A.J. Padilla, *The Law and Economics of Article 82 EC*, Oxford: Hart Publishing, 2006, Chapter 3.

them to generate a modest rent.<sup>18</sup> The challenge is to find the appropriate point on the sliding scale where a firm can be said to hold enough market power to warrant a finding of dominance and consequently make the firm fall under the scope of application of Article 82 EC. In line with basic principles of law, that point should be set high enough to avoid undue intervention. It is apparent from the excerpts above that the ECJ was aware of that problem, and that it had in mind a significant level of market power where the firm could discipline competitors and thereby affect competition on the market.

This is why, when the Commission writes in para. 11 of the Guidance paper that it “considers that an undertaking which is capable of profitably increasing prices above the competitive level for a significant period of time does not face sufficiently effective competitive constraints and can thus generally be regarded as dominant”, it is setting the bar much too low, at least as far as exclusionary abuses are concerned.<sup>19</sup> Indeed, many markets are characterised by a certain amount of product differentiation, which gives firms the ability to extract some rent from the market, however modest. In addition, it is very difficult in practice to ascertain correctly where the competitive price level lies. As a consequence, the interpretation set out in para. 11 carries a risk of unwarranted findings of dominance (and, if anti-competitive foreclosure is also alleged, of Type I-errors in the enforcement of Article 82 EC).

As already recalled, with the Guidance paper the Commission intends to move towards a more effects-based understanding of Article 82 EC. This implies that more structural analytical elements typically found in the assessment of dominance resurface in the assessment of abuse as well:

<sup>18</sup> See, *i.a.*, R. Posner, *Antitrust Law*, 2nd Ed., Chicago, Il: University of Chicago Press, 2001, p. 265; D.W. Carlton and J.M. Perloff, *Modern Industrial Organization*, Scott, Foresman/Little, Brown 1989, p. 738; and M. Motta, *Competition Policy – Theory and Practice*, Cambridge: Cambridge University Press, 2004, pp. 115-116. Only in the theoretical model of perfect competition or in the Bertrand model with homogeneous products would firms enjoy no market power.

<sup>19</sup> Note that while this excerpt might correspond to the definition of ‘market power’ under US antitrust law, under § 2 of the Sherman Act *substantial* market power is required in order to find that a firm has ‘monopoly power’.

since the abuse is defined by reference to its effects,<sup>20</sup> structural elements are relevant in establishing whether the course of conduct will lead to anti-competitive foreclosure. That much is clear from the list of relevant elements set out in para. 20 of the Guidance paper.<sup>21</sup> Accordingly, if – and only if – the abuse assessment is carried out correctly, it is very likely that a significant level of market power will be required in order to support a finding that a course of conduct leads to anti-competitive foreclosure.

Against this background, the notion of dominance is best seen as a screen or a safe harbour: only above the dominance threshold is the likelihood of anti-competitive foreclosure high enough to warrant a more in-depth inquiry into the course of conduct pursued by a firm. This is why the low threshold set out in para. 11 is not consistent with the thrust of the Guidance paper. This is true, in particular, as regards the setting of the market share indicator to 40% (in para. 14).

In light of the above, that 40% figure also appears on the low side. It seems to us that it would be more consistent with both theory and practice to put at 50% the level of market share below which there is a rebuttable presumption that a firm holds no dominant position. In theory, if half or more of the relevant market is in the hands of competitors and generally contestable, it is difficult to see how the dominant firm could hold such significant market power as to be able to discipline competition without consequences for itself. In practice, in most cases under Article 82 EC so far, firms found dominant had a market share above 50% (and usually well above 50%); this corresponds also to the findings of the survey carried out by the US Department of Justice regarding the application of § 2 of the Sherman Act.<sup>22</sup> By creating a rebuttable presumption to this effect, the Commission would, more often than not, avoid excessive caution by firms

<sup>20</sup> For an analysis of the concept of anti-competitive foreclosure, see Section 1.2.1 below.

<sup>21</sup> See Section 1.4 below.

<sup>22</sup> US Department of Justice, *Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act*, 2008, pp. 21-24. Even if that report has been withdrawn, the reasons for withdrawing it have more to do with the approach to the assessment of unilateral conduct than with the analysis of monopoly power.

that are probably not dominant, while it would retain the full discretion to intervene in individual cases above or below the 50% threshold.

What is more, with the move to a more effects-based approach to abuse, the Commission must be more careful to calibrate the levels of dominance so that the degree of market power offers a probability of harm. The Commission already does this in the case of certain abuses, most notably refusal to supply. In a number of cases including *Commercial Solvents, RTE and ITV v Commission, Oscar Bronner* and *Microsoft*, the finding of dominance has moved beyond a general test to one of *de facto* monopoly and indispensable input into a second market. In such cases, the degree of dominance required for a finding of abuse is so high that it could be viewed virtually as a constituent element of the concept of abuse. Certainly, the Court of First Instance made it clear in the *Microsoft* case that the degree of dominance was itself a major factor in confirming a finding of abuse.

What is now needed is a greater degree of care by the Commission to bring cases in which the degree of dominance is more closely related to the type of abuse. Instead of an unrelated two-step test dominance/abuse, there should be more care at the dominance stage of investigation to ensure that the degree of market power is such that the abusive conduct might potentially lead to actual harm.

What is also needed is a more explicit recognition in its Guidance paper in paras. 9-11 of the way its approach to definition of market power and dominance will vary depending upon the nature of the alleged abuse; certain types of abuse require an even greater level of market power than the standard dominance test.

### ***Recommendations***

- Para. 11 should either be removed from the Guidance paper, or at least amended to specify that a finding of dominance requires significant market power as defined in para. 11, as opposed to an unspecified degree thereof.
- Given the function of the notion of dominance in an effects-based approach to Article 82 EC, we also recommend raising the market share indicator to 50%, as this threshold is more in line with theory and practice than the current 40% indicator identified in para. 14 of the Guidance paper.

- The Commission should acknowledge that, for certain types of abuse, an even higher level of market power might be required than under the general dominance test.

### ***1.1.1 Barriers to expansion and entry and countervailing buyer power***

In para. 12 of the Guidance paper, the Commission correctly identified i) the market position of the dominant firm and its competitors, ii) barriers to expansion and entry and iii) countervailing buyer power as the three main factors in the assessment of dominance. In this sub-section, we look more closely at the latter two factors.

- With respect to countervailing buyer power, para. 18 of the Guidance paper seems to follow the same line of analysis as the Horizontal Merger Guidelines [2004] OJ C 31/5, paras. 64-67. However, the Guidelines are more detailed than the Guidance paper on this point: accordingly, we recommend that the statements made in the Guidance paper be further developed along the lines of the Guidelines.
- Given that countervailing buyer power (point iii above) will not be present in many cases, for all intents and purposes, the main if not the only hope for an undertaking to avoid a finding of dominance based on an examination of market shares (point i above) is to argue that the barriers to expansion and entry on the relevant market are low and that it is therefore subject to competitive pressure from potential entrants or smaller competitors (point ii above).

Against this background, the Commission defines barriers to expansion and entry in a very broad manner. According to para. 17 of the Guidance paper, such barriers include “advantages specifically enjoyed by the dominant undertaking, such as economies of scale and scope, privileged access to essential inputs or natural resources, important technologies or an established distribution and sales network. They may also include costs and other impediments, for instance resulting from network effects, faced by customers in switching to a new supplier. The dominant undertaking’s own conduct may also create barriers to entry, for example where it has made significant investments which entrants or competitors would have to match, or where it has concluded long-term contracts with its customers that have appreciable foreclosing effects”

(footnotes omitted). To complete the picture, it is added that “persistently high market shares may be indicative of the existence of barriers to entry and expansion”, thereby opening the door to a prompt dismissal of arguments relating to such barriers.

On the basis of the broad definition given by the Commission, there will always be some feature of the relevant market or of the defendant firm that qualifies as a barrier to entry. Accordingly, the prospects for arguing successfully that a large market share is counter-balanced by the absence of barriers to entry and expansion are bleak, to say the least.

In our view, it would be useful if the Commission would bring the Guidance paper into line with the economic literature in order to have a more correct definition of barriers to entry and expansion.<sup>23</sup> Time plays a central role in this more recent literature, as reflected also in the Horizontal Merger Guidelines. Accordingly, if the dominant firm enjoys advantages that do not as such delay entry, then they should not constitute barriers to entry for the purposes of Article 82 EC. Para. 16 of the Guidance paper already specifies that the Commission considers barriers to expansion and entry to be relevant only whenever they impede expansion or entry that is i) likely, ii) timely and iii) sufficient (i.e. not simply small-scale). It seems, from the wording of this paragraph, that the Commission considers these three conditions as cumulative – for expansion or entry to be considered as exerting pressure on the putatively dominant firm, all three conditions have to be met.

The Commission should thus clarify that the factors listed in para. 17 of the Guidance paper become relevant as barriers to entry or expansion only when they lead – individually or in combination with other factors – to impeding the possibility of likely, timely and sufficient entry. The

<sup>23</sup> Leaving aside the very broad view put forward by Bain (1956) – who came up with the concept of barrier to entry – and the very narrow view put forward by Stigler (1968), recent literature (McAfee et al., 2004) advocates a more balanced definition, whereby a “barrier to entry is a cost that delays entry and thereby reduces social welfare relative to immediate but equally costly entry”. See J.S. Bain, *Barriers to New Competition*, Cambridge, MA: Harvard University Press, 1956; G. Stigler, *The Organization of Industry*, Chicago, IL: University of Chicago Press, 1968 and R.P. McAfee, H. Mialon and M. Williams, “What Is a Barrier to Entry?”, 94, *American Economic Review*, Papers and Proceedings, 2004, p. 461.

Commission should also explain in more detail what is meant by likely, timely and sufficient.

### ***Recommendations***

- The Commission should develop the section on countervailing buyer power in line with the corresponding section of the Guidelines on Horizontal Mergers.
- The Commission should thus clarify that the factors listed in para. 17 of the Guidance paper become relevant as barriers to entry or expansion only when they lead – individually or in combination with other factors – to impeding the possibility of likely, timely and sufficient entry. The Commission should also explain in more detail what is meant by likely, timely and sufficient.

## **1.2 The theory of harm and the definition of abuse**

The Guidance paper recognises that the aim of enforcement activity with respect to exclusionary conduct is to promote and protect consumer welfare and that it would be inappropriate to determine whether conduct is abusive based simply on the effect of the conduct on competitors. The Guidance paper recognises that “competitors who deliver less to consumers in terms of price, choice, quality and innovation will leave the market” (para. 6) – and the Guidance paper regards such departures from the market as the natural and appropriate consequence of “an effective competitive process” (*ibid.*).

Aware that its objective should be to protect consumers and consumer welfare rather than protecting competitors, the Commission explains in the Guidance paper that it aims to focus its enforcement efforts in the area of exclusionary conduct on ‘anti-competitive foreclosure’ (as opposed to foreclosure *per se*). The Commission defines anti-competitive foreclosure as a situation where: a) the conduct of the dominant company hampers or eliminates effective access of actual or potential competitors to supplies or markets and b) is likely to have an adverse impact on consumer welfare, whether in the form of higher price levels than would have otherwise prevailed or in some other form (para. 19). Both conditions are meant to be necessary for an exclusionary abuse: foreclosure and likely consumer harm, i.e. the likelihood that as a consequence of the conduct the

dominant company will be in a position to profitably affect the parameters of competition – such as prices, output, innovation, the variety and quality of goods or services – to the detriment of consumers.

Paras. 20-22 of the Guidance paper elaborate on how the Commission will attempt to determine whether conduct that makes life difficult for competitors should be regarded as the workings of an effective competitive process or instead anti-competitive foreclosure. The general discussion in this section of the Guidance paper is meant to be read with the discussion of specific forms of abuse in section IV of the paper.

There are three main problems with this section of the Guidance paper:

- *Any anti-competitive foreclosure theory should be supported in the first instance by a coherent theory of harm.* More precisely, any theory of anti-competitive foreclosure must be supported by a careful consideration of both the incentive and ability of the dominant firm to foreclose competition. This need to explain the dominant firm's incentive as well as its ability to foreclose is especially important in cases of alleged vertical foreclosure. The Commission makes this point in its Non-Horizontal Merger Guidelines. The same point should be emphasised in this Guidance paper on exclusionary conduct enforcement priorities.
- The Guidance paper presents in para. 20 a list of factors that the Commission will consider when assessing the likelihood that specific conduct will have anti-competitive effects. This is a critical step in the analysis. *The Guidance paper however provides insufficient guidance as to how these factors will be considered and weighed.* This absence of specificity denies dominant firms the element of predictability to which they are entitled.
- Para. 22 states that there may be situations in which the conduct in question “can only raise obstacles to competition” and “creates no efficiencies”. The Guidance paper states that, in such circumstances, it is not necessary for the Commission to carry out a detailed assessment of the conduct before reaching the conclusion that the conduct is likely to result in consumer harm. We submit that such situations are so rare that any benefit that might result from having the option of conducting a truncated analysis in these rare cases is outweighed by the risk that the Commission might mistakenly use a truncated analysis in a situation in which a fuller analysis of the

effects on consumer welfare is warranted. *Especially in a paper that is meant to summarise enforcement priorities, we suggest the Commission and other users of the Guidance paper ignore para. 22 and instead demand, in all cases, evidence regarding the likely effects on consumers.*

### ***Recommendations***

- The Commission must ensure that any case alleging anti-competitive foreclosure is supported by a coherent theory of harm – i.e. an explanation of the anti-competitive benefits that the dominant firm might realise if it were able to foreclose competition (incentive).
- As discussed below, the Commission should ensure that cases of alleged anti-competitive foreclosure are also supported by empirical evidence regarding the dominant firm's ability to foreclose and the likelihood of consumer harm.

#### ***1.2.1 The list of generally relevant factors***

As just discussed, it is not sufficient for the Commission to present a coherent theory of harm, i.e. an explanation of the dominant firm's anti-competitive incentives to foreclose. The Commission must also support cases of alleged anti-competitive foreclosure with empirical evidence regarding the dominant firm's ability to foreclose and the likelihood of consumer harm. In para. 20 of the Guidance paper, the Commission lists and discusses factors that it will consider in making this assessment.

The Commission identifies seven factors that it considers generally relevant to the assessment of anti-competitive foreclosure: the position of the dominant undertaking, the conditions on the relevant market which may affect the impact of foreclosure, the competitive importance of foreclosed competitors, the competitive importance of the customers or input suppliers, the extent of the allegedly abusive conduct (market share affected by the conduct, duration, etc.), evidence of actual foreclosure and direct evidence of any exclusionary strategy (para. 20). This list of generally relevant elements in the assessment of abuse is aimed at providing examples of evidence that can be used to prove an anti-competitive foreclosure; however, it lacks the sharpness that would be expected in the light of para. 19.

First, it bears noting that some of the factors listed in para. 19 seem more relevant for the assessment of dominance than for the assessment of the allegedly anti-competitive conduct. In particular:

- *The first, second and fifth factors on the list are mainly structural.* If taken in isolation, to the exclusion of other elements, they would reflect an outdated Structure-Conduct-Performance (SCP) paradigm and entail a risk that any course of conduct by a dominant company would be an abuse.<sup>24</sup>
- *The last two factors in the list may be particularly misleading.* Direct evidence of foreclosure is consistent with anti-competitive foreclosure, but it can never be considered as sufficient proof of anti-competitive foreclosure. Firms may leave the market because the dominant firm outperformed them through business acumen or superior products. Inefficient competitors are then ‘harmed’, but consumers benefit. The risk of spurious correlations should thus not be underestimated.

As regards the direct evidence of an exclusionary strategy, in para. 20 the Commission specifies that it will not be used as direct proof of the abuse, but only as an instrument that may be helpful to ‘interpret’ the conduct of the dominant firm. Here it is very important to distinguish between mere sales talk – however outrageous and colourful – and concrete evidence of a well thought-out plan to eliminate rivals. The latter can be useful, as an element to explain the theory of harm (i.e. the dominant firm’s incentive to foreclose) and establish its plausibility. The Commission must be careful, however, not to fall into the trap of treating the former type of evidence – sales talk – as crucial, and deriving a finding of abuse based on informal statements by salesmen without involvement in company policy. Intent is relevant only in a limited number of cases (e.g. predation when prices are

<sup>24</sup> The SCP paradigm was the dominant framework for empirical research in industrial organisation (IO) between the 1950s and early 1980s. The paradigm postulates a causality chain running from market structure, firms’ conduct and their performance. The influence of the paradigm only began to wane in the 1980s with the emergence of new approaches such as the New Industrial Organisation. The origin of the SCP paradigm can be traced to the work of the Harvard economist Edward Mason in the 1930s, and in Joe S. Bain’s book entitled *Barriers to New Competition*, op. cit.

between average avoidable cost and average total cost, vexatious litigation, reprisals).

However, the first five elements in the list may play a useful role as screening devices, which can be used to exclude the risk of anti-competitive foreclosure. For instance, in cases of alleged predation, the absence of barriers to entry may be used to exclude the likelihood of recoupment.<sup>25</sup> More generally, for pricing conduct a small percentage of the total sales in the relevant market affected by the dominant firm's discount policy and its short duration may be useful to exclude the likelihood of an anti-competitive story and is therefore an important complement to the assessment of whether the price is below some cost indicator.

The fourth and fifth elements – consideration of the position of competitors and customers/suppliers – are particularly important from an effects-based perspective. Indeed, the competitive process must be understood as a complex interaction between market players: each player is aware of the position of the others and tries to anticipate their reaction as it makes its own moves. Structure and behaviour are closely intertwined. Only if the position of others is properly factored in can the competition authority differentiate between desirable aggressive competition and conduct that can genuinely foreclose efficient rivals.

Overall, the factors listed in para. 20 can be relevant to establish whether a given course of conduct is likely to foreclose rivals, but are less apt to reveal whether that foreclosure is detrimental to consumer welfare. Indeed, what is still blurred in the discussion in paras. 20-21 is the crucial last step in the assessment of abuse under an effects-based approach, namely the actual or likely impact on consumer welfare. In this respect, it would be useful if the Guidance paper could contain the following:

- *A clearer identification of criteria for a structured assessment of the most common practices, able to capture the likely consumer harm.* In particular, absent evidence of actual consumer harm, a consistent story supported by evidence should always be provided showing that in the specific case under consideration consumer harm is likely. In doing this, the Commission should also clearly spell out the short- and long-term impact on consumers.

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<sup>25</sup> See section 2.4 below.

- *An explanation of how these different factors will be weighed in the assessment of most common practices*, which would prove helpful for potentially dominant firms in assessing whether their conduct is likely to be considered abusive or not.
- *A statement clarifying that the Commission should provide evidence that the chosen theory of anti-competitive foreclosure applies to the specific circumstances of the case*. It is not sufficient to state that a generic theory could apply to a similar conduct in some circumstances. Importantly, as required by Community courts in the review of decisions concerning non-horizontal mergers, evidence should be factually accurate, reliable and consistent, contain all the information that must be taken into account to assess a complex situation and be capable of substantiating the conclusions drawn from it. The burden then might shift to the defendant to rebut a *prima facie* case of anti-competitive effects.

### ***Recommendations***

- The Commission should clarify that none of the seven factors listed in para. 20 can be used in isolation to prove anti-competitive foreclosure. They should always be included in a plausible theory of consumer harm based on cogent and convincing evidence.
- The Guidance paper should state explicitly that no finding of abuse will be made without the position of competitors and customers/suppliers having been examined.
- The Commission should consider introducing rules for a structured assessment of the most common practices, able to capture the likely consumer harm. In the absence of evidence of actual consumer harm, a consistent story supported by evidence should always be provided showing that in the specific case under consideration consumer harm is likely. The short- and long-term impact on consumers should be clearly spelled out.
- The Commission should provide factually accurate, reliable and consistent evidence that the chosen theory of anti-competitive foreclosure applies to the specific circumstances of the case, as it is not sufficient to state that a generic theory could apply to a similar conduct in some circumstances.

### ***1.2.2 Truncated assessments***

In para. 22 of the Guidance paper, the Commission states that if it appears that the conduct can only raise obstacles to competition and that it creates no efficiencies, “its anti-competitive effect may be inferred” and it is not necessary for the Commission to carry out an assessment of the likely consumer harm.

The Guidance paper mentions two examples of conduct that it believes fall into this category. The first is when a dominant firm prevents its customers from testing the products of competitors (either by making this a condition of sale or by offering payments not to test competitors’ products). The second example mentioned by the Commission is when a dominant firm pays a distributor or customer to delay the introduction of a competitor’s product.

These examples highlight the problems with the suggestion that there is a non-trivial class of conduct where a truncated assessment would be appropriate. We argue that the examples must be interpreted narrowly, so as to include only conduct that by itself is clearly likely to harm consumers. Otherwise, the result would be a serious weakening of the standard of proof for the Commission and the shift on the dominant company of the burden of providing convincing evidence that the conduct has legitimate justifications and does not have the alleged anti-competitive effect.

More generally, we submit that situations in which the conduct in question clearly raises obstacles to competition and yet creates no efficiencies are so rare that any benefit that might result from having the option of conducting a truncated analysis in these cases is outweighed by the risk that the Commission might mistakenly use a truncated analysis in a situation in which a fuller analysis of the effects on consumer welfare is warranted. Accordingly, we suggest that the Commission modifies para. 22 of the Guidance paper to define more narrowly the (exceptional) cases in which it is allowed to avoid a full assessment of anti-competitive foreclosure.

### **Recommendations**

- The circumstances under which the Commission is allowed to avoid a full assessment of anti-competitive foreclosure, including presumptions of illegality with reversal of burden of proof, should be narrowly justified, viewed as strictly exceptional and interpreted accordingly.

### **1.3 Price-based exclusionary conduct and the ‘as efficient competitor’ test**

In explaining the concept of ‘anti-competitive foreclosure’ as it applies to price-based conduct in the Guidance paper, the Commission states that it will ‘normally’ intervene where the conduct is capable of hampering competition from competitors that are as efficient as the dominant company. This principle has been developed by some economists to provide a rule for predatory pricing (prices below an appropriate measure of cost):<sup>26</sup> we consider it to represent a clear and sensible approach, and if followed consistently it would improve upon the approach adopted in the EU in existing case law.

However, in the Guidance paper the Commission goes on (para. 24) to indicate that, in certain circumstances, it may depart from this principle and intervene even though the conduct would not foreclose an ‘as efficient competitor’ (AEC). The Commission suggests that departing from the AEC principle could be appropriate if, for example, the relevant market is one in which network and/or learning effects are important.<sup>27</sup> In such markets, new entrants will naturally have higher costs at the time of entry than an established dominant firm, usually because of a lack of economies of scale or scope comparable to the dominant firm. Under these conditions, strict

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<sup>26</sup> See O'Donoghue & Padilla (2006), op. cit., pp. 189-191.

<sup>27</sup> On network and learning effects, see i.a. M. Spence, “Competition, Entry and Antitrust Policy”, in Salop et al. (1981), *Strategy, Predation and Antitrust Analysis*; M. Katz and C. Shapiro (1994), *System Competition and Network Effects*, *Journal of Economic Perspectives*, Vol. 8, No. 2, p. 107; and R. Padolesi and A. Renda (2003), “How Safe is the King's Throne? Network Externalities on Trial”, in P. Cucinotta, R. Padolesi and R. Van Den Bergh (eds), *Post-Chicago Developments in Antitrust Law*, Cheltenham: Edward Elgar Publishing.

application of the AEC test might permit the dominant firm to engage in pricing conduct that would deter entry by firms who could become at least as efficient as the dominant firm if they were able to establish themselves in the market.

The concerns that lead the Commission to consider departing from the AEC principle are understandable as a matter of economic theory. As a practical matter, however, the Commission's proposed approach is problematic. In particular, while applying the AEC test is not necessarily without its own complications, the complications and uncertainty faced by dominant firms would be that much greater if, in addition, they had to contend with the possibility that their conduct would be assessed by something other than the AEC principle. Again, as already recalled, it is essential that the criteria selected by the Commission are such that dominant firms can engage in self-assessment of the potential abusive nature of their market conduct. Related to this point, but even more important from a public policy perspective, there is an obvious risk that the possibility of departure from the AEC principle could make dominant firms overly cautious about responding to competition and could result in higher prices to consumers.

For these reasons, we believe the Commission must define far more precisely the circumstances under which it would depart from the AEC principle (see recommendation below). If the Commission is unwilling or unable to define these circumstances with precision, then the Commission should apply the AEC principle in all cases, even though there might be cases in which strict adherence to this principle could allow anti-competitive conduct to go unpunished.

We believe that the Commission's concern should be regarded as reasonable in one specific situation, i.e. in relation to a competitor that is aggressive, but not yet efficient, which provokes a reaction from the dominant firm that is specifically aimed at the competitor in question. In that situation the Commission should rely on the principle 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 more sound and justifiable approach than the not-yet-as-efficient

theory, and a more practical one.<sup>28</sup> It would be helpful if the Commission stated that this is the only situation in which a less efficient competitor should be protected.

### ***Recommendations***

- The Commission should state that the only situation in which a less efficient competitor would be protected is when: i) the competitor is aggressive, but not yet efficient, and this provokes a reaction from the dominant firm and ii) the conduct of the dominant company is specifically aimed at the competitor in question.
- In that situation the Commission should rely on the principle that prohibits ‘reprisal’ abuses, rather than the not-yet-as-efficient theory.

## **1.4 The cost benchmark**

### ***1.4.1 Choosing the appropriate cost benchmark***

The Guidance paper identifies two cost benchmarks that the Commission is likely to use in determining whether a dominant firm’s pricing should be regarded as exclusionary: average avoidable cost (AAC) and long-run average incremental cost (LRAIC).<sup>29</sup>

<sup>28</sup> Some Commission officials believe that when a company is ‘super dominant’ (undefined), it is appropriate to protect less efficient competitors, to prevent complete monopolisation, or as a supplement to regulatory measures. See also the Opinion of Advocate General Fennelly delivered on 29 October 1998 in *Compagnie maritime belge transports SA* (C-395/96 P), *Compagnie maritime belge SA* (C-395/96 P) and *Dafra-Lines A/S* (C-396/96 P) v *Commission*, Joined cases C-395/96 P and C-396/96 P, [2000] E.C.R. I-1365 in para. 137. For a definition and discussion of superdominance, see O’Donoghue & Padilla (2006), op. cit., pp. 166-168; and Geradin et al. (2005), *The Concept of Dominance in EC Competition Law* (available at SSRN: <http://ssrn.com/abstract=770144>).

<sup>29</sup> AAC is defined as “the average of the costs that could have been avoided if the company had not produced a discrete amount of (extra) output, in this case the amount allegedly the subject of abusive conduct”. LRAIC is defined as “the average of all the (variable and fixed) costs that a company incurs to produce a

However, the cost benchmarks chosen by the Commission are not applied consistently throughout the Guidance paper.

- With regard to *single-product loyalty discounts*, the Guidance paper states that: i) where the effective price is below AAC, as a general rule the discount scheme is capable of foreclosing equally efficient competitors;<sup>30</sup> ii) where the effective price is between AAC and LRAIC, the Commission will investigate whether other factors point to the conclusion that entry or expansion even by as efficient competitors is likely to be affected.<sup>31</sup>
- By contrast, *in all other cases, failure to cover LRAIC is normally considered sufficient* to conclude that a practice is capable of excluding equally efficient competitors.<sup>32</sup>
- *Failure to cover AAC is only taken into account in the analysis of profit sacrifice*, which is a separate requisite for unlawful predation.<sup>33</sup>

The reason for the difference of treatment between single-product discounts and other pricing policies is not entirely clear. Similar to loyalty discounts, pricing policies such as bundled discounts and price squeeze are

particular product" (see Guidance paper, § 26, footnote 2, p. C.45/11). Unlike AAC, LRAIC includes also sunk fixed costs.

<sup>30</sup> See Guidance paper, § 44.

<sup>31</sup> In particular, the Commission will investigate whether and to what extent rivals have realistic and effective counterstrategies at their disposal. According to the Guidance paper, the Commission will consider that a rebate scheme is capable of foreclosing equally efficient competitors if rivals do not have such counterstrategies at their disposal. In particular, this could happen when competitors can also use a non-contestable portion of their buyers' demand as leverage to decrease the price of the relevant range. See Guidance paper, § 44. Surprisingly, the Commission is willing to adopt a more tolerant approach where entry or expansion by minor competitors is likely to be more difficult, due to the existence of two or more firms holding a significant market power over given shares of customers' requirements.

<sup>32</sup> See Guidance paper, §§ 60 (multi-product rebates), 67 (predation) and 80 (margin squeeze).

<sup>33</sup> According to the Commission, pricing below AAC indicates that a firm is sacrificing profits in the short term with a view to strengthening or maintaining its market power (see Guidance paper, § 64).

sustainable in the long run, since they do not necessarily entail any loss or reduction in profits. If a dominant firm prices below LRAIC for a prolonged period, sooner or later an equally efficient competitor could be forced out of the market. However, when a dominant firm implements a pricing policy for a limited period, LRAIC may not be the most appropriate cost benchmark to establish whether equally efficient competitors could be excluded. In the short run, costs that vary only in the long run cannot be avoided and should not be taken into account when establishing whether a given price is profitable. As long as AAC are covered, an equally efficient rival would not suffer any loss that it could avoid by exiting. As a consequence, it would not have incentives to exit the market.

On the other hand, when a market is characterised by very high sunk fixed costs and very low avoidable costs, the use of an AAC benchmark might not adequately reflect the specific economic reality of the industry concerned. Competitors would not sustain the sunk investment needed to enter a market if they did not have a reasonable prospect of recouping all product-specific costs. In such a case, LRAIC could offer a more realistic picture of the costs of entering a market and remaining in it.<sup>34</sup> In any case, the Commission should take into account that, in many settings, pricing below LRAIC but above AAC could be economically rational for a dominant firm.<sup>35</sup>

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<sup>34</sup> However, it should be noted that, if the contested practice is implemented for a long period, AAC and LRAIC tend to yield similar outcomes. Normally, the longer the time period considered, the larger AAC will be, since more and more sunk costs become avoidable over time.

<sup>35</sup> A firm pricing below LRAIC could cover its variable costs and make a contribution to its already sunk fixed costs. Accordingly, the firm would not be necessarily be better off by discontinuing or reducing production. For instance, firms active in cyclical industries may sell at below LRAIC during the downturn of the business cycle, and recoup during the upturn.

### ***Recommendations***

- In order to establish whether equally efficient competitors could be foreclosed, the Commission should use two different cost benchmarks, not only for single-product loyalty discounts, but also for other pricing policies.
- Where prices are below AAC, the Commission should conclude that the contested practice is capable of foreclosing equally efficient competitors. Where prices are between AAC and LRAIC, the Commission should investigate whether additional factors point to the conclusion that entry or expansion by equally efficient competitors is likely to be affected.

#### ***1.4.2 Common costs***

The Guidance paper says very little about the allocation of common costs (i.e. costs incurred in common for a number of products). The cost benchmarks favoured by the paper (i.e. LRAIC and AAC) do not include an appropriate share of common costs. However, in a footnote, the Commission states that, “[i]n situations where common costs are significant, they may have to be taken into account when assessing the ability to foreclose equally efficient competitors”.<sup>36</sup>

We believe that the Commission is right in wanting to take common costs into account when they are important (as, for instance, in network industries). Ignoring common costs may create a significant bias against rivals who are only active in one product and have to cover all the stand-alone costs of that product. Furthermore, the *AKZO* judgment, setting forth cost-based standards to determine predation, certainly gives no indication that common costs can be ignored.<sup>37</sup>

Unfortunately, the Commission gives: i) very limited indications on the circumstances in which common costs should be taken into

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<sup>36</sup> See Guidance paper, § 26, footnote 2, p. C.45/11.

<sup>37</sup> Case C-62/86, *AKZO* [1991] ECR I-3359.

consideration<sup>38</sup> and ii) no guidance on the vexing question as to which cost allocation methodologies it will accept.

With regard to point i) above, the opinion of our group is that the Commission should be particularly cautious when deciding whether common costs should be taken into account. A form of incremental cost is generally more appropriate, for the following reasons:

- *Antitrust rules should not prevent dominant firms from taking advantage of their scope economies when setting prices.* When a firm decides whether to produce an additional good, it normally compares incremental costs and incremental revenues. If the firm concerned already covers common costs through the sales of other products, whose demand is less elastic, a rule requiring that each product makes an appropriate contribution to general overheads could result in higher prices. Dominant firms should not be obliged to behave as if they were less efficient;
- *Competitors should be encouraged to expand their product range,* if it is more efficient to do so;
- *The allocation of common costs to different products is particularly complex and uncertain.* Although many conventional accounting methods have been proposed, there are no unambiguous and commonly accepted criteria for allocating common costs.

In light of the above, common costs should be taken into account only under very specific circumstances. The Commission should demonstrate not only that common costs are significant, but also that competitors could not reasonably realize similar scope economies by expanding their product range (not necessarily to produce exactly the same products as the dominant firm), so as to cover common costs through the sale of other products.

As to the criteria for allocating common costs, we believe that the Commission should not prescribe particular cost allocation methods. This might be appropriate in a regulatory context, but not in a competition law framework. In light of the high margin of discretion and uncertainty inherent in the allocation of common costs, antitrust authorities and courts

<sup>38</sup> The Guidance paper says only that common costs “may” be taken into account where they are “significant” (*ibid.*).

ought to accept the cost allocation method employed by the dominant firm, provided that it is reasonable (e.g. used by cost accountants, economists or regulatory authorities and consistently used by the dominant firm itself across its different activities (where, obviously, there are shared costs).

### ***Recommendations***

- Common costs should be taken into account where: i) they are significant; and ii) competitors cannot realize similar scope economies by expanding their product range, so as to cover common costs through the sale of other products.
- The Commission should accept any cost allocation method for common costs employed by a multi-product company, provided that it is: i) reasonable and normally accepted and used by cost accountants, economists or regulatory authorities; and ii) consistently used by the dominant firm.

## **1.5 Efficiency defence**

The issue of the standard for anti-competitive foreclosure is closely linked to the role of objective justification and efficiency defences. In principle, the shift to a more effects-based application of Article 82 EC should entail that efficiencies are better integrated into the assessment of the effects of the observed conduct. Yet, if enforcement is based on negative presumptions or truncated assessments, or if the ‘consumer harm’ requirement for anti-competitive foreclosure remains underdeveloped, defences could play a crucial role.

The effect of the approach to efficiencies in the Guidance paper is to import into Article 82 (under defences) the four cumulative conditions of Article 81(3) EC.<sup>39</sup> The conditions, as proposed in the Guidance paper in para. 30, read as follows:

- a) *The efficiencies have been, or are likely to be, realised as a result of the conduct.* They may, for example, include technical improvements in

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<sup>39</sup> See the Commission’s Guidelines on the application of Article 81(3) of the Treaty (OJ C 101, 27.4.2004, p. 97).

the quality of goods, or a reduction in the cost of production or distribution.

- b) *The conduct is indispensable to the realisation of those efficiencies:* there must be no less anti-competitive alternatives to the conduct that are capable of producing the same efficiencies.
- c) *The likely efficiencies brought about by the conduct outweigh any likely negative effects on competition and consumer welfare in the affected markets.*
- d) *The conduct does not eliminate effective competition,* by removing all or most existing sources of actual or potential competition.

We consider the Commission's choice to import the Article 81(3) methodology into Article 82 to be undesirable for a number of reasons.

- *First, the 81(3) methodology conceived for granting exemptions under Article 81 does not seem fit for the assessment of unilateral conduct of dominant companies.* In particular, importing the four conditions of Article 81(3) into Article 82, while making the objective justification and efficiency defences more systematic, also makes them less likely to be satisfied. An efficiency defence based on the four cumulative conditions is not a flexible one: the last (negative) requirement (for conduct not to eliminate competition) means that a dominant firm's conduct, although socially desirable because it creates efficiencies, will still be prohibited. The very presence of a dominant position means that in practice it will be usually presumed that the condition for consumers getting a fair share of the benefit will not be satisfied. This approach is particularly inadequate in those highly innovative markets where quasi-monopoly positions may exist for a period only to be rapidly eroded.
- *Secondly, even today – with less strict requirements – there has been no Article 82 case where an efficiency defence was successful.* In the Guidance paper the Commission stresses that, when claiming an efficiency defence, the dominant undertaking "will generally be expected to demonstrate, with a sufficient degree of probability and on the basis of verifiable evidence", that the four conditions are fulfilled (para. 30). On the other hand, when assessing whether the conduct is necessary and proportionate and whether the likely efficiencies outweigh any likely negative effects on competition and consumer welfare, the Commission enjoys a lot of discretion. So, while the 81(3) approach sounds scientific, in practice few dominant players are

likely to prevail in defending themselves. This is not merely because firms with market power need more compelling efficiency justification than those who do not have market power, but also because the test as set out in the Guidance paper is skewed against the defence succeeding where a firm is dominant.

The strict conditions for a defence underline the importance not to postpone the assessment of the efficiency of a conduct to the last stage of the analysis. When assessing anti-competitive foreclosure the approach to the impact of the conduct on the market should not be artificially blinded: the whole impact of the conduct should be taken into account, including the resulting efficiencies. Otherwise, efficiencies risk being systematically underestimated.

Indeed, if the impugned conduct produces efficiencies such that on balance consumer welfare improves, then on the basis of the general approach to exclusionary conduct set out by the Commission in para. 19 of the Guidance paper there is no abuse. On this point, the opinion of Advocate-General Jacobs in *Syfait* remains very persuasive.<sup>40</sup> If a course of conduct, such as an increase in output coupled with a decrease in prices in order to gain market share, enabled a dominant firm to reap economies of scale without escaping competitive pressure entirely, no abuse should be found to start with.

The ‘efficiency defence’ becomes all the odder when it entails a consideration of longer-term perspectives, typically relating to innovation or investment in infrastructure. For example, claiming that compulsory licensing of IP-protected goods would adversely affect the dominant firm’s innovation incentives would hardly qualify as an ‘efficiency defence’ as conceived of in the Guidance paper. In those cases, a longer-term perspective could help the Commission in assessing the impact of certain remedies on consumer welfare.

The main argument why the Commission might want to park this discussion in a defence (as opposed to the overall assessment of abuse itself) seems of a more practical order: the competition authority should not

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<sup>40</sup> *Syfait* was decided on procedural grounds. When the case came before the Court of Justice again in *Sot.Lelos*, Advocate General Colomer was more cautious than Advocate General Jacobs on the issue. The Court finally ruled on the basis of a ‘commercial interests’ argument.

be forced to go on a fishing expedition for possible ‘efficiencies’ as part of its assessment of abuse, and later held accountable for it on review. However, putting efficiencies at the tail-end of the discussion, as a defence, makes them practically useless: how likely is it that a dominant firm whose conduct was found to have led to an anti-competitive foreclosure – even if the welfare assessment might not have been complete – would manage to turn the case around by proving efficiencies? The transplant of the Article 81(3) EC criteria into Article 82 EC makes this inquiry even more artificial, and transforms the efficiency defence into an uphill battle for defendants.

Against this background, we recommend the Commission to adopt a more nuanced approach to efficiencies: in line with the effects-based approach outlined in para. 19 of the Guidance paper, the consideration of counterbalancing efficiencies should be part of the assessment of abuse. However, the defendant should have the burden of alleging and substantiating efficiencies. Once the efficiency is alleged (with a relatively low burden of proof), it is then up to the competition authority to take it fully into account in its determination of abuse.<sup>41</sup> In any event, such an approach should apply to the assessment of the impact of public intervention on dynamic efficiency and longer-term consumer welfare, which must be balanced against shorter-term considerations and not kept for a later stage.

### ***Recommendations***

- In line with the effects-based approach outlined in para. 19 of the Guidance paper, the consideration of counterbalancing efficiencies should be part of the assessment of abuse, rather than left as a defence. However, the defendant should have the burden of alleging efficiencies.

## **1.6 Use of economic evidence**

As the Commission moves towards a more effects-based approach to exclusionary abuses, it is reasonable to expect that the treatment of

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<sup>41</sup> This is how the Court of First Instance understood the respective roles of the Commission and the company in *Microsoft* (see paras 688 and 1144).

available economic evidence will play a greater role in the future. In this respect, there are factual circumstances that could be regarded as providing *prima facie* evidence that the conduct in question was legal. These factual circumstances may be divided into two categories of economic evidence, one that refers to the foreclosure condition and the other that refers to the consumer harm condition.

In this respect, it must be remembered that both categories of economic evidence provide elements that are sufficient to establish a presumption of legality. This is due to the fact that, since foreclosure and consumer harm are necessary for a conduct to be defined as an exclusionary abuse, both have to be proved for a conduct to be deemed abusive, whereas it is sufficient to disprove one to conclude that a conduct is not anti-competitive.

### ***1.6.1 Evidence regarding the foreclosure condition***

If the conduct has been in place for a sufficient period of time, the market position of the rivals or their behaviour may indicate that the conduct did not have foreclosing effects.<sup>42</sup> The following factors may be considered as relevant:

- 1) *Distribution of market shares.* If during the relevant period of time rivals have increased their market shares, while the market share of the dominant undertaking declined, this should constitute *prima facie* evidence that the conduct is unlikely to have exerted a foreclosure impact in the relevant market.
- 2) *Rivals' strategies in terms of price, quality and other selling conditions.* If, after controlling for the influence of exogenous factors, there is robust and verifiable evidence that rivals have reduced their price, improved the quality of their products or offered their clients better selling conditions while continuing to earn profits, we should conclude that the conduct under investigation is likely to be unable to foreclose rivals.

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<sup>42</sup> The time span that has to be considered sufficient depends on the chosen theory of harm as some anti-competitive strategies require more time than others to produce their foreclosing effects.

- 3) *Entry.* Foreclosure may also have the effect of impeding the entry of potential competitors. Hence, if during the relevant period of time new firms entered the relevant market on a sufficient scale to make their business viable – so that entry corresponds to the definition provided in the Guidance paper in para. 16, and is likely to take place swiftly and with sufficient scale – we should conclude that it is unlikely that the conduct was able to foreclose the market.

### ***1.6.2 Evidence regarding the consumer harm condition***

If the conduct has been in place for a sufficient period of time, the behaviour of consumers may provide indications that the conduct did not harm them and, thus, was not anti-competitive.<sup>43</sup> The following elements may be relevant:

- 1) *Price.* If during the relevant period of time, taking into account the influence of exogenous factors, consumers have been normally charged a lower price to purchase the same quantity of products, we should infer that the conduct of the dominant undertaking is unlikely to result in consumer harm. Of course, this type of argument is difficult to use in predation cases, as a lack of consumer harm should be appraised by definition over a sufficiently long time frame, including the recoupment period.
- 2) *Quantity.* If, taking into account the influence of exogenous factors, consumers buy a larger quantity of product even if the price has not changed, this reflects an upward shift of their demand curve, and thus an increase in their willingness to pay. Hence, for certain cases, if during the relevant period of time consumers have purchased a larger quantity of the product, this could be taken as (rebuttable) evidence that the conduct under investigation is unlikely to cause

<sup>43</sup> The length of the ‘sufficient period of time’ depends on the chosen theory of harm. It is apparent that a temporary price reduction or a temporary quantity increase is consistent with a predatory strategy. Therefore, when predation is alleged, this type of evidence cannot be considered sufficient to prove that the observed strategy is legal. However, also in this case, if the price reduction, or the quantity increase, outlasts the reasonable period of time devoted to the exclusion of rivals, it shows that it is unlikely that consumers are harmed by the conduct of the dominant firm.

consumer harm, or at least has not caused harm until the moment in which the case is being decided. On the other hand, for predation cases – as well as all cases in which the exclusionary abuse entails a price cut in the short term, such as discounts – the issue may be more complex, as during the predatory period, when prices are low, the quantity demanded will go up.

- 3) *Quality.* Even if the quantity purchased has not increased and the price has not declined, consumers can be better-off if the quality of the product they buy has increased, as their willingness to pay for the higher quality products is likely to be higher and thus to contribute positively to their welfare. If there is robust and verifiable evidence that, during the relevant period of time, consumers have had access to products of better quality, we should infer that the alleged abusive conduct is unlikely to be anti-competitive.<sup>44</sup>

The various types of economic evidence discussed in this section are not irrefutable. It is always possible that if the conduct under investigation had not taken place, the dominant undertaking's market share would have declined more than it actually has, that rivals would have charged even lower prices, expanded their output, offered better products or proposed better selling conditions, or that more new competitors would have entered the market. Similarly, it is always possible that, in the absence of the alleged abusive conduct, consumers would have enjoyed even lower prices, purchased an even larger quantity or obtained even higher quality products.

Accordingly, economic evidence could be used only to establish a *prima facie* evidence that the contested conduct was not likely to lead to actual foreclosure or consumer harm. Nevertheless, it would be useful if the Commission clarified whether and how available evidence will be taken into account in establishing a case for exclusionary conduct. This would at once: i) introduce more symmetry in the Guidance paper, where only the factors to be taken into account to establish dominance and abuse are clarified, but not those that may constitute evidence that the conduct may indeed have been lawful; ii) highlight the importance of economic

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<sup>44</sup> This, of course, requires that: i) the quality of the product can be unequivocally defined; and ii) there is no way to infer that, absent the alleged exclusionary conduct, quality would have improved even more.

evidence in a more effects-based approach; and iii) help dominant firms assess the likely anti-competitiveness of their conduct.

Finally, the use of economic evidence crucially depends on the phase of investigation that is considered. In particular:

- i) At a preliminary stage (interim measures), concrete evidence of foreclosure or consumer harm cannot be required.
- ii) At the inquiry stage, the Commission should gather concrete economic evidence.
- iii) If by the time the Commission finally gets to decide the case, there is further evidence that foreclosure did not occur or consumers were not harmed, then that evidence should be taken into account.
- iv) As for the time period between the Commission decision and any subsequent judgments, the Commission decision must be assessed on the basis of the facts as they were known at the time of the decision. The Commission cannot be held accountable if its theory of harm failed to materialise after the Decision (on the assumption that remedies are not immediately or properly implemented).

### ***Recommendations***

- The Commission should clarify that in some circumstances, economic evidence may create a *prima facie* presumption that the conduct at hand was unlikely to lead to anti-competitive foreclosure. The Commission should also list and describe the type of evidence that may be relevant in this respect.
- The factual circumstances described above should be considered sufficient to prove the legality of a certain conduct, unless the Commission can provide cogent and verifiable evidence that all the relevant and beneficial facts would have occurred on a larger scale in the absence of the conduct of the dominant undertaking.

## 2. SPECIFIC FORMS OF ABUSE

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**A**fter illustrating the Commission's general approach to exclusionary conduct, the Guidance paper dedicates specific sections to a number of specific forms of abuse, such as exclusive dealing, single-product and bundled rebates, tying and bundling, predation, refusal to supply and margin squeeze.

In these sections, the Commission applies to specific forms of conduct the general approach illustrated in Part III of the Guidance paper. It is useful to recall that this general approach is fundamentally built, *inter alia*, on the following elements:

- For conduct to be considered exclusionary under Article 82 EC Treaty, the undertaking that engages in that conduct should be found to hold a dominant position. Dominance is defined as "a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on a relevant market, by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers".<sup>45</sup>
- The key concept in the scrutiny of allegedly exclusionary abuses is that of anti-competitive foreclosure, defined as a situation in which the conduct at hand is likely to lead to both foreclosure of as-efficient competitors and harm to consumers.
- For price-based exclusionary conduct, the Commission clarifies already in Part III of the Guidance paper (para. 26) that in assessing whether the conduct is likely to foreclose as-efficient competitors, it

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<sup>45</sup> Guidance paper, para. 10, quoting *United Brands* and *Hoffman-La Roche*.

will rely on two cost benchmarks, i.e. average avoidable cost (AAC) and long-run average incremental cost (LRAIC).<sup>46</sup> More in detail:

[F]ailure to cover AAC indicates that the dominant undertaking is sacrificing profits in the short term and that an equally efficient competitor cannot serve the targeted customers without incurring a loss (...) Failure to cover LRAIC indicates that the dominant undertaking is not recovering all the (attributable) fixed costs of producing the good or service in question and that an equally efficient competitor could be foreclosed from the market.

In the next sections, we comment on the sections of the Guidance paper dedicated to specific forms of abuse, and also on the consistency of each section with the general approach contained in Part III of the Guidance paper.

## 2.1 Single-product rebates

### 2.1.1 *Rebates with effects ‘similar to’ exclusive agreements*

Rebates that are conditional on a particular form of purchasing behaviour (e.g. purchases over a defined reference period in excess of a certain threshold) are discussed in the Guidance paper under the general heading “exclusive dealing”. As a matter of economics, this treatment of conditional rebates is generally understandable, particularly in the case of retroactive rebates or any other form of conditional rebate in which there is a sharp reduction in the incremental price when volumes exceed a specified threshold level.

The problem with the Commission’s treatment of conditional rebates as a ‘soft form’ of exclusive dealing thus is not that the analogy is incorrect.

<sup>46</sup> As defined by the Guidance paper, AAC is the average of the costs that could have been avoided if the company had not produced a discrete amount of (extra) output – in this case, the amount allegedly the subject of abusive conduct. LRAIC is the average of all the (variable and fixed) costs that a company incurs to produce a particular product. LRAIC is usually above AAC because, in contrast to AAC (which only includes fixed costs if incurred during the period under examination), LRAIC includes product-specific fixed costs made before the period in which allegedly abusive conduct took place.

The problem is that, given the hostility in European competition law to exclusive dealing on the part of dominant firms (misplaced in our view<sup>47</sup>), there is a risk that some users of the Guidance paper might conclude that, because conditional rebates are analogous to exclusive dealing, then conditional rebates on the part of a dominant firm should receive the same harsh treatment as exclusive dealing by a dominant firm – i.e. closer to a *per se* prohibition than to an effects-based approach. This would be an unfortunate outcome because conditional rebates can be an important form of competition that benefits consumers.

The loyalty-inducing effect of retroactive rebates will be greatest (and the analogy with exclusive dealing strongest) when rebate schemes are customer-specific and involve individualised volume thresholds. When thresholds are set on a customer-specific basis, the supplier is likely to set the threshold at a level near, but not quite equal to, the customer's anticipated demand. By providing a prize in the form of retroactive rebates, the supplier provides the customer with an incentive to increase its purchases from the supplier to get over the threshold. Given this objective, the supplier does not want to set the threshold too low (because then customers can qualify for retroactive rebates without necessarily increasing their purchases from the supplier to any significant extent). The supplier also does not want to set the threshold at an unrealistically high level (because if the threshold is beyond reach, again it will not have the desired effect on customers' purchases). Thus, when retroactive rebate schemes are customer specific, thresholds are likely to be set at near (but not quite equal to) each customer's level of anticipated demand. In this situation, any effort by rival suppliers to persuade customers to switch non-trivial volumes is

<sup>47</sup> Allowing dominant companies the right to bid for exclusivity can be pro-competitive. Some important buyers insist on buying from a sole supplier, to get the lowest prices, or because they are more efficient if they deal with a single supplier. A guarantee of exclusivity can also be necessary to justify customer-specific investment. See e.g. E. Elhauge, "Why above-cost price cuts to drive out entrants are not predatory – and the implications for defining costs and market power", *Yale Law Journal*, Vol. 112, 2003, pp. 681-827. Exclusive dealing is common in various sectors of industry, in particular in connection with capital equipment that requires regular maintenance and servicing, e.g. engines of aircraft.

likely to cause many customers to lose the retroactive rebates they otherwise would have earned.

In contrast, when thresholds are not set on a customer-specific basis, the supplier will have to compromise in setting threshold levels. While the resulting rebate scheme is likely still to have strong loyalty-inducing effects on some customers, for other customers the thresholds will be unrealistically high (and therefore will have no loyalty-inducing effect) and for other customers the thresholds will be too easy to meet. When thresholds are unrealistically high or too low, rival suppliers will have an easier time persuading customers to switch significant volumes because, in either case, the customer can switch significant volumes without sacrificing retroactive rebates.

These observations suggest that the analogy to exclusive dealing is strongest in the case of retroactive rebates with individualised thresholds. These observations also suggest that – as occurs in the assessment of the competitive effects of exclusive dealing contracts – when analysing the competitive effects of retroactive rebates the Commission should consider:

- 1) the likely volume of sales accounted for by customers whose purchases are likely to be less than the threshold level; and
- 2) for the latter type of customers, the difference between their anticipated purchases and the threshold level. These are the volumes that can be considered as ‘available’ to rival suppliers – i.e. if customers switched these volumes to rival suppliers, they would not be sacrificing retroactive rebates from the dominant supplier.

As with exclusive dealing, if the size of this ‘available market’ is large (relative to rivals’ minimum efficient scale), then it is less likely that the retroactive rebate scheme can have anti-competitive foreclosure effects.

### ***Recommendations***

- The Commission should clarify that, in pointing out the similarities between conditional rebates and exclusive dealing, it does not mean to suggest that conditional rebates on the part of dominant firms should be treated as equivalent to exclusive dealing for competition law purposes.

- The Commission should clarify that conditional rebates by dominant firms should be assessed according to the same effects-based methods that the Commission will use to assess other forms of potentially exclusionary conduct (e.g. predation).
- The Commission should also clarify that any analysis of the exclusionary effects of conditional rebates should consider the extent of the market ‘available’ to rival suppliers without causing customers to lose any retroactive rebates that the customers otherwise would have received from the dominant supplier. If the ‘available market’ so defined is large relative to rivals’ minimum efficient scale, then it is less likely that the dominant firm’s rebate scheme can have anti-competitive foreclosure effects.

### ***2.1.2 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 says about incremental rebates is that, if the net or effective price resulting from the rebate is above the dominant company’s Long Run Average Incremental Cost of producing that quantity, then the Commission is unlikely to intervene. This is clear and intelligible.<sup>48</sup>

For retroactive rebates, what the Commission says is far more complicated. As explained below, some members of our group feel that the Commission’s proposed treatment of retroactive rebates is unnecessarily complicated while other members believe that the Commission’s proposed treatment is generally sensible.

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<sup>48</sup> Para. 43 of the Guidance paper states: “[t]he lower the estimated effective price over the relevant range is compared to the average price of the dominant supplier, the stronger the loyalty-enhancing effect. However, as long as the effective price remains consistently above the LRAIC of the dominant undertaking, this would normally allow an equally efficient competitor to compete profitably notwithstanding the rebate. In those circumstances the rebate is normally not capable of foreclosing in an anti-competitive way.”

### 2.1.2.1 *The 'relevant range'*

The Commission proposes a multi-step procedure for determining whether a dominant firm's system of retroactive rebates has the potential to have anti-competitive foreclosing effects.

- First, 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). Even the members of our group who are sympathetic to the Commission's approach acknowledge that a 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.
- 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.<sup>49</sup>
- 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. 41). 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

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<sup>49</sup> 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 is choosing which supplier to buy from (para. 40 of the Guidance paper says that this is not the right approach).

*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 including the rebate for previous purchases: paras. 41-44) for the ‘relevant range’ is above its LRAIC.

#### 2.1.2.2 *The ‘relevant range’ - objections*

The members of our group who are critical of the Guidance paper’s treatment of retroactive rebates suggest that there are a number of fundamental objections to this complicated ‘relevant range’ approach for retroactive rebates.

The Commission does not explain how a dominant company could possibly calculate the ‘relevant range’ with anything approaching precision. Critics of the Commission’s approach suggest that this approach could be used only with hindsight and access to confidential information. They suggest that the Commission’s approach is therefore contrary to the general principle that the legal rules must be capable of being applied by dominant companies.<sup>50</sup>

Critics of the Commission’s approach also insist:

1. *It may lead dominant firms to keep their prices up*, whereas competition law is intended in general to bring them down, except in cases of clear below-cost pricing.
2. *It may be difficult or impossible for the dominant firm to make the calculations needed*. It is unworkable in practice, too complicated, and because the ‘relevant range’ is imprecise and subjective, it cannot be precisely known to the dominant company.
3. *It would be arbitrary*, because the ‘contestable share’ and the ‘relevant range’ may be different for different buyers (because they may have different requirements) and different rivals (because they may have different production capacities). 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.

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<sup>50</sup> See *supra*, note 4 and accompanying text.

4. *If the 'relevant range' 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 therefore 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 a rather counter-intuitive result, because if the contestable volumes are really small, then it makes less sense for a dominant firm to try to exclude rivals from competing for these (small) volumes through a targeted predation strategy.
5. *It draws an unjustified distinction between incremental and retroactive rebates.* The Commission does not propose the use of the relevant range or contestable share concepts for incremental rebates (and should not do so). Accordingly, it should not propose the use of these concepts for retroactive rebates, as there is no reason to believe that the latter are 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 anti-competitive nature of the conduct, not its possible effect on the buyer's purchases. The dominant company should be able to apply the test to its own conduct, to determine whether it is lawful. Buyer's conduct may be influenced by many factors, and may not always be in the buyer's own interest.
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.* But this is exactly what happens if the concept of the relevant range is adopted, as the size of the relevant range very much depends on the requirements and preferences of individual buyers.
9. The approach is even more uncertain than the above description suggests, because *the Commission adds more qualifications*, not already mentioned.

- a. The Commission may look at ‘other factors’ if the dominant company’s price is between average avoidable cost (AAC) and LRAIC (para. 44).
- b. 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.
- c. The Commission will see if “realistic and effective counterstrategies” are available to rivals (para. 44).
- d. Last, the dominant firm may justify a given price by reference to efficiencies (para. 46).

#### *2.1.2.3 The critics’ view of the practical effects of the Guidance paper’s treatment of retroactive rebates, and a suggested alternative*

The members of our group who are critical of the Guidance paper’s treatment of retroactive rebates have the following views with respect to the practical effects of the approach described in the Guidance paper.

- First, *the effect of the Commission’s approach will be to discourage dominant companies from giving retroactive rebates, or to cause them to give small rebates, a result that could not have been intended by the Commission and that would hamper competition.*
- On the other hand, if the Commission decided not to insist on the unworkable concept of the relevant range, the approach adopted would cause less (but still considerable) problems. *An approach using the contestable share concept but not the ‘relevant range’ would be open to many of the same objections*, except that it would be less complicated and more workable, because a dominant company may be able to estimate the contestable share (although that is sometimes very difficult). In particular, the problem that the contestable share is different for different buyers and for different competitors would remain – the dominant company would have to estimate whichever contestable share might be appropriate: to be cautious, it may base its estimate on the capacity of the smallest competitor (if the dominant

company knows that) and the requirements of the most specialised buyer or buyers. The dominant company would then have to calculate what price the small competitor would have to offer for those requirements to compensate the buyers of that quantity for the loss of the retroactive rebate. Finally, it would have to ensure that the rebate does not lead to its price for that quantity being below LRAIC.

- Moreover, if the Commission would give up both the relevant range and the contestable share concepts, in practice the final result would be only to require the net effective price per unit 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.

#### ***The critics' recommendations***

- The Commission should certainly abandon the relevant range concept, and should probably also abandon the contestable share test.
- The Commission should state clearly that the net effective price for the threshold quantity plus one unit after granting the rebate should be above LRAIC. This should entirely replace the discussion of retroactive rebates.

#### ***2.1.2.4 An alternative view of the Guidance paper's treatment of retroactive rebates***

As already mentioned, other members of our group have more sympathy with the approach to retroactive rebates proposed in the Guidance paper, especially in the case where the dominant firm sets individualised thresholds. These members of our group agree that the Commission's effective price test (based on the 'relevant range') is potentially difficult for dominant firms to implement. But they are concerned that the alternative formulation of the test proposed above (i.e. basing the analysis on the net effective price for the threshold quantity plus one unit), while easier to implement, is too weak and will miss cases where retroactive rebates are being used as part of a 'targeted predation' strategy.

To explain, consider the following numerical example:

- A customer's total order is 110 units.

- List price is €10/unit.
- A retroactive rebate of €1 per unit is paid on all purchases once this customer's total purchases exceed 100 units (the threshold will vary from customer to customer, depending on the anticipated level of demand).
- The dominant firm's costs are €8 per unit.
- An equally efficient rival has the potential to attract up to 30 of the 110 units ('relevant range').

Under these assumptions, the dominant firm's rebate structure would be unobjectionable under 'threshold quantity plus one unit' proposed above. At 101 units, total revenue would be €909 and total costs would be €808.

The members of our group who sympathise with the Commission on retroactive rebates are concerned that this test can easily produce wrong results.

The sympathisers agree that, if the customer in this example switched only 9 units (so that it still bought 101 units from the dominant firm and therefore still qualified for the dominant firm's retroactive rebate), the rival firm would only have to price below €9 (i.e. the price that the customer pays to the dominant firm on incremental units, once total purchases have crossed the threshold level of 100).

Suppose however that, in order to achieve an efficient scale of operations, rivals cannot survive on picking up the difference (9 units in this example) between each customer's total demand and each customer's threshold level. As noted above, whether this is true and whether the 'available market' left over by a dominant firm's rebate scheme is sizeable relative to rivals' minimum efficient scale is an issue that any analysis of the competitive effects of retroactive rebates should consider. But suppose that, in order to achieve a sustainable scale, rivals need to induce enough switching such that a significant number of customers would have to sacrifice the retroactive rebates that they would otherwise receive from the dominant firm.

In that situation, the members of our group who sympathise with the Commission's approach to retroactive rebates think that it is sensible to consider the price that the rival would have to offer in order to compensate customers for giving up the dominant firm's retroactive rebates. In the example above, given the structure of the dominant firm's rebate system, a

rival would have to offer less than €6.33 per unit to have any hope of attracting the 30 units that the customer in the example could potentially switch to a rival supplier.<sup>51</sup> Thus, even if the rival had the same costs as the dominant firm (€8 per unit), the rival would be unable to compete for the contestable volumes.

Demonstrating that the effective price over the ‘relevant range’ is less than the dominant firm’s LRAIC or AAC should not be viewed as sufficient evidence that a dominant firm is engaged in an anti-competitive foreclosure strategy. As the critics of the Guidance paper’s approach emphasise, the effective price can vary across customers (because of differences in the extent to which customers are willing to switch) and across rivals (for example, some rivals may have less capacity to attract volume from the dominant firm). If the effective price is less than the dominant firm’s costs only for some rivals (but not others) and/or only with respect to some customers (but not, say, all major customers), then it becomes less likely that the dominant firm is truly engaged in an anti-competitive foreclosure strategy.

Moreover, the Commission should be required to show that, even if the effective price is below cost, the conduct can be seen as part of an overall predatory strategy, which ultimately would result in higher prices for consumers, when the dominant firm ‘recoups’ the investment it has made in predating its rivals. The Commission implies that this analysis of recoupment is not necessary. The Commission claims that conditional rebates differ from predation because they do not entail a profit sacrifice (para. 37 of the Guidance paper). We disagree with this proposition as a general statement. Recoupment will typically be required also in a case of predatory rebates, because foregoing margins on non-contestable volumes in order to reduce prices on contestable volumes can involve a profit sacrifice for the dominant firm.

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<sup>51</sup> The effective price (€6.33) equals the total amount the customer would pay if all purchases were made from the dominant firm ( $€990 = 110 \times €9$ ) less the amount the customer would pay for non-contestable volumes if the customer switched ( $€800 = (110 - 30) \times €10$ ), all divided by the contestable volume (30). In our example, if the rival is able to switch less than 55 units, the effective price always falls below cost.

As mentioned, *the members of our group who generally have sympathy with the Guidance paper's approach to retroactive rebates accept that dominant firms may have difficulty deciding in advance whether a proposed rebate structure will be regarded as objectionable by the Commission. However, these members of our group note that dominant firms have ways of managing this risk.* For example, if the regulatory risk associated with retroactive rebates is considered too great, dominant firms can use incremental rebates rather than retroactive rebates as a means of generating incremental sales (because, as discussed above, it is easier for dominant firms to determine whether a system of incremental rebates is likely to be regarded as objectionable by the Commission). Incremental rebates and retroactive rebates are not equivalent in terms of their incentive effects, for example, in promoting sales effort on the part of distributors (when sales are near but not yet equal to the threshold level). But dominant firms particularly concerned about the regulatory risk associated with retroactive rebates might decide that foregoing the incentive benefits associated with retroactive rebates might be a price worth paying. Alternatively, a dominant firm can offer a standardised retroactive rebate scheme rather than an individualised one. Such an alternative would also result in weaker incentive effects but it is also less likely to lead to effective prices that are below cost for a significant part of the market (as long as buyers are sufficiently heterogeneous).

#### ***The sympathisers' recommendations***

- The Commission should clarify that any analysis of the exclusionary effects of conditional rebates should consider the extent of the market 'available' to rival suppliers without causing customers to lose any retroactive rebates that the customers otherwise would have received from the dominant supplier. If the 'available market' so defined is large relative to rivals' minimum efficient scale, then it is less likely that the dominant firm's rebate scheme can have anti-competitive foreclosure effects.
- Even if the 'available market' as just defined is too small relative to rivals' minimum efficient scale, the Commission should clarify that it will consider whether the effective prices of all rivals for contestable volumes fall below the dominant firm's costs. Showing that effective prices for contestable volumes are below the dominant firm's costs for only some rivals should not be sufficient to support a case of anti-competitive foreclosure.

- The Commission should also clarify that, even if effective prices are below the dominant firm's costs for the contestable volumes of some customers, the Commission is unlikely to intervene if there are other customers for which the effective price is greater than the dominant firm's costs and where these other customers have contestable volumes larger in aggregate than the minimum efficient scale of an as-efficient competitor.
- The Commission should also clarify that the overall framework for analysis of a rebate scheme will typically be a predatory one. It should therefore be required to explain why smaller existing rivals are not able to also engage in periods of low prices to match the dominant firm, and why the dominant firm can be expected to recoup the profit sacrifice resulting from offering rebates to consumers, once rivals are marginalised or forced to exit.

## 2.2 Tying

The section of the Guidance paper on tying and bundling recognises in para. 49 that “tying and bundling are common practices intended to provide customers with better products or offerings in more cost effective ways”. The Guidance paper however also cautions that, in some circumstances, tying or bundling can have anti-competitive foreclosure effects. Below, we comment on the proposed ‘distinct product’ test proposed in para. 51; we also provide some comments on the models of anti-competitive tying and bundling discussed by the Commission in the Guidance paper.

### *2.2.1 The Commission’s formulation of the distinct product test*

A first step in any bundling case is determining whether the allegedly tying and tied products should be regarded as distinct products or whether they should instead be treated as part of integrated system (single product). The distinct product test acts as a screen for non-problematic cases before the detailed assessment of whether anti-competitive foreclosure exists.

The Guidance paper proposes the following formulation of the distinct product test (para. 51):

*Two products are distinct if, in the absence of tying or bundling, a substantial number of customers would purchase or would have purchased the tying product without also buying the tied product from the same supplier, thereby allowing stand-alone production for both the tying and the tied product.*

As a preliminary point we note that the wording of the test differs from the wording which the Commission has used in previous cases and which has been endorsed by the Court of First Instance:

*The Commission was also correct to state, at the same recital, that in the absence of independent demand for the allegedly tied product, there can be no question of separate products and no abusive tying.*

It would be helpful for the Commission to explain why it has deviated from the CFI's wording of the distinct product test, i.e. the shift in emphasis from separate demand for the tied product to separate demand for the tying product and what consequences (if any) are intended.

In any event, we recommend that the key question for the distinct product test should be whether, in the absence of tying or bundling, a substantial number of customers (at the relevant level of trade) would 'mix and match' – i.e. purchasing the tying product from the dominant firm while purchasing the tied product from a different supplier. When there is reason to believe that a substantial number of customers would 'mix and match' in the absence of tying or bundling, the Commission will find distinct products.

There is a corollary to this approach, which is not mentioned in the Guidance paper but deserves emphasis. The other side of the distinct product test in the Guidance paper is that, if there is reason to believe that all but an insubstantial number of customers (at the relevant level of trade) still would have purchased the tying and tied product from the same supplier even if there had been no tying or bundling, then the products involved should not be regarded as distinct products.<sup>52</sup>

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<sup>52</sup> In investigating this issue, the comparison should be between customer behaviour in a world in which the dominant firm practices pure bundling and in a world in which the dominant firm instead practices mixed bundling, but where the difference between the dominant firm's package price and its hypothetical standalone price for the tying product should be large enough to

The reason for emphasising this corollary is as follows. If all but an insubstantial number of customers still would have purchased the tying and tied products from the same supplier (i.e. the dominant firm) even in the absence of tying or bundling, then the case should not be analysed as a bundling case. In this case, the same market outcomes would have resulted even if the dominant firm had not engaged in tying or bundling, and hence there can be no causal link between the potential competition concerns and any tying or bundling. This said, there could still be competition problems in the affected markets for reasons other than tying (for example due to an unlawful refusal to supply).<sup>53</sup>

Determining whether the products involved in a case of alleged bundling should be regarded as distinct products will obviously depend on the facts of the case. Questions arise, however, with respect to the statement in the Guidance paper that, in determining whether the distinct product test is satisfied the Commission will consider indirect evidence “such as the presence on the market of undertakings specialised in the manufacture or sale of the tied product without the tying product”.

The Commission should recognise and confirm that, in applying the distinct product test the real issue is whether, during the period of the bundling, all but an insubstantial number of customers still would have purchased the tying and tied product from the same supplier (i.e. the dominant firm) even if the dominant firm had not engaged in tying or bundling. If the answer to this question is yes, then the products should not be regarded as distinct products and the case should not be analysed as a bundling case – regardless of whether, in the past, customers had purchased the tying and tied products from separate suppliers.

permit competition from an as-efficient competitors in the market for the tied product.

<sup>53</sup> For further discussion of this causation point and its relevance to the Windows Media Player part of the *Microsoft* case, see Ahlborn & Evans, “The Microsoft Judgment and Its Implications for Competition Policy towards Dominant Firms in Europe”, *Antitrust Law Journal* (forthcoming 2009). See also M. Dolmans and T. Graf, “Analysis of Tying under Article 82 EC: The European Commission’s Microsoft Decision in Perspective”, *World Competition*, 4, 2004, pp. 225-44.

### ***2.2.2 Comments on the models of anti-competitive bundling discussed in the Guidance paper***

The Guidance paper devotes seven paragraphs (paras. 52-58) to explaining the circumstances in which tying or bundling is most likely to have anti-competitive effects. In view of the fact that mixed bundling is dealt with separately (paras. 59-61),<sup>54</sup> it is clear in context that the analysis in these seven paragraphs pertains to pure bundling – i.e. to situations in which the dominant undertaking does not offer the tying product separately from the tied product. *Even so, the fact that paras. 52-58 pertain to pure bundling should be clarified.*

The analysis in the Guidance paper of how pure bundling can have anti-competitive effects is generally consistent with the economic literature on this topic. The only obvious gap is the absence of any explicit discussion of the incentive that a dominant undertaking might have to foreclose competition in the market for a tied product that is currently a complement to the tying product but which has the potential to evolve into a substitute for the tying product (sometimes termed ‘defensive leveraging’ theory).<sup>55</sup> It may be argued that this incentive to foreclose is already covered by para. 58 of the Guidance paper, in which the Commission outlines how a dominant undertaking might want to foreclose competition in the market for an important complement in order to make it more difficult for new entrants to access the market for the tying product. This would be a defensible argument. Even so, given the importance of the ‘complement today, substitute tomorrow’ model in the economic literature, more explicit discussion of this model in the Guidance paper would be appropriate.

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<sup>54</sup> See Section 2.3 above for comments.

<sup>55</sup> Dennis W. Carlton and Michael Waldman, “The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries”, *Rand Journal of Economics*, Vol. 33, summer, 2002, pp. 194-220.

### ***Recommendations***

- The Commission should explain and why the Guidance paper uses a different wording for the distinct product test compared to the case law and should clarify the intended consequences (if any);
- The key question for the distinct product test should be whether, in the absence of tying or bundling, a substantial number of customers would ‘mix and match’ – i.e. purchasing the tying product from the dominant firm while purchasing the tied product from a different supplier.
- Further thought should be given to the statement in the Guidance paper that, in determining whether the distinct product test is satisfied the Commission will consider indirect evidence “such as the presence on the market of undertakings specialised in the manufacture or sale of the tied product without the tying product”. Such evidence may allow the conclusion that products are distinct in some circumstances but not in others.
- The Commission should recognise and confirm that, in applying the distinct product test the evidence that ultimately matters is evidence which answers the key question set out above, namely whether, during the period of the bundling, all but an insubstantial number of customers (at the relevant level of trade) still would have purchased the tying and tied product from the same supplier (i.e. the dominant firm) even if the dominant firm had not engaged in tying or bundling.
- The Commission should clarify that one of the situations in which tying and bundling can have anti-competitive effects is when the tied product is currently a complement to the tying product, but has the potential to evolve into a substitute of the tying product.

### **2.3 Bundled discounts**

Competition issues arising from bundled discounts and rebates (bundled discounts) have not been addressed thoroughly in EC case law and decision practice. The Community institutions have generally held that

retroactive bundled discounts constitute a particularly harmful form of loyalty discount.<sup>56</sup> In addition, they have held that bundled discounts may act as a tie-in within the meaning of Article 82, letter *d*, EC, thus hindering access to the market by competing suppliers of individual products included in the bundle.<sup>57</sup>

The Commission Guidance paper contains only a few remarks on multi-product discounts. The Guidance paper sets out two alternative tests: i) when bundle-to-bundle competition is not reasonably possible, the Commission would normally not intervene if the incremental price paid by customers for each of the bundled products (this is equivalent to allocating the entire discount to that product) covers the LRAIC of including the product in the bundle; ii) when bundle-to-bundle competition is reasonably possible, a total bundle predation-style safe harbour would apply.

Similar to single-product loyalty discounts, bundled discounts may be conditioned on the achievement of certain thresholds within a given reference period. Where demand for one or more of the bundled products is not entirely contestable, the competitive assessment of this form of bundled discounts can be extremely complex and uncertain. The Guidance paper takes into account the risks arising from the existence of an assured base of sales in the section on single-product loyalty discounts,<sup>58</sup> but it says nothing on the same phenomenon with regard to bundled discounts. The

<sup>56</sup> According to the traditional approach of the Community institutions, bundled discounts exacerbate the fidelity-inducing effect of a retroactive discount system, since the failure to reach the thresholds within the reference period may cause the loss of discounts over more than a single product line. See Commission decision of 9 June 1976, Case IV/29.020, *Vitamins*, O.J. L 223/27 (1976), § 24; ECJ, Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 965, § 110; Commission decision of 5 December 1988, Case IV/31.900, *BPB Industries plc*, O.J. L 10/50 (1989), §§ 148-152.

<sup>57</sup> See ECJ, Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 965, § 111; Commission decision of 7 October 1981, Case IV/29.491, *Bandengroothandel Frieschebrug BV/NV Nederlandsche Banden-Industrie Michelin*, O.J. L 353/33 (1981), §§ 27 and 50; Commission decision of 22 December 1987, Case IV/30.787-31.488, *Eurofix Bauco/Hilti*, O.J. L 65 (1988), §§ 75 and 83; Commission decision of 20 June 2001, Case COMP/E-2/36.041/PO, *Michelin*, O.J. L 143/1 (2002), §§ 256-258.

<sup>58</sup> See Guidance paper, §§ 37-45.

members of our group have expressed differing views on the treatment of single-product loyalty discounts.<sup>59</sup> In any case, we believe that the Commission should address in more detail the issue of bundled discounts conditioned on the achievement of certain thresholds within a given reference period, so as to ensure a sufficient degree of consistency in the treatment of single-product and bundled discounts.

The following paragraph provides some considerations on the treatment of bundled discounts. For the sake of simplicity, we assume that demand for competitive products included in the bundle is entirely contestable.

### ***2.3.1 The allocation of the discount to different bundled products***

As noted above, the Guidance paper states that, when bundle-to-bundle competition is not reasonably possible, the Commission would normally not intervene if the incremental price paid by customers for each of the bundled products covers the LRAIC of including the product in the bundle. The Guidance paper does not explicitly define the notion of incremental price. The Commission addresses this issue in more detail in the Discussion Paper (see paras. 190 ff., in particular para. 192). The Discussion Paper clarifies that “the incremental price of a product C sold in a discounted bundle ABC is the price of ABC less the sum of the stand-alone prices of A and B (or the price of AB if such an option exists)”. This is equivalent to allocating the overall discount granted by the dominant firm to the product concerned.

In order to guarantee that an equally efficient rival offering only one product is able to compete, the Guidance paper implies that the incremental price of each of the bundled products should be above cost. Such a strict test, applied to each product in a dominant undertaking’s bundle, could over-deter. Especially when the bundle consists of numerous products, the allocation of the discount to each of the bundled products may lead to very low incremental prices.

Suppose that a dominant firm grants a percentage discount on the price of the bundled products, provided that the purchases of those products achieve or exceed certain thresholds during a given reference

<sup>59</sup> See above, Sections 2.1.2.3 and 2.1.2.4.

period. If the discount is calculated on the price of many products and its rate is not trivial, the incremental price of each product analyzed in isolation could fall below cost. Nonetheless, equally efficient rivals may still be able to compete if competitors offer a subset of the bundled products. For competitors offering a subset of the bundled products, the relevant inquiry is the incremental price of the subset of bundled products relative to the incremental cost of this subset. If the incremental price of the relevant subset exceeds incremental cost, then the dominant undertaking's bundle discount cannot exclude equally efficient competitors – even though the bundle discount might imply incremental prices below cost for single products within the bundle.

In light of the above, rather than comparing the incremental price and cost of each product in the dominant undertaking's bundle, it seems preferable to begin the analysis by focusing on the subsets of products actually offered by competitors. The analysis should be conducted for single products only when there are competitors that offer only one of the products in the dominant undertaking's bundle and only when these single-product competitors account for a significant share of the competition that the dominant undertaking faces with respect to these products. If instead most of the competition to the dominant undertaking in the supply of these products comes from competitors who produce multiple products also offered by the dominant undertaking, then a single-product analysis is unlikely to be appropriate.

In determining the appropriate set of products to use in conducting the analysis of incremental prices and costs, the analysis should also consider whether there are significant obstacles to the expansion of rivals' product range and/or rivals cannot cooperate with other suppliers to offer a bundle including a subset of the bundled products. If competitors can easily expand their product range or engage in other forms of bundling counter-strategies, then bundled discounts are less likely to have a foreclosing effect, even if the incremental price is below incremental cost for the subsets of bundled products currently offered by competitors. When such options are available to competitors, the price-cost test should also be conducted with respect to the subset of products covered by these bundling counter-strategies.

### **Recommendation**

- The discount should be allocated to a subset including all the bundled products reasonably open to competition, unless it is possible to demonstrate that a different allocation is more appropriate. Allocation to single bundled products, and/or to smaller subsets of the competitive products, may be appropriate where: i) competitors producing only one product, or a smaller subset of the competitive products, account for a significant share of the competition that the dominant firm faces with respect to these products; and ii) competitors cannot expand their product range or engage in other effective forms of bundling counter-strategies, so as to offer a subset including all the competitive products. In these cases, the discount should be allocated to the largest subsets of the competitive products that are offered, or could reasonably be offered, by competitors, either alone or jointly with other producers.

## **2.4 Predation and profit sacrifice**

In the *AKZO* case the Court stated two rules.<sup>60</sup> First, it is illegal to charge prices below average variable cost. Second, it is illegal to charge prices below average total cost if there is evidence of intent to force a competitor out of the market. That was clear.

On the other hand, the Guidance paper allows a reading of Article 82 which goes much further, and is totally unsatisfactory. With this reading, the Commission would change the law (not merely describe a situation coming under the second *AKZO* rule). According to paras. 63-65, “[d]eliberately foregoing profits in the short term, to foreclose a competitor” (referred to as ‘profit sacrifice’) is said to be illegal. In particular, 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”.

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<sup>60</sup> Case C-62/86, *AKZO* [1991] ECR I-3359.

In explaining why it proposes to broaden the definition of predation to include the concept of ‘profit sacrifice’, the Guidance paper explains in footnote 42: “If the estimate of cost is based on the direct cost of production (as registered in the undertaking’s accounts), it may not adequately capture whether or not there has been a sacrifice”. The Commission seems to have in mind a case, such as the case brought by the US Department of Justice against American Airlines,<sup>61</sup> in which the DOJ alleged that, in order to defeat new entry on particular routes, American Airlines diverted planes that could have generated more revenue in the short run on alternative routes to the routes where the entry was occurring, in order to flood these routes with additional flights and to persuade the new entrant to exit. In this case, revenues covered variable costs as measured in accounting terms; but the DOJ alleged that American Airlines’ revenues on the competitive routes did not cover the airline’s opportunity costs – i.e. the revenue that its aircrafts could have generated if they had been deployed on other routes.

The DOJ’s attempt to include the concept of opportunity cost when assessing whether prices are predatory was understandable as a matter of economics. Opportunity cost is at the heart of economics. When analysing the cost of using resources in any particular activity, the correct measure of cost as a matter of economics is not accounting cost; it is the highest valued alternative use of those resources.<sup>62</sup>

The section of the Guidance paper on predation would have been clearer if the paper had simply said that, in measuring costs, the Commission will not necessarily restrict itself to accounting costs but will also consider opportunity costs. Instead, the Commission has written the section on predation in a way that creates the potential for much confusion. Read literally, the Commission seems to expand the *AKZO* rules in two respects: first, pricing above average total cost may be considered

<sup>61</sup> In *United States v. AMR Corp.*, the government alleged that American Airlines had violated the Sherman Act by expanding its capacity on routes that low-cost carriers had entered, such that the incremental costs incurred in the expansion were not covered by the incremental revenue it added. See *United States v. AMR Corp.*, 353 F.3D 1109 (10<sup>th</sup> Cir. 2003).

<sup>62</sup> On the notion of ‘opportunity cost’, see i.a. A. Alchian, “Cost”, *International Encyclopedia of the Social Sciences*, Vol. 3, New York, NY: Macmillan, 1968, pp. 404-415.

exclusionary; and, second, the showing *ex post* with the benefit of hindsight that a more profitable (or less unprofitable) pricing strategy might reasonably have been available may be taken as evidence of ‘intent’ to exclude a competitor.

Based on the case law, only few examples are known where the European Courts were faced with exclusionary behaviour which involved above-cost pricing. However, the European Court of Justice never condemned above-cost pricing as such, but only in connection with the simultaneous application of other kinds of abusive conduct (such as exclusionary price cuts).<sup>63</sup> Accordingly, from this case law no support can be found for the suggestion that, by itself, a ‘profit sacrifice’ by a dominant undertaking constitutes an abuse within the meaning of Article 82 EC.

Indeed, we see no justification for any suggestion in the Guidance paper that a profit sacrifice could be illegal if the price is above average total costs.<sup>64</sup> Any threat of illegality of above cost profit sacrifices is likely to discourage price competition. While it is not always easy for companies, especially multi-product companies, to allocate the various costs to the products they sell, they are used to performing cost analyses. To this extent, the *AKZO* rule fits in with the decision-making process companies can be expected to engage in. However, to require companies to analyse alternative pricing strategies (and determine what might, from a regulatory perspective, be more ‘reasonable’ conduct amongst several alternatives) certainly adds a considerable degree of uncertainty and complexity, and therefore transaction costs.

We are not aware of evidence (and the Commission has not suggested that there is any) showing that profitable pricing strategies of dominant companies have ever led to substantial foreclosures, which might possibly justify discouraging price competition and the imposition of additional transaction costs in many cases. Rather, as with other parts of

<sup>63</sup> E.g. Case C-395/96P and C-396/96P, *Compagnie Maritime (CEWAL)* v. *Commission* [2000] ECR I-1365, paras 115-117. See also the Opinion of AG Fennelly, in paras 111-139.

<sup>64</sup> For a critical review of the ‘profit sacrifice’ test in the broader context of exclusionary abuse, see the CEPS Special Report by John Temple Lang, *The Requirements for a Commission Notice on the Concept of Abuse under Article 82 EC*, CEPS, Brussels, 2008, pp. 29-30.

the Guidance paper, we are concerned that the Commission is attempting to make provision for an unusual or extreme theoretical case – causing considerable extra cost of doing business to many companies in many situations and ultimately with the risk of findings of abusive conduct that are *not* justified.

Furthermore, the suggestion that above-cost profit sacrifices can be predatory is inconsistent with the Commission's own basic as-efficient-competitor principle.<sup>65</sup> Indeed, the Commission makes no distinction between the effects of the 'profit sacrificing' on as efficient compared to less efficient competitors.

Moreover, this suggestion reaching beyond the *AKZO*-principles is unworkable, as it:

- *Is extremely vague and difficult to apply*, especially when it comes to deciding what pricing alternatives were reasonable, at the time when the conduct began.
- *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 anti-competitive for some identifiable reason). In other words, the serious ambiguity in what the Commission says about rebates is also potentially a flaw in what it says about 'profit sacrifice'.
- *Would require cumbersome enforcement actions*. It is hard to imagine that the '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 in order to foreclose a competitor. As an intention to foreclose competitors (in some sense) is relevant under both the second *AKZO* principle and the suggested new 'profit sacrifice' test, surprise inspections may be needed with either test.

Nevertheless, if the suggestion that 'above-cost profit sacrifices' can be predatory were upheld by the courts (which is doubtful), it would be so broad that defences would have to be very clearly recognised. The Commission only says efficiencies to achieve economies of scale or "related to expanding the market" will be considered. But with or without the

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<sup>65</sup> See above, Section 1.2.2.

'above-cost profit sacrifice' suggestion, defences should be clearly accepted at least for:

- meeting competition,<sup>66</sup>
- incurring promotional expenditure and loss-leading,
- obtaining economies of scale in network industries,
- starting up big investments and
- reducing excess capacity in a recession.

In all these cases, a company may legitimately be financially or commercially obliged to sell below its average total costs, sometimes for substantial periods, in order to break even.<sup>67</sup> If the Commission's proposals were accepted, this would render this company's decisions more difficult in two ways. First, the company will have to assess whether less profitable prices may be considered exclusionary. Second, the company will have to assess whether alternative courses of action might be considered more reasonable by the Commission (or a national court). This makes an explicit recognition of these defences in the Guidance paper all the more necessary.

### ***Recommendations***

- The Commission should alter the Guidance paper to refer to profit sacrifice only as a possible example of the second AKZO rule.
- Furthermore, the Commission should explicitly accept a number of defences against allegations of exclusionary pricing, including cases where the dominant firm acted for the purpose of meeting competition, engage in promotional expenditure and loss-leading, achieving economies of scale in network industries, start up big investments, or when the firm's conduct was justified by excess capacity during a recession period.

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<sup>66</sup> The objection has been made that this defence cannot be accepted when the aim of competition law is viewed as the protection against consumer harm rather than the protection of competitors. We believe this objection is unfounded. When a dominant company meets the competition, while at least covering its average avoidable or variable costs, this is part and parcel of the competitive process from which consumers benefit.

<sup>67</sup> For a comprehensive treatment of these cases, see e.g. O'Donoghue & Padilla (2006), op. cit., pp. 286-302.

## 2.5 Refusal to contract

The Guidance paper section on refusal to contract is vaguely drafted, and goes further than the existing case law. There is no reference to “exceptional circumstances” as in previous cases such as *Magill*, *IMS* and *Microsoft*, nor is it made clear that there can be a duty to contract only if the refusal is illegal for some specific and identifiable reason, and not merely because a contract would lead to more competition in the short term.

As a result, we believe that in several respects the Guidance paper needs clear limiting principles. A duty to supply should arise only in “exceptional circumstances”. There should be dominance in the downstream market, or a likelihood of dominance if the refusal continues. There should also be evidence of actual foreclosure and actual or likely consumer harm. And the refusal should involve an asset or information that is indispensable, not only “convenient” for as efficient rivals in the downstream market to effectively compete with the dominant firm. Finally, there can be a duty to contract only if there is clear scope for added-value competition or innovation in the downstream market<sup>68</sup>.

Furthermore:

- Questions arise where in determining ‘indispensability’, the Commission appears to apply a negative presumption for discontinuation of supply cases. The Commission states that it is more likely to find that the indispensability condition is satisfied in favour of a finding of abuse; for example, if the recipient had made relationship-specific investments. As stated in para. 84 of the Guidance paper, “[i]f there has been a previous supply by the dominant firm, the latter will have to demonstrate why circumstances have actually changed in such a way that the continuation of its existing supply relationship would put in danger its adequate compensation”. This should not be interpreted as a reversal of the evidential burden of proof of indispensability or consumer harm. In a rule of reason analysis, it may be appropriate to reverse the burden of proof in the context of ‘justification’ (para. 90) but not in the

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<sup>68</sup> It has always been clear that there is no duty to contract if the downstream activities consist only of distribution or re-sale without added-value services. In those circumstances refusal to contract cannot harm consumers.

context of indispensability or consumer harm (para 84). In other words, the existence of prior supply relationship may be ‘a relevant factor’, but it should not in itself be sufficient evidence of indispensability. Nor should the dominant company’s right to dispose freely of its property be reduced to an economic right to receive adequate compensation. This may have a chilling effect on potentially welfare-enhancing transactions: if dominant companies enter into commercial agreements, once they supply someone they will risk being locked into that relationship for a long time. That may decrease their incentives to deal in the first place. Accordingly, the Commission should at least clarify under what conditions the dominant firm will be able to avoid continuation of previous supply. These should presumably include situations where the other conditions of a duty to deal are met, but where the customer refuses to or is unable to pay compensation, or where the customer refuses to supply the dominant firm on fair and reasonable terms with an input that is essential for the dominant firm (‘defensive suspension’).

- The Commission states that a ‘potential market’ for the input may be enough (para. 69). This is consistent with the case law, but should be clarified. 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. There can only be a duty if it would be economically rational for a non-dominant owner to contract, everything else being equal. It is difficult to imagine circumstances where there could be a duty to supply competitors with the dominant company’s final product.
- The test of a “new kind of product for which there is a clear and unsatisfied demand”, under the *Magill* judgment, might indeed be an example of the harm to consumers that is required by Article 82(b), according to the Court in the *Microsoft* judgment. But the mere fact that production marketing or technical development of competitors is limited is not enough to cause harm to consumers (as Article 82(b) itself makes clear), so once again limiting principles are needed. If competitors are only copying the dominant company’s product, or merely producing the same product more cheaply without adding new functionality or new features, there is no justification for a duty

to supply under Article 82(b).<sup>69</sup> Except in standards cases, where different considerations may apply, adding one more competitor is not a justification for imposing a duty to contract. In other words, Article 82 should only protect competition by innovation, not competition by imitation.

- If product change that could have exclusionary effect is said to be justified by efficiencies, but exclusionary effect can be avoided or mitigated by a supply of information about the change, the dominant company may have a duty to avoid or reduce those effects by supplying the information. 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 a duty to provide competitors with the interoperability information they need may be envisaged, if the exceptional circumstances are met – i.e. the refusal relates to indispensable information, may cause competitors in one of the two markets to exit, and may lead to consumer harm in the medium- to long-term.
- Since the mere refusal to licence an intellectual property right or to supply a property can never be in itself an exclusionary abuse, there must be some other identifiable abuse for which the refusal to supply is the vehicle, and for which the duty to contract is the appropriate remedy.

### *2.5.1 Stifling of 'follow-on innovation'*

Para. 87 of the Guidance paper says consumers may be harmed if the refusal to contract is likely to stifle follow-on innovation. As expressed, this statement is not qualified by reference to 'exceptional circumstances' and is also both too vague and too broad. It would be obviously incorrect to suggest that there can be a duty to contract merely to enable a competitor to copy or marginally improve on a product already made by the dominant company. Moreover, nothing is said in the Guidance paper to suggest that this approach would apply only in 'exceptional circumstances'.

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<sup>69</sup> The IMS Health interim measures decision of the Commission involved a single market and the decision would have allowed competitors to use IMS Health's principal competitive advantage to produce products almost identical to those of IMS Health.

A rational and more correctly expressed principle based on Article 82(b) would entail an assessment of the dynamic efficiencies generated by a duty to contact – e.g. if it adds one or more innovative competitors – against long-term dynamic efficiencies that may be associated with a refusal to supply. In this respect, the assessment of whether imposing a duty to contract will generate efficiencies in the longer-term or stifle incentives to invest is necessarily a case-by-case one. Useful criteria to reach an informed judgment can be identified, and entail that a refusal to contract is more likely to be anticompetitive if the following cumulative conditions are met:

- (a) If it eliminates or permanently handicaps competition, or creates or maintains dominance in a 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;
- (b) Where the duty to contract would provide competitors with 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;
- (c) Where consumer harm is shown, for instance, by restriction of innovation incentives or new products that would not be brought to market but for a license;
- (d) Where the IP owner's incentives to innovate and invest are not reduced by a compulsory license (or perhaps a reduction is clearly outweighed by increased innovation by rivals, although this needs further discussion). In any event, analysing the investment incentives of the parties requires caution. All incentives to invest must be carefully weighed in assessing refusals to contract. When the Commission decides to favour the rivals' incentives to invest and innovate, such assessment must be based on clear evidence and not merely on an assumption that, if given access to the indispensable good, those rivals will actually invest and innovate. Similarly, when the Commission decides to favour the dominant firm's incentives to invest and innovate, such assessment must be based on clear evidence and not merely on an assumption that a duty to supply would reduce its investment in innovation. In other words, in balancing, the hypothetical should not be favoured over the concrete.

Another important issue is that of pricing. In the context of the remedy, the price can be determined by reference to Fair, Reasonable And Non-Discriminatory (FRAND) principles – normally, equal to the incremental value derived by the licensee over the value derived from the next best alternative in an *ex ante* competitive environment. This can often be determined in practice by referring to proxies such as the price charged by owners of complementary essential IP for the same products, or the fee charged by the IP owner itself for similar IP in competitive conditions.

### ***Recommendations***

- The Commission should reconcile its treatment of refusal to contract with existing case law, and in particular with reference to the ‘exceptional circumstances’.
- The Commission should also make sure that its assessment of refusal to contract remains within the boundaries of the ‘anticompetitive foreclosure’ test that inspires the whole Guidance paper.
- The Commission should clarify under what conditions the dominant firm will be able to avoid continuation of previous supply.
- The Guidance paper should contain a clearer statement on the fact that only competition by innovation, not competition by imitation, is to be pursued by imposing a duty to contract when the relevant exceptional circumstances are met.
- The Guidance paper should state that the treatment of refusals to contract requires an assessment of the long-term impacts of imposing a duty to contract on all players’ incentives to invest and innovate, as well as consumer welfare. Useful criteria can be identified and included in the Guidance, which would add clarity for market players and lead to more easily understandable and applicable rules.
- The Commission should clarify under what (exceptional) circumstances it will protect follow-on innovation by competitors, and why.

## **2.6 Margin squeeze**

The Guidance paper is unacceptably incomplete on the issue of margin or price squeeze. The Guidance paper, without explanation, joins the issue of

margin squeeze with refusals to deal (Section 9). The only other reference to margin squeeze appears in para. 80, where the Commission explains in basic and fairly obvious terms what a margin squeeze is and its preference for relying on the equally efficient competitor test, based on the long-run average incremental cost (LRAIC) of the downstream division of the integrated dominant undertaking.

This very limited and unexplained treatment of margin squeeze is insufficient. Margin squeeze has featured prominently in a number of recent Commission decisions in Deutsche Telekom and Telefonica, and has been the subject of a detailed judgment by the Court of First Instance in *Deutsche Telekom*. The consequences of adverse findings may also be enormous: witness the €152 million fine in *Telefonica* (currently on appeal).

Moreover, at national level, there have been a relatively large number of margin squeeze decisions, and a good deal of differences and confusion in approach.<sup>70</sup> The issue is also likely to assume more importance as regulated markets move gradually away from full regulation to an environment in which competition law applies in full, as is the case in particular for electronic communications. In such instances a robust margin squeeze set of principles are essential to stop the market from lurching back to a position of ineffective competition again. The Guidance paper should therefore have treated the topic of margin squeeze more comprehensively.

### ***2.6.1 Margin squeeze needs to be considered as a separate abuse***

Whether and to what extent margin squeeze is to be considered as a separate abuse under Article 82 was an issue on which there was a measure of disagreement within the group.

On the one hand, there was a minority within the group that argued that margin squeeze is not a separate abuse in its own right. This was based on the following considerations:

- a) *A prohibition on margin squeeze pre-supposes that non-integrated rivals should be granted a guaranteed minimum profit margin.* This is tested

<sup>70</sup> For a review of the main national cases, see D. Geradin and R. O'Donoghue, "The Concurrent Application of Competition Law and Regulation: the Case of Margin Squeeze Abuses in the Telecommunications Sector", *Journal of Competition Law and Economics*, No. 1, 2005, pp. 355–425.

using an ‘imputation’ test which, in essence, asks whether the dominant firm’s effective price is below the relevant wholesale and retail costs. The intuition behind the imputation test is that a negative spread in the case of the dominant firm is a good proxy for as-efficient rivals being (potentially unlawfully) constrained. However, this test wrongly conflates two different things: i) data concerning the input price to the non-integrated rival and ii) the downstream costs of the incumbent as a proxy for the costs of an equally-efficient competitor. This risks guaranteeing a rival the right to a minimum profit, which could simply result in the sharing of a monopoly profit, with no consumer gain.

- b) *A price squeeze may be found based on relatively arbitrary and irrelevant differences.* Suppose for example the dominant charges €10 for the input to rivals (which costs €5 to produce) and charges €11 to final consumers, when the cost of distributing the product is €1.1, then in principle a margin squeeze exists. But if the second stage cost is €1, there would be no margin squeeze. However, whether the downstream distribution costs are €1 or €1.1, is not the material issue, since the problem lies elsewhere, in the consistent (high) profit that the integrated firm is gaining in the upstream market.

In addition, from a more practical standpoint, considering margin squeeze as a separate abuse may be dangerous as it may constitute a shortcut to avoid more difficult predation cases. From a practical viewpoint, margin squeeze could in many circumstances be easier to prove than predation, since it relies on an examination of wholesale and retail prices (both observable) and the retail costs of the incumbent (harder to ascertain, but not impossible). In comparison, a predation test is more exacting on the authority.

Accordingly, certain members of the group favoured a more straightforward test:

- i) If the downstream price is predatory, in that it does not cover the costs of the downstream operations (assuming the costs of procuring the input is the same for the integrated monopolist and the competitor), the standard approach applies. If the price is not predatory, that is the end of the predation analysis.
- ii) If predation is excluded, there are two possibilities: i) there is actual discrimination by the dominant firm in favour of its own operations, which would be a clear violation of Article 82(c) whether or not there

is an abuse of margin squeeze; or ii) there is uniform pricing but the price to non-integrated rivals might, at the limit, be considered exploitative. Again, this would be true whether or not there is a separate abuse of margin squeeze. Indeed, charging an ‘excessive’ price is in effect a refusal to deal, since it amounts to the most extreme form of discrimination.

On the other hand, a majority of the group took as a starting point the conclusion in the judgments in *Industrie des Poudres Sphériques* and *Deutsche Telekom* that there is a separate abuse of margin squeeze. This was thought to be justified on the basis that, while margin squeeze has certain similarities to other abuses, many of these are apt to mislead. In other words, it is worthwhile to have a separate, although not unique, set of principles for margin squeeze cases. The reasons for this view can be summarised as follows.

- a) *Margin squeeze cases under Article 82 EC are not the same as excessive pricing cases since:*
  - The legal basis differs. Margin squeezes are cases of limiting production to the prejudice of consumers under Article 82(c): an excessive price is an abuse under Article 82(a). Indeed, calling an upstream price that gives rise to a margin squeeze abuse ‘excessive’ is likely to cause unnecessary confusion between exploitative and exclusionary abuses, making the abuses of margin squeeze and excessive pricing simultaneously less clear.
  - The legal tests differ. In assessing an excessive price, a commonly-applied benchmark is the firm’s own costs of supplying the relevant product or service compared to similar products in the same market or other related markets. In a margin squeeze case, a price is not excessive in relation to the dominant firm’s costs, but in relation to the relevant price and profit margin of as-efficient rivals on a downstream market. An excessive price is abusive because of its relation to the relevant costs of supplying a single product, whereas an exclusionary margin squeeze is concerned with the excess of the price relative to prices on another related market. Put differently, excessive prices concern the *maximum legal price*, whereas a margin squeeze concerns the *minimum (non-exclusionary) profit*.

- b) *Margin squeeze cases are not merely discrimination cases under Article 82(c).* It only makes sense to rely on Article 82(c) where the dominant firm is *actually* discriminating between its own operations and non-integrated rivals' (which is subject to a strict rule); in all other cases, Article 82(b) is the necessary legal basis, since any discrimination is at best implied.
- c) *While margin squeeze cases are most analogous to predatory pricing cases, there are non-trivial differences that make distinguishing between them necessary, or certainly useful.* This may, in some respects, bring margin squeeze cases under Article 82 out of line with recent US Supreme Court jurisprudence in *Pacific Bell Telephone Co v linkLine Communications, Inc*, but this is defensible:
- The incentives differ as between pure predation and margin squeeze. In predation cases there is usually no need to consider whether or not the alleged predator would benefit from successfully excluding rivals—it always will, to some extent. In contrast, in a margin squeeze case, a vertically integrated company may have reduced incentives to exclude rivals from a downstream market, since the competitor will also be an upstream customer. A vertically integrated dominant company might lose more by losing upstream customers than it could gain as a result of their withdrawal from the downstream market.
  - In a margin squeeze case, the dominant company is not necessarily losing money overall (though it may be). It might be merely taking its profit upstream rather than downstream: the business engaged in a margin squeeze can be profitable on an 'end-to-end' (i.e. integrated) basis throughout the period of abuse.
  - In a margin squeeze case, the question of future recoupment does not necessarily arise as it often does in predation cases. Or, more precisely, the fact that, in a margin squeeze case, the dominant firm remains profitable upstream can make recoupment more or less simultaneous so future recoupment issues do not arise. In a pure predation case, the loss-making and recoupment phases necessarily involve two different time periods. However, it is important to note that there is at least an *opportunity cost* to the dominant firm in a margin squeeze, since

higher wholesale prices it charges will mean lower sales to the downstream competitors who purchase wholesale inputs from it.

- The remedies differ. In a pure predation case, the remedy is usually to increase the (loss-making) price. In a margin squeeze case, the dominant firm could be required (or given the option) to lower the input price, increase the retail price, or slightly adjust, either upwards or downwards, the upstream and retail prices.

### ***2.6.2 Margin squeeze and refusal to deal***

A difficult, and unresolved, issue is whether a margin squeeze is illegal only where the dominant firm has a legal duty to deal in the first place. The argument is that if the dominant firm has no legal duty to deal, there cannot be a duty to deal at a particular price that allows as efficient rivals to make a living profit. This question will wholly, or at least partly, be answered in a pending Article 234 EC reference before the Court of Justice, where the Court is asked whether margin squeeze constitutes an abuse of dominance in a situation where there is no regulatory obligation to supply.<sup>71</sup> It is also an issue in the pending *Telefonica* appeal before the Court of First Instance.

It remains to be seen whether the Court of Justice or Court of First Instance will clarify this issue in a comprehensive manner. In the meantime, however, it is unhelpful for the Commission to include margin squeeze in its refusal to deal section in the Guidance paper without further comment or explanation. In particular, this was patently not the position that the Commission itself took in the *Telefonica* decision in 2007 (see para. 309). It is also contrary to what the Commission said in its 2005 Discussion Paper (see para. 220).

While it may be over-prescriptive to say that there can only ever be a margin squeeze where there is a duty to deal, it is nonetheless important that margin squeeze abuses under Article 82 should at least take account of the well-known potential pitfalls of duty to deal cases, in particular the trade-off between the possible benefits of increases in competition resulting from imposing an obligation to supply and the possible long-run adverse

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<sup>71</sup> Case C-52/09 *Konkurrensverket v TeliaSonera AB* (pending).

effects on incentives to invest and innovate. In considering this trade-off, it is appropriate to consider a) the extent to which adding more competitors will increase competition (there could be an immaterial increase in competition if two or more firms simply share the previous monopoly profits); and b) the scope for meaningful added-value competition on the downstream market.

### ***Recommendation***

- While, subject to the views of the Community Courts, it may be too prescriptive to say that there can only be a margin squeeze where there is a legal duty to deal. Margin squeeze cases should take account of the well-known potential pitfalls of duty to deal cases: a) adding more competitors does not necessarily improve competition, in particular if two or more firms simply share the previous monopoly profits; b) there must be scope for meaningful added-value competition on the downstream market before a duty to deal (or to deal on specific terms) can be imposed; and c) any duty to deal should encourage more competition than it discourages.

### ***2.6.3 The need to ensure that wholesale and retail prices are comparable***

A key feature of margin squeeze is that the dominant firm is supplying an input to rivals who use it to compete with the dominant firm in one or more downstream markets. Because margin squeeze cases always involve at least two markets it is important to ensure that like is compared with like. The basic theory of margin squeeze relies on the twin assumptions that a) there is a simple, linear vertical chain of production, i.e., a single, clearly-identifiable upstream product and a single, clearly-defined downstream product in which the upstream product is a high, fixed proportion of total costs, and b) rivals have no opportunity for additional revenues on the retail market.

For example, it may be under a) that rivals use the input in variable proportions or can mix and match it with other inputs to some extent. Under b), it is often for example the case in telecommunications that rivals can use the wholesale input to provide a range of value-added services, some of which may not even be offered by the dominant firm in the retail market. In *Deutsche Telekom*, the Commission assessed the margin squeeze

solely by reference to Deutsche Telekom's (and competitors') access charges and excluded revenues from calls. In simple terms, the wholesale input had various uses at a retail level for different services so Deutsche Telekom argued that it was essential to look at the total retail opportunities and revenues, and not just one service.

While the Court of First Instance rejected the specific argument in *Deutsche Telekom*, it is important that the margin squeeze analysis should capture the economic reality of how competitors use access to the wholesale input in question. For example, telecommunication service providers generally compete on bundles of access and individual call services, which is why many national authorities also include other revenue in a local loop margin squeeze analysis.

It may also be that the wholesale input supplied by the dominant firm is not a relatively high, fixed proportion of downstream operators' overall costs. It could be a small proportion, or be used in variable proportions by downstream competitors. If so, there would be practical problems in inferring that downstream rivals' apparent lack of profitability was caused by the dominant firm's input pricing and, therefore, harmful to conclude that rivals should be subsidised by the dominant firm. Put differently, there is always uncertainty in this kind of analysis. If the cost share is small, then exclusionary effect likely to be small so it may be more appropriate to give some benefit of the doubt to the dominant firm.

In other words, while the Guidance paper is clearly right to say that an as-efficient competitor test based on the dominant firm's costs is a *necessary* requirement for an abusive margin squeeze, the question arises as to whether an as-efficient test is *sufficient* in a margin squeeze context. Because of the existence of two markets and the use of the dominant firm's product as a (mere) input, the intuition behind the as-efficient competitor test – that it is a sound proxy for those of efficient rivals – may be incorrect in many cases. It only tests whether a firm with identical costs and supplying an identical product would be profitable or not. (This problem does not arise in a predatory pricing case in a single market, either at all or to the same extent.)

It is also important in margin squeeze cases to verify what is causing rivals to be unprofitable (if that is indeed the case). There may be non-

exclusionary explanations. For example, in *National Carbonising*,<sup>72</sup> the Commission ultimately concluded that there was no margin squeeze, since for both companies, industrial coke was profitable and domestic coke was not (due to competition from gas and electricity). In periods of reduced industrial activity, neither company could shut down their coke plants (a coke plant cannot be shut down), but the dominant company sold a higher proportion of industrial coke than the complainant, because it had more long-term industrial-coke supply contracts. Thus, lack of profitability was not caused by the dominant firm: it was simply a function of the inherent (objective) characteristics of the downstream market.

Some argue that the above-mentioned problems require, in a margin squeeze case, proof of pricing not only below the dominant firm's costs but also below rivals' actual costs. However, this has been rejected by the Court of First Instance in *Deutsche Telekom* (para. 192), for the sound practical reason that the dominant firm cannot and should not know its rivals' costs. But this finding does not preclude a competition authority from at least making a cross-check to see whether, based on their own actual costs, rivals are actually or likely foreclosed. (The competition authority can of course ask rivals for the information.) In a marginal case, the dominant firm should probably receive the benefit of the doubt if rivals are profitable.

At the very least, it is imperative that the Commission should check in a serious and forensic way for anti-competitive effects in margin squeeze cases. Merely failing the as-efficient competitor test cannot be sufficient. This should be uncontroversial given the Commission's overall insistence now on evidence of anti-competitive effects.

### ***Recommendations***

- A finding of margin squeeze should always require evidence of actual or likely anti-competitive effects, i.e. harm to consumer welfare in the sense defined in this Report.

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<sup>72</sup> See *National Coal Board, National Smokeless Fuels Limited and the National Carbonising Company Limited*, OJ 1976 L 35/6.

- It is always important to verify whether any lack of profitability by the dominant firm's rivals is caused by factors not attributable to the dominant firm.
- There should be no finding of margin squeeze when: i) the dominant firm's wholesale input costs are a small part of rivals' overall costs; ii) the dominant firm's wholesale input is used in variable proportions by rivals; or iii) rivals use the input to provide a range of services (whether or not the dominant firm itself also offers competing services).

## 2.7 Margin squeezes in new markets

Margin squeezes in new and dynamic markets raise great difficulties for competition authorities and courts. On the one hand, it may be difficult and unsound to draw conclusions from the analysis of costs and revenues in a market in an unsteady state. So there is a risk of finding abuses where there are none or deeming conduct lawful where it is abusive. There are risks in both directions. If efficient rivals' operations are kept unprofitable due to a margin squeeze at the stage of development of the market, there is a risk that the rivals would either exit or remain as marginalised players, allowing the dominant firm to reap excess profits in a rapidly growing market. Markets with network effects may also 'tip' irreversibly in favour of a dominant firm.

These problems raise significant difficulties for competition authorities and it is important to realise that there is no single, right answer as to what should be done with them. The main points to note are the following:

- a) Relying solely on historic costs or book accounts is likely to be wrong in the case of new markets. There may be sunk costs or other investments that take time to recoup. Requiring profits for each sub-period (e.g. monthly) may be unrealistic in these circumstances. Historic costs are more suitable for mature markets.
- b) A pragmatic answer to the problem of markets in unsteady state is to exclude all or part of the start-up period from the calculation of costs and to only count from when the market becomes more stable (see Case COMP/38.233 *Wanadoo Interactive*, para. 71).

- c) Another option would be to say that even if the dominant firm is technically losing money in the start-up phase, it is loss minimising and so is not engaging in an abusive margin squeeze. But the dominant firm cannot be given *carte blanche* in this regard. If in fact it is reducing prices more than necessary to minimise losses, or if it is likely that the business assumptions underpinning its loss-minimisation strategy are hopelessly optimistic, then it is incumbent on it to take remedial action at the earliest opportunity. However, footnote 43 of the Guidance paper sets the bar too high in this regard. It states that, while "...undertakings should not be penalised for incurring ex post losses where the ex ante decision to engage in the conduct was taken in good faith, that is to say, if they can provide conclusive evidence." This is poor wording because the "*conclusive evidence*" in this scenario is that the dominant firm lost money. A better formulation – which seems consistent with what the Commission presumably intended – is that the dominant firm had "a business case is based on unjustified and implausible assumptions or where there has been a failure by the undertaking to take remedial action once it became apparent that it would not meet the targets."<sup>73</sup>
- d) Another solution is to depreciate initial losses over time on the basis, for example, that they are long-term investments in customer acquisition. In *Wanadoo*, this was the Commission's preferred approach and, on the facts, it opted for a depreciation period of four years. The downside is this approach is that depreciation policies are essentially questions of judgment, for which there is no single objectively correct answer (much depends on the purpose).
- e) There are also standard techniques used to measure cash flow over time in the context of investment-making decisions. The most commonly-used method is discounted cash flow (DCF), based on whether the net present value (NPV) of the project is positive or not. A potentially significant problem with this approach is that a positive NPV may include positive margins that result from the exclusion of competitors, i.e., it can build in the reward for anti-competitive behaviour.

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<sup>73</sup> See Guidelines on the application of the Competition Act 1998 in the telecommunications sector, OFT 417, para. 7.23.

### **Recommendations**

Start-up phases in markets raise significant complexities in margin squeeze cases. The mere fact of the dominant firm's having losses or its failure to pass an as-efficient competitor test should not be sufficient in itself for a finding of abuse. The Commission should consider the following techniques in such cases, which may be applied cumulatively in many cases:

- Relying on historic costs only will generally be inappropriate.
- It may make sense to exclude a short start-up phase from the analysis entirely.
- Loss minimisation is an acceptable strategy for a dominant firm in a start-up phase. However, the dominant firm must be held to strict standards in this regard. A business case that is based on unjustified and implausible assumptions is unacceptable.

#### **2.7.1 Margin squeeze in (partly) regulated markets**

A striking feature of the two major Commission decisions on margin squeeze (*Deutsche Telekom, Telefonica*) is that they both concerned markets where the prices in question were subject to *ex ante* regulation under the various EU telecommunications directives.

Whether intended or not, *Deutsche Telekom* has given rise to a good degree of confusion on the application of Article 82 EC in regulated markets. In that case, the national regulatory authority (NRA) had subjected retail prices to a maximum price cap according to baskets of services. Moreover, the NRA examined the issue of margin squeeze in at least five separate decisions, and concluded that rivals could remain competitive by selling access at a low price and recouping additional amounts through call charges.

*Deutsche Telekom*, not surprisingly, argued that its prices were set by the NRA so any margin squeeze that resulted should be attributed to the German state and pursued through infringement actions under Article 226 . This argument was rejected by the Court of First Instance. First, it held that there was only a maximum price cap so the retail prices could be adjusted if necessary by *Deutsche Telekom*. Second, the court held either the NRA did not apply Article 82 or did not do so properly (para. 119).

But this pays insufficient attention to the duties on NRAs not to approve or even encourage measures that are contrary to Article 82 EC.<sup>74</sup> It also places regulated/dominant firms in a quandary because they will need to comply with any non-competition objectives sought by the NRA under *ex ante* regulation while also ensuring at the same time that the primacy of *ex post* competition law objectives is also respected. This is the case even where the NRA sets the wholesale price, regulates the maximum retail price, and has specifically looked at the price spread between the two on several occasions and concluded that they raised no material issues. Given the high fine imposed on Telefonica in 2007 for a margin squeeze abuse (€152 million), the costs to regulated companies of getting this wrong and being forced to second-guess the NRA are obviously enormous. This is unfair.

### ***Recommendations***

The Commission should reiterate the following points:

- The fundamental principle that NRAs should not approve or encourage measures that are contrary to Article 82 EC (or create unjustified monopolies and/or situations in which a firm cannot easily avoid abusing its dominant position under Article 86 EC).
- That, in general, if a NRA misapplies Community law, the remedy is an infringement action against the Member State, not a competition investigation by the Commission.
- That, while regulation and competition law in principle co-exist, the Commission should in general only intervene in cases where there is parallel *ex ante* regulation where: i) the regulatory legislation lacks the requisite legal basis or enforcement powers to take effective action; ii) where there is a ‘lazy’ or ‘captured’ regulator unwilling or unable to apply its own rules.

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<sup>74</sup> Case 66/86, *Ahmed Saeed* [1989] ECR 803. The Court held that the German regulatory legislation did not preclude the NRA from authorising charges that were contrary to Article 82 EC (para. 123). This may have been literally true, but it cannot be denied that Articles 10 EC and 82 EC together create such an obligation on national authorities and courts, irrespective of what the legislation says or does not say. See, e.g., Case C-81/05 *Case C-81/05 Anacleto Cordero Alonso v Fondo de Garantía Salarial (Fogasa)* [2006] ECR I-7569, para. 46.

- That, in general, in cases where there is parallel ex ante regulation by NRAs, it is better to allow the NRAs to implement any remedies since they will be closer to the facts and be better able to do detailed monitoring.

### **3. DISCRIMINATION: UNANSWERED QUESTIONS**

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The Commission needs to ensure that its views on Article 82(c) and the Guidance paper are consistent. It would be undesirable to have different rules for different kinds of abuse. One basic question about discrimination remains without authoritative answers in the existing case law: Is harm to consumers necessary for discrimination to be illegal? Surprisingly, the answer is not clear from the case law, but as a matter of policy and to ensure that the legal rules on discrimination are consistent, harm to consumers must be considered necessary in all cases of abuse.<sup>75</sup>

The Guidance paper discusses only exclusionary abuses, and not discrimination, (or exploitation or reprisals). But discrimination and exclusionary abuses cannot be kept separate, so the omission of discrimination is serious. A paper that discusses foreclosure without mentioning discrimination is incomplete.

Para. 20, fourth indent, is particularly worrying. That indent begins:

The position of the customers or input suppliers: This may include consideration of the possible selectivity of the conduct in question. The dominant undertaking may apply the practice only to selected customers or input suppliers who may be of particular importance for the entry or expansion of competitors, thereby enhancing the likelihood of anti-competitive foreclosure.

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<sup>75</sup> O'Donoghue & Padilla, op. cit., pp. 191-194 and ch. 11; and John Temple Lang, "Anti-competitive non-pricing abuses under European and national antitrust law", in Barry Hawk (ed.), *2003 Fordham Corporate Law Institute*, 2004, pp. 235-340 at 245, 250-253.

This seems clearly to mean that pro-competitive matching of competitors' prices, even above LRAIC, might be illegal because it is 'selective', even if no harm to consumers results. The same objection can be made against what the Commission says about 'individualised' rebates (para. 45). Presumably the Commission does not intend this, and this passage should be clarified.

The Guidance paper should say that in most cases price rebates and other differential prices that are permitted as non-exclusionary are also legal under Article 82(c). It should also say that if a rebate is equally available to all buyers, the fact that only some will qualify for it does not make it illegal.<sup>76</sup> In general, different treatment that is neither exploitative nor exclusionary is legal (unless it is a reprisal).

The Commission should make it clear that even though the price level may sometimes be determined by marginal buyers, it is legal to price-discriminate between marginal and infra-marginal buyers, and so deprive the latter of some of the benefit of competition.

### ***Recommendations***

- A section on discrimination should be added in the next revision of the Guidance paper to ensure that the Commission's views on Article 82(c) and those contained in the Guidance paper are consistent.
- In that section, the Commission should state that in most cases price rebates and other differential prices that are permitted as non-exclusionary are also legal under Article 82(c). It should also say that if a rebate is equally available to all buyers, the fact that only some will qualify for it does not make it illegal. In general, different treatment that is neither exploitative nor exclusionary is legal (unless it is a reprisal).
- The Commission should also make it clear that even though the price level may sometimes be determined by marginal buyers, it is legal to price-discriminate between marginal and infra-marginal buyers, and so deprive the latter of some of the benefit of competition.

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<sup>76</sup> See however the *Portuguese airport charges* case [2001] ECR I-2613.

# ANNEX I

## LIST OF TASK FORCE PARTICIPANTS

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Chairman:	Dr. John Temple Lang Cleary Gottlieb Steen & Hamilton LLP, Brussels and London Professor, Trinity College, Dublin Visiting Senior Research Fellow, Oxford
Rapporteur:	Prof. Andrea Renda Senior Research Fellow, CEPS
Christian Ahlborn Partner, Competition & Antitrust Linklaters	Altan Cingoz Division Head Regulatory Management Turkcell
Steven Anderman Professor of Law University of Essex	Maurits Dolmans Lawyer Cleary Gottlieb Steen & Hamilton LLP
Ginevra Bruzzone Deputy Director General Assonime	Kaarli Haar Eichhorn Counsel, Competition, Regulation & Government Relations GE Europe NV
Marco Bronckers Partner, Vermulst Verhaeghe Graafsma & Bronckers	Gianluca Faella LUISS Guido Carli
Paolo Buccirossi Director LEAR – Laboratorio di economia antitrust, regolamentazione	Ian Forrester Lawyer White & Case LLP
Peter Camesasca Partner Howrey LLP	Townsend Feehan External Relations Manager Legal & Corporate Affairs EMEA Microsoft
Paolo Chiricozzi Antitrust & European Regulation ENEL SpA	

Marcus Glader  
Research Partner  
Advokatfirman Vinge

Paolo Iannuccelli  
Antitrust & European Regulation  
ENEL SpA

Erdal Kiraz  
Team Member  
Interoperator Relations  
Turkcell

Assimakis Komninos  
White & Case LLP

Anders Ladefoged  
Director Business Law & CSR  
Confederation of Danish Industry -  
DI

Pierre Larouche  
Professor - Tilburg Law & Economics  
Center (TILEC)  
Tilburg University

Guido Lobrano  
BUSINESSEUROPE

Robert O'Donoghue  
Barrister  
Brick Court Chambers

Angelica Orlando  
Antitrust & European Regulation  
ENEL SpA

Cristoforo Osti  
Clifford Chance LLP

Roberto Pardolesi  
Professor of Comparative Law  
LUISS Guido Carli

Nickolas Reinhardt  
Senior Policy Advisor  
Fleishman-Hillard Inc.

Nadine Rossmann  
Legal Advisor – Competition Policy  
BDI – Bundesverband der Deutschen  
Industrie

Robert Stillman  
CRA International – Charles River  
Associates

Anders Stenlund  
Director  
Confederation of Swedish Enterprise

Henrik Schultz  
Senior Counsel, Attorney-at-Law,  
LLM  
Confederation of Danish Industry -  
DI