Judging market power by market shares is an approach closely associated with the SCP paradigm, which was challenged by the Chicago School. Nonetheless, market share analysis remains at the heart of competition law inquiry because it provides a relatively simple rule of thumb to identify markets where competition is at risk. The chapter also suggests that the Commission has been less than enthusiastic in applying Chicagoan approaches (for example, there is a wider list of conditions that constitute entry barriers in EC competition law than the Chicago School identifies), but has accepted some of the insights of the post-Chicago paradigm, for instance aftermarkets and direct proof of market power.

The second lesson from this chapter is about the role that policy plays in the definition of the relevant market. As shown in chapter 2 with reference to the meaning of 'agreement', even technical legal issues may be resolved on the basis of the underlying policies that animate the law. In this chapter we have seen some decisions where the Commission's definition of the relevant market can be characterised as 'strategic'. That is, the market is identified in order to achieve a specific regulatory objective: pay-TV is seen as a separate market even when the application of the hypothetical monopolist test may suggest otherwise because the Commission wishes to apply competition law to promote the development of this industry, or to safeguard pluralism. Accordingly, even if a more economics-oriented approach to market power is developed, there are instances where market definition is used to facilitate the achievement of wider, public policy ambitions.

6

Abuse of a dominant position: anticompetitive exclusion

Contents

1 Introduction

Dominance is not unlawful, but 'where an undertaking is in a dominant position it is in consequence obliged, where appropriate, *to modify its conduct* so as not to impair effective competition on the market *regardless of whether the Commission has adopted a decision to that effect*'.[1] This dual obligation on dominant firms, to avoid acts that harm competition and to modify their practices if they are likely to harm competition, forces them to observe the markets they operate in and to monitor the effects of their commercial practices, which may become illegal if market circumstances change. Every act of a dominant firm is laden with risk, in particular when even commercial behaviour regarded as normal may constitute abuse within the meaning of Article 82.[2]

Article 82

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
(b) limiting production, markets or technical development to the prejudice of consumers;
(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Anatomically, Article 82 contains a general section, which prohibits the abuse of a dominant position, followed by a non-exhaustive list of examples of behaviour that may constitute abuse.[3] In contrast with Article 81, there is no stated purpose in the language of Article 82.[4] Other language versions of the Treaty offer no further guidance. For example, the French version speaks of 'exploitation in an abusive manner' ('exploiter de façon abusive'). In an early

[1] Case T-5/02 *Tetra Laval v. Commission* [2002] ECR II-4381 para. 157 (my emphasis). See also Case 322/81 *Nederlandse Banden-Industrie Michelin v. Commission* [1983] ECR 3461 (*Michelin 1*) para. 57; Cases T-125 and 127/97 *The Coca-Cola Company and Coca-Cola Enterprises Inc. v. Commission* [2000] ECR II-1733 paras. 80–5.
[2] Case T-65/89 *BPB Industries and British Gypsum v. Commission* [1993] ECR II-389 para. 69.
[3] Case 6/72 *Europemballage Corporation and Continental Can Company Inc v. Commission* [1973] ECR 215 para. 26.
[4] Case T-203/01 *Manufacture française des pneumatiques Michelin v. Commission* [2003] ECR II-4071 (*Michelin 2*) para. 237.

analysis, Joliet, drawing on the list of examples of abuse set out in Article 82 and the French language version of the Treaty, suggested that this provision was intended to catch 'instances where dominant market power is exploited, used, or exercised *to the detriment of suppliers and purchasers*'.[5] So even if the list of abuses is illustrative, any additions to the abuse doctrine must harm suppliers or purchasers. However, already in the late 1960s the Commission was pressing for a wider concept of abuse, to encompass activities designed to harm or oust *competitors*.[6] The language of Article 82 therefore created ample discretion for the decision-maker to determine its protective scope by reference to the kind of policy objectives it favoured – be it the protection of consumer interests or the protection of economic freedom of other market participants. The analysis of the abuse doctrine in this chapter begins with an exploration of the possible protective scope of Article 82.[7]

The abuse doctrine has four possible roles. The first is to protect the market from dominant firms when these reduce output and raise prices. The second is to protect the market from dominant firms when these harm competitors so as to obtain the power to reduce output and increase prices. These two roles are based upon economic theories. The former represents a neoclassical approach, while the second is representative of post-Chicago theories that firms behave strategically to gain market power. A third role for the abuse doctrine is to protect other market participants from the acts of dominant firms. Under an economic freedom model, dominant firms are the major reason for competition policy. They have the commercial power to harm others: competitors, customers or consumers. A fourth role for the abuse doctrine is to protect the internal market. These last two roles are explicitly political, and correspond to two of the core values of EC competition law.

The first three interpretations correspond to the concepts of dominance discussed in chapter 5, which suggests that the concept of dominance one embraces colours the meaning and scope of the abuse doctrine. In section 2, these models are considered in more detail with the help of a case study. Based on what was said in chapter 5, the reader will be aware that dominant firms are controlled for their power to harm the competitive process, so that dominance means the power to harm consumers, customers and competitors. Therefore, of the concepts of abuse noted above, the third is the one that represents the Commission's position most logically. However, as we noted in chapter 5, currently the Commission is carrying out a review of Article 82 so as to bring it

[5] R. Joliet *Monopolization and Abuse of Dominant Position* (Liège: Université de Liège, 1970) p. 247.
[6] Concentration of Enterprises in the Common Market: memorandum of the EC Commission to the Governments of the Member States (1 December 1965) at 29.
[7] The notion of a protective scope is drawn from two sources. First, it occurs in the interpretation of statutes under the tort of breach of statutory duty in England, and also in the interpretation of statutory liability under the French or German Civil Codes. Second, this concept was used by AG Kokott in Case C-95/04P *British Airways v. Commission* (Opinion of 23 February 2006) para. 69, a passage which is considered below.

in line with 'mainstream economics'.[8] The motivation for this review is twofold: first, reform is necessary as a matter of coherence (if Article 81 has been recast so as to focus on consumer welfare rather than economic freedom, so should Article 82); second, reform is necessary because no aspect of EC competition law has incurred the wrath of commentators more than the Commission's application of Article 82. The Commission's first 'reform' document was published in December 2005;[9] however, the seeds for the reform of Article 82 are already inherent in the case law, which suggests that the Commission's reform programme envisages incremental change rather than radical revolution.

The reform process is designed to affect the concept of dominance and the concept of abuse. As we suggested in chapter 5, dominance is being redefined to mean substantial market power to harm consumer interests. This suggests that the protective scope of Article 82 should also be refocused so as to apply only to practices that harm consumers. That is, if we switch from an ordoliberal to an economic conception of market power, we should make the same shift when considering the abuse doctrine. Both the concept of dominance and the protective scope of the abuse doctrine should be moulded by considerations of consumer welfare. The effect is to restrict the protective scope of Article 82.

2 Why penalise the abuse of a dominant position? *BA/Virgin* as a case study

The role of the abuse doctrine can be examined by considering a recent controversial decision, *British Airways/Virgin*. The dispute centred on rebate schemes that British Airways (BA) provided for travel agents. (A rebate is a retrospective discount.) Travel agents buy tickets from the airlines and sell these to travellers. They make profits by a commission, which BA pays on the basis of the number of tickets they sell. BA offered travel agents additional financial incentives in the form of rebates if they sold more of its tickets. In 1993 Virgin complained to the Commission about BA's marketing schemes whose effect, it claimed, was to reduce the incentives for travel agents to sell tickets of competing airlines. The Commission defined the relevant market as that for air travel agency services in the United Kingdom. It found that BA was the dominant purchaser of these services. BA's market share in the total of air ticket sales handled by travel agents was between 39 and 46 per cent, while its competitors had market shares below 10 per cent.[10] Combined with the fact that BA offered flights to many more destinations compared to its competitors,

[8] P. Lowe 'DG Competition's Review of the Policy on Abuse of Dominance' 2003 *Fordham Corporate Law Institute* 163, 165 (Hawk ed. 2004).

[9] DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses (December 2005).

[10] Case T-219/99 *British Airways v. Commission* [2003] ECR II-5917 para. 211.

BA was an 'obligatory business partner of travel agents'.[11] Travel agents could not operate without selling BA flights as part of their portfolio. In this market context, should one penalise BA for introducing financial incentives designed to reward travel agents if they sell even more of its tickets?

2.1 Neoclassical analysis

From a neoclassical perspective, a monopoly reduces economic welfare because, unhindered by actual or potential competitors, it is able to reduce output, thereby leading to a price increase. Consumers unable to buy at the higher price suffer a loss in utility. The same consequence can occur when the largest firm faces some competition from fringe firms. On the assumption that the fringe firms are unable to expand their output significantly, the dominant firm takes the output capacity of the fringe into account and realises that for the residual demand the fringe cannot meet, it holds a monopoly. Thus the monopoly price is set by reference to the residual demand.[12] For example, suppose that there are 100 customers and the fringe firms can supply at most ten customers. The dominant firm is in competition vis-à-vis those ten customers but holds a monopoly over the rest of the market. Arguably a firm in a dominant position reduces welfare less than a monopolist – it cannot reduce output by as much as it would wish because of the supply by the fringe firms, but the more significant the dominant firm's market power, the greater the deadweight loss.[13]

A neoclassical economist reading *British Airways/Virgin* would see that BA's rebate schemes with travel agents were found to be abusive because they were loyalty inducing, reducing the opportunities of travel agents to sell their services to other airlines and preventing other airlines' access to the market.[14] Here the concern was not that flights would be more expensive: in fact the rebates' effect on ticket prices was not even considered. Moreover, it is likely that travel agents would offer better deals and more services to consumers so as to sell more tickets and win the rebate. The rebate can be seen as a strategy to give distributors greater incentives to market BA's tickets. This attitude suggests that EC competition law is concerned with behaviour that excludes other participants from the market, and fails to consider the welfare effects of this – a competitor, and not competition, is protected.[15] Under a neoclassical approach, the rebates offered by BA, the dominant firm, appear efficiency enhancing provided that the prices set are not below cost. On this

[11] Ibid. para. 217.

[12] D. W. Carlton and J. M. Perloff *Modern Industrial Organization* 2nd edn (New York: Harper Collins, 1994) pp. 160–1.

[13] M. A. Utton *Market Dominance and Antitrust Policy* (Cheltenham: Edward Elgar, 1995) p. 64.

[14] *Virgin/British Airways* [2000] OJ L30/1.

[15] E. M. Fox 'We Protect Competition, You Protect Competitors' (2003) 26 *World Competition* 149.

view, Article 82 should play no role in controlling the way dominant firms attempt to compete with rivals.[16]

2.2 A post-Chicago paradigm: anticompetitive exclusion

Recent research in economics has indicated that an alternative paradigm can be used to explain why BA's tactics may merit punishment, drawing upon literature suggesting that strategies designed to injure rivals can reduce consumer welfare. As Ordover and Saloner explain: 'the hallmark of these strategies is that, invariably, they reduce the expected level of profits that incumbent's rivals – present and future – can hope to earn'.[17] The strategies are anticompetitive because they dissuade rivals from entering a new market or force rivals to exit, and in the long run allow dominant undertakings to raise prices, having removed all significant competitors. Often the strategies in question (e.g. lower prices, increased advertising, distribution agreements including loyalty rebates, non-cooperation with the newcomer) are exactly the kind of procompetitive response that we would expect from a firm whose market position is challenged. Thus a distinction needs to be drawn between responses by competitors that increase welfare (competition on the merits) and those that reduce it (anticompetitive exclusion). A simple example of anticompetitive exclusion is Ordover and Willig's theory of predatory product innovation: an incumbent may design a new product aimed at diverting sales away from the rival. If this is successful, and provided re-entry is costly, the incumbent is then able to raise prices to an anticompetitive level, for he now dominates the market. The new product's introduction is deemed predatory when the recovery of the costs incurred in developing the new product can only occur if the competitor exits the market, and not from the sales of the product.[18] The behaviour makes no business sense but for its exclusionary effect. The example is somewhat unpersuasive because if consumers value product innovation a firm will not innovate unless it anticipates profits.[19] Nevertheless, it exemplifies the gist of the theories of anticompetitive exclusion: an apparently procompetitive reaction by the dominant firm excludes rivals and gives the incumbent the power to enjoy greater profits once rivals exit. The harm to economic welfare is noted once rivals have left, but the root cause of the harm

[16] See R. Epstein 'Monopoly Dominance or Level Playing Field? The New Antitrust Paradox' (2005) 72 *University of Chicago Law Review* 49, who argues that exclusionary behaviour by dominant firms should not be regulated by US antitrust law.

[17] J. A. Ordover and G. Saloner 'Predation, Monopolization and Antitrust' in R. Schmalensee and R. D. Willig *Handbook of Industrial Organization* vol. I (Amsterdam: North-Holland, 1989) ch. 9 p. 538.

[18] J. A. Ordover and R. D. Willig 'An Economic Definition of Predation: Pricing and Product Innovation' (1981) 91 *Yale Law Journal* 8.

[19] For a critique of this approach, see M. Motta *Competition Policy* (Cambridge: Cambridge University Press, 2004) pp. 454–6.

lies in the strategy implemented by the dominant firm which raises the costs of existing rivals and deters potential rivals from entering.

If we analyse BA's strategy of offering incremental rebates to travel agents that sell more BA tickets under this paradigm, it may be described as a mechanism for *raising rivals' costs*.[20] BA's rivals have to offer similar, if not more generous, financial incentives to travel agents in order to remain in the market. Thus, the cost of competing against BA is increased through BA's marketing scheme. This strategy can be successful provided three conditions are satisfied: first, the incumbent must be willing to pay to exclude the entrant more than the entrant is willing to pay to stay in the market – that is, BA must be willing to pay travel agents better rebates than Virgin; second, the new entrant must be unable to find alternative means of entering the market; third, the excluding firm must have market power so that it can exploit the disadvantage suffered by its rival.[21] According to this view, a legal test for determining whether BA's tactics are in breach of competition law would be the following:[22]

1. Whether the dominant firm's conduct raises rivals' marginal costs;
2. If the firm that has adopted the cost-raising strategy can subsequently increase prices after rivals' costs have been increased;
3. Whether rivals have any effective counterstrategies to render the incumbent's tactics worthless;
4. Whether the incumbent can justify its strategy as increasing economic welfare.

In a similar vein, Richard Posner has agreed that it is legitimate to enforce competition laws against dominant firms which exclude competitors from the market, provided that the excluded firm is as efficient as or more efficient than the dominant firm and provided that the exclusionary practices carried out by the dominant firm cannot be justified as efficient.[23] The two provisos ensure that the purpose of competition law remains the maximisation of efficiency – the exclusion of a competitor is not punished unless the welfare effects are negative.

The methodology suggested by these two tests requires a detailed analysis of the market in question, considering the viability of alternative distribution channels and the costs faced by the incumbent and the challenger. The

[20] T. G. Krattenmaker, R. H. Lande and S. C. Salop 'Monopoly Power and Market Power in Antitrust Law' (1987) 76 *Georgetown Law Journal* 241.

[21] Ordover and Saloner 'Predation, Monopolization and Antitrust' p. 566.

[22] Krattenmaker et al. 'Monopoly Power'.

[23] R. A. Posner *Antitrust Law* 2nd edn (Chicago: University of Chicago Press, 2001) pp. 194–5. Some readers might balk at seeing Posner cited under a 'post-Chicago' heading, given that he is best known for adopting a 'Chicago School' approach. However, I use the 'post-Chicago' label to indicate a paradigm of economic thought. It is a historical label denoting an epoch of economic thinking rather than an ideological label. Posner's important book adopts some of the insights of contemporary economic thinking. As such it is post-Chicagoan.

post-Chicago approach shares the goals of the neoclassical paradigm but differs by identifying a wider range of methods that may be deployed by a dominant firm to reduce economic welfare.

2.3 The economic freedom paradigm

Finally, a wider conception of anticompetitive exclusion is also possible. The standard of the post-Chicago paradigm is limited in two ways: first, it is concerned only with the exclusion of competitors, not with the exclusion of or harm to firms operating at other levels of trade; second and more significantly, it is premised upon a 'total welfare' analysis whereby the exclusion or elimination of a competitor is not the harm that competition law seeks to address. The real harm is the dominant firm exploiting its market power once the rival is gone. However, from the perspective of 'economic freedom' that we set out in chapter 2, the concept of abuse can be extended to protect market participants from abusive tactics of dominant firms. This wider protection is justified by economic and political means. From an economic perspective, competition law should protect all firms that are threatened by a dominant firm's activities, not only firms that are as efficient as the dominant firm. First, it is not easy to determine whether a firm threatened with elimination is (or will become) more efficient than the incumbent dominant firm: unless other firms are given an opportunity to establish themselves on the market, new firms will find it hard to enter.[24] Second, when a new firm enters it is likely that the dominant firm will be more efficient – it will have an established distribution network, experience of the market, and generally lower costs. Unless the new entrant is afforded some breathing space, it will struggle to enter.[25]

Accordingly, safeguarding pluralism is an important means of guaranteeing healthy markets, and the discipline of Article 82 is necessary for this reason. From this perspective, the standard of proof in the post-Chicago paradigm is too high. From a political perspective, a tougher line against dominant firms can be justified in another way: the economic power of a dominant firm is akin to the political power of the state. Hence, public law standards of control should be extended from their traditional arena (administrative power) to regulate analogous manifestations of economic power.[26] On this basis one might be more comfortable with a rule prohibiting the *existence* of dominance, but it would be problematic to enforce such a rule. From a slightly different

[24] But see the articulate objections to this line of argument in E. Elhauge 'Why Above-Cost Price Cuts to Drive Out Entrants are not Predatory – and the Implications for Defining Costs and Market Power' (2002) 112 *Yale Law Journal* 681 part IV.

[25] A position articulated by the Commission in *DSD* [2001] OJ L166/1 para. 121, where it recognised that it would be economically realistic for a new entrant to start with a small operation.

[26] See G. Amato *Antitrust and the Bounds of Power* (Oxford: Hart Publishing, 1997) p. 66 for a similar argument.

perspective, this wider conception of abuse of dominance has been said to have affinities with private law doctrines of duress and undue influence, as it is designed 'to protect businesses and individuals in their freedom to trade'.[27] According to this liberal conception, the ability to participate in the market free from unacceptable constraints is a right to be safeguarded regardless of utilitarian considerations about the welfare effects of such protection.

2.4 Which standard was applied in *BA/Virgin*?

The neoclassical conception of abuse cannot explain the *BA/Virgin* decision, but the post-Chicago and the economic freedom paradigms can offer an explanation for the Commission's finding. The Commission's decision demonstrates an uneasy tension – sometimes favouring a consumer welfare view premised upon some post-Chicago ideas, sometimes supporting the economic freedom paradigm. The reasons why the loyalty rebates BA offered to travel agents were condemned were the following: (1) they removed the travel agent's freedom to select its customers, and this 'regardless of any possibility for the travel agents or competing airlines to minimise or avoid [the] effects' of the loyalty schemes;[28] (2) by offering discriminatory commissions to travel agents they distorted competition among them;[29] (3) they harmed all BA's actual and potential competitors, and 'therefore harm competition in general and so consumers, rather than only harming certain competitors who cannot compete with BA on merit'.[30] The first two grounds are based on economic freedom conceptions, penalising a dominant firm for interfering with the freedom to trade of other market participants, while the third ground is premised upon a conception of abuse much closer to the post-Chicago theories by noting that consumer welfare is reduced when the dominant firm's exclusionary tactics harm competitors who are as efficient as BA, and implicitly tolerating the exclusion of less efficient competitors.

There is a similar ambiguity in the CFI's ruling that upholds the Commission's decision. The CFI held that as a result of BA's tactics: '[a]gents were thereby deterred from offering their travel agency services to airlines in competition with BA whose entry into or progress in the UK market for travel agency services was thereby necessarily hindered'.[31] Some aspects of the CFI's reasoning suggest that the Court was concerned about the exclusion of 'as efficient competitors'. For example, the Court notes that none of BA's rivals sold as many tickets as BA and therefore they did not have the level of revenue to give them a 'sufficiently broad financial base to allow them to establish a reward scheme similar to BA's in order to counteract the exclusionary effect of that scheme against them'.[32] And the CFI added that BA was

[27] H. Collins *The Law of Contract* 3rd edn (London: Butterworths, 1997) p. 146.

[28] *Virgin/BA* [2000] OJ L30/1 para. 102. [29] Ibid. para. 111. [30] Ibid. para. 106.

[31] [2003] ECR II-5917 para. 287. [32] Ibid. para. 278.

unable to offer any economic efficiency justification for the rebate schemes, leaving it to infer that the reward schemes were designed to oust rivals.

On the other hand, the CFI retains a focus on the economic freedom model, by considering the losses of travel agents' independence, and also in deciding that the actual effects of BA's practices are irrelevant. With respect to the latter point, BA noted in its appeal that the market shares of its competitors had increased in spite of the rebate scheme, which might indicate that there is no anticompetitive exclusion resulting from the rebate schemes. The Court's response was twofold. First, as a matter of law the CFI ruled that 'it is not necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned. It is sufficient in that respect to demonstrate that the abusive conduct of the undertaking in a dominant position tends to restrict competition, or, in other words, that the conduct is capable of having, or likely to have, such an effect.'[33] Having proven that BA had market power and that its competitors lacked the resources to compete against it, then it follows that BA's practices are able to have adverse effects. This can be criticised for penalising a firm that has financial resources to devise effective marketing strategies. More generally, the Court indicated that there is an infringement of Article 82 when a firm attempts to oust rivals, because 'the fact that the hoped-for result is not achieved is not sufficient to prevent a finding of abuse'.[34] The Court's second response was that the growth of competitors was modest and that without the rebates 'it may legitimately be considered that the market shares for those competitors would have been able to grow more significantly'.[35] It is remarkable how a competition authority and court claim to know more about how markets might develop than most business analysts. It is passages like these that fortify the criticisms that the Commission and Courts are devoted to safeguarding competitors through the use of Article 82.[36]

It is instructive to contrast the Commission's analysis with the ruling on similar facts in the United States.[37] Virgin embarked on private litigation and complained that BA's incentive agreements with travel agents (which, like the schemes in the UK, provided for commissions or discounts when certain thresholds for sales had been met) were in breach of section 1 of the Sherman Act (prohibiting agreements in restraint of trade), but this argument was dismissed because the court found that Virgin had failed to show that consumers had suffered. On the contrary, the loyalty agreements were pro-competitive: the reward of customer loyalty was found to be competition on the merits, a conclusion which is the exact opposite of that taken by the European Commission. Virgin claimed that the incentive schemes were in breach of section 2 of the Sherman Act (the rough equivalent of Article 82),

[33] Ibid. para. 293. [34] Ibid. para. 297. [35] Ibid. para. 298.
[36] The same approach was taken in *Michelin 2* [2003] ECR II-4071 paras. 239–40.
[37] *Virgin Atlantic Airways v. British Airways* (2001) 257 F 3d 256.

constituting predatory pricing or as leveraging, but failed. Tellingly, the court began its opinion by restating the concepts underlying antitrust law under current US doctrine: 'Foremost among them is the notion that competition fosters consumer welfare. Since competition, which is the very essence of business, results in lower prices for consumers, it is a positive aspect of the marketplace. Thus, what the antitrust laws are designed to protect is competitive conduct, not individual competitors.'[38] The philosophy espoused in this passage is very different from that animating the bulk of the Commission's decision on similar facts.

Before drawing lessons from this case study, some background to the *BA/Virgin* dispute is necessary to obtain a more complete understanding of this case. First, BA's strategy should be placed in the overall context of the relationship between the two airlines in the 1990s. In January 1991 the Civil Aviation Authority allowed Virgin to operate flights from Heathrow and since that time BA had engaged in a 'dirty tricks' campaign against Virgin. BA was particularly concerned that Virgin was competing against BA on its most profitable routes (London–New York and London–Tokyo), thereby causing a significant dent in BA's profits even if BA flew to considerably more destinations than Virgin. This campaign included espionage and attempts to discredit Virgin, which resulted in an expensive lawsuit for defamation that BA settled.[39] In addition, BA deployed a strategy known as 'switch selling' whereby travel agents would contact passengers booked on Virgin flights and offer a comparable BA flight in addition to bonus 'air miles' on BA's frequent flyer programmes. Agents that managed to switch a passenger received a £5 Marks & Spencer gift voucher.[40] BA's rebate agreements with travel agents were part of this campaign, and the press characterised BA's rebate schemes as 'bribes' to travel agents to sell BA tickets over those of its competitors.[41] Second, the Commission's action against British Airways should be seen in the wider context of the liberalisation of air transport.[42] The gist of the Commission's policy is to facilitate the entry of new airlines and to offer greater choice for consumers. British Airways was a former flag carrier. That is, the UK government had owned and financed BA, affording it a commercial advantage over new entrants. These two features may explain the Commission's aggressive stance against British Airways. However, the assumption that a recently privatised firm is laden with money does not always hold: in fact BA had been cutting costs deeply in the years leading up to privatisation, in particular given the global commercial strength of other flag carriers.[43]

[38] Ibid. at 259.
[39] See generally M. Gregory *Dirty Tricks: British Airways' Secret War Against Virgin Atlantic* (London: Little, Brown, 1994).
[40] Ibid. p. 223.
[41] 'Virgin Wins Luxembourg Appeal on Dirty Tricks in BA Sales', *Guardian*, 18 December 2003.
[42] See ch. 12. [43] Gregory *Dirty Tricks* pp. 19–26.

2.5 The protective scope of Article 82

In spite of the last two observations, which indicate that the Commission's interest in regulating BA was to ensure that markets were liberalised, the decision in *BA/Virgin* represents the current approach to Article 82 and we can draw three lessons from it. The first is that the 'economic freedom' paradigm has a strong influence in regulating dominant firms. BA's 'dirty tricks' and its rebate schemes are comparable in that they represent attempts to harm competitors. Associating anti-competitive behaviour with 'ungentlemanly' commercial conduct also colours much of the reporting of the dirty tricks affair. Article 82 is a kind of 'business tort' where firms with market power have obligations to deal fairly when faced with competition. The 'economic freedom' conception underpinning Article 82 allows the abuse doctrine to prohibit behaviour perceived to be unacceptable.[44] A particularly eloquent formulation of this point of view has been set out by Advocate General Kokott, and it is worth quoting extensively:

> The starting-point here must be the protective purpose of Article 82 EC. The provision forms part of a system designed to protect competition within the internal market from distortions (Article 3(1)(g) EC). Accordingly, Article 82 EC, like the other competition rules of the Treaty, is not designed only or primarily to protect the immediate interests of individual competitors or consumers, but to protect the *structure of the market* and thus *competition as such (as an institution)*, which has already been weakened by the presence of the dominant undertaking on the market. In this way, consumers are also indirectly protected. Because where competition as such is damaged, disadvantages for consumers are also to be feared.
>
> The conduct of a dominant undertaking is not, therefore, to be regarded as abusive within the meaning of Article 82 EC only once it has concrete effects on individual market participants, be they competitors or consumers. Rather, a *line of conduct* of a dominant undertaking is abusive as soon as it *runs counter to the purpose* of protecting competition in the internal market from distortions (Article 3(1)(g) EC). That is because, as already mentioned, a dominant undertaking bears a particular responsibility to ensure that effective and undistorted competition in the common market is not undermined by its *conduct*.[45]

So competition is not an end result (the neoclassical view), but a process, or an institution that is protected because it has an intrinsic value. The protection of consumers is an indirect benefit and not the focus of the law.

The second lesson is that while the decision might be rooted in an economic freedom paradigm, there is also some attempt to justify the adverse finding using economic analysis; in particular there are affinities between certain parts of the CFI's analysis and recent economic thinking about the adverse effects of

[44] Ibid. p. 222.

[45] Case C-95/04P *British Airways v. Commission*, Opinion of AG Kokott, 23 February 2006, paras. 68–9 (emphasis in the original).

exclusionary practices. The roots for the reform of Article 82 are inherent in the current abuse doctrine. However, one major limitation in redefining the protective scope of Article 82 is the Court's general statement on the nature of abuse in the seminal cases, which has been regularly repeated by the judiciary:

> Article [82] covers practices which are likely to affect the structure of a market where, as a direct result of the presence of the undertaking in question, competition has already been weakened, and which, through recourse to methods different from those governing normal competition in products or services based on traders' performance, have the effect of hindering the maintenance or development of the level of competition still existing on the market.[46]

This passage suggests a two-stage inquiry: first the identification of abnormal conduct, second the effect on competition. The first limb is problematic in that it suggests that there are certain forms of conduct that are a priori abusive in character. As we will find below, proof that a firm engages in such practices is often sufficient to find an abuse. If abusive conduct is capable of having exclusionary effects, then there is no need to investigate whether these effects materialise.[47] The presence of such a strict abuse doctrine prevents major reform. However, the second limb of the test (the effect on competition) affords the Commission considerable flexibility. As we noted in the context of Article 81, the Commission has reinterpreted the concept of a restriction of competition so that it means a reduction in consumer welfare rather than a restriction of economic freedom. A similar reinterpretation of the above definition of abuse opens the possibility of rethinking the protective scope of Article 82.

The third lesson is about the relationship between Article 82 enforcement and the Community's policy. This has two dimensions. The first relates to the use of Article 82 in industries which have been liberalised recently, where the concern is to facilitate market access to new entrants that lack the competitive advantages of the incumbents. The effect is that the Commission favours aggressive enforcement of Article 82 in these markets. The second, related, consideration is that in recent years, market access is not valued as a good in itself, rather it is perceived to be the means by which consumer welfare is enhanced.

These observations suggest conflicting roles for Article 82, which should inform the Commission's current wish to revisit its enforcement strategy. From an economic perspective, Article 82 can make economic sense if the post-Chicago exclusionary theories are examined more fully in the decision-making process. This requires less emphasis on 'economic freedom' than the

[46] *Michelin 1* [1983] ECR 3461 para. 70. Often a similar passage from *Hoffmann La Roche* (para. 91) is cited, but it has been noted that the English version was translated erroneously. See Kallaugher and Sher 'Rebates Revisited: Anti-Competitive Effects and Exclusionary Abuse under Article 82' [2004] *European Competition Law Review* 263, 269–70.

[47] *Michelin 2* [2003] ECR II-4071 paras. 239–42.

current law. Such an approach would be consonant with the receding importance of economic freedom we noted in chapter 2 when considering Article 81. From a policy perspective, however, there are three tensions if this route is followed. The first is that it may be legitimate to apply tougher abuse standards in industries which have been recently liberalised as a means of making markets more competitive. The second tension is with the Commission's interest in using competition law to promote consumer welfare. This can afford the Commission considerable discretion to regulate markets. As we noted above, the US judges were unimpressed with Virgin's claim because they saw prices falling as a result of BA's actions, while the Commission noted that consumers would gain if they were able to obtain a more diverse range of airlines offering flights. Both saw consumer interests in a different light. The Commission's broad definition of 'consumer welfare' (which we explained in chapter 4) gives it the power to regulate markets in an intrusive manner which risks undermining the adoption of economic standards. The third source of tension comes from the fact that by reducing the protective scope of Article 82 the Commission loses the power to use this provision to regulate markets where there may be a Community interest in intervening, for example to protect small traders or to promote the integration of the market.

These tensions suggest that one major challenge in deploying an economics-based standard to the abuse provision is that other policy considerations militate in favour of a different, more aggressive, role for Article 82. In fact, until now the concept of abuse has been shaped by reference to a range of diverse values. Therefore this chapter is organised by exploring how different values have informed enforcement, and how the shift away from economic freedom and towards consumer welfare might be accomplished, together with the limits of this reform process.[48] Section 3 considers how the abuse concept applies to the exercise of market power designed to restrict the output of rivals by raising their costs.[49] Here there is a tension in the case law because, on the one hand, it appears that the rules are framed according to post-Chicago economic theories, while, on the other hand, at times it seems as if the rules are designed to protect market participants. Section 4 is about how the abuse doctrine applies to the exercise of market power to harm other market participants who are not competitors of the dominant firm, an approach which is most closely associated with the economic freedom model. Section 5 shows how the abuse concept has been used to support market integration.

[48] While occasional reference to US antitrust law is made, direct comparison between s. 2 of the Sherman Act and Article 82 is undesirable as the two provisions reflect differing regulatory philosophies. There may be overlaps and similarities on occasion but not systematically. Thus the list of abuses does not correspond fully to a list one would make of monopolisation under s. 2, which is primarily concerned with the abuses analysed in section 3. For an exploration of the differences, see T. E. Kauper 'Whither Article 86? Observations on Excessive Prices and Refusals to Deal' 1990 *Fordham Corporate Law Institute* (Hawk ed. 1989), especially pp. 651–5.

[49] Krattenmaker et al. 'Monopoly Power'.

3 Excluding rivals

The most common concern in EC competition law has been practices that force rivals out of markets and/or prevent the entry of new rivals.[50] These are at the centre of the Commission's reform process, where the tension between the economic freedom and post-Chicago models of abuse is most acute. We start by exploring the theory of 'raising rivals' costs' so as to provide a framework for exploring how far the current abuse doctrine requires reform if one wishes to depart from the economic freedom model.

3.1 Raising rivals' costs

In certain markets competitors are in a situation of economic dependence vis-à-vis the dominant firm. *Deutsche Bahn* provides an apt illustration.[51] The dominant firm held a statutory monopoly over the supply of rail transport services in Germany. These services were used by transport firms to move containers from ports in Northern Germany, Belgium and the Netherlands. Deutsche Bahn sold its services in a discriminatory manner: it charged less to Transfrecht (the transport firm that operated from the German port which was 80 per cent owned by Deutsche Bahn) and more to operators transporting containers from Belgium and the Netherlands. The impact of this was an increase in container traffic to Hamburg and a decrease of traffic through the Dutch and Belgian ports. Deutsche Bahn promoted its services at the expense of those of the Dutch and Belgian rail operators and also promoted the interests of its transport subsidiary. The Commission considered this a particularly serious abuse because it negated the EC's aim to develop international combined transport services in the EC.[52] This is a clear example of how a dominant firm can raise costs for its rivals, possibly causing them to leave the market, thereby allowing the dominant firm to increase prices once rivals have been eliminated.

A rival's costs may also be raised when there is no economic dependence. For instance, in *Irish Sugar* the Commission found a breach of Article 82 when Irish Sugar (dominant in the industrial sugar market in Ireland with a market share of 88 per cent) sold its product at discriminatory prices, setting a higher price to sugar packers who competed against it downstream, thereby 'restrict[ing] competition by rival sugar packers on the retail sugar market'.[53]

[50] Van Bael and Bellis *Competition Law of the European Community* 4th edn (The Hague: Kluwer International, 2005) pp. 904–5, noting that it is ironic that while a literal interpretation of Article 82 should have led the Commission to concentrate on exploitative abuse, its enforcement priorities have been towards exclusionary abuses.

[51] [1994] OJ L37/34, upheld in Case T-229/94 *Deutsche Bahn v. Commission* [1997] ECR II-1689; ECJ Case C-436/97P [1999] ECR I-2387.

[52] See Directive 91/440 on the development of the Community's railways [1991] OJ L237/25; *Twenty-fourth Report on Competition Policy* (1994).

[53] Case T-228/97 *Irish Sugar plc v. Commission* [1999] ECR II-2969 para. 167.

Both practices have the same effect – excluding a competitor from the dominant firm's market.[54]

Rivals' costs can also be raised indirectly through contractual agreements with customers that make it more expensive for competitors to lure customers away from their contracts with the dominant firm. For example, a long-term contract with a penalty clause can raise rivals' costs, because in order for the rival to induce the customer to switch, his price has to make it worthwhile for the customer to break the current contract, pay the penalty clause and buy the product from the new entrant. This scenario deters entry by raising costs and consolidates the incumbent's dominance.[55] While the penalty clause benefits both the dominant firm and the consumer (the monopolist can lower prices because he will collect rents when the penalty clause is enforced), prices would be even lower if other entrants could compete – the penalty clause excludes more efficient entrants. The consumer signs the contract because of uncertainty on his part about the entry of a cheaper supplier: after all, if all other consumers sign the long-term contract with the incumbent, then the new entry will not materialise.

A dominant firm will often use both direct and indirect means to eliminate a competitor, as evidenced by British Sugar's diversified strategy to raise Napier Brown's (NB) costs.[56] NB was a sugar merchant competing with British Sugar which dominated the retail market and which was also the largest producer of sugar in the UK, holding a dominant position upstream of NB. British Sugar's efforts to exclude NB included refusals to supply NB with industrial sugar, a move that would 'precipitate NB's withdrawal from the retail sugar market' and a discriminatory refusal to supply beet-origin sugar. Moreover, British Sugar raised NB's costs directly by reducing its retail sugar price by a margin greater than its costs of processing industrial sugar, a price neither NB, nor any other efficient firm, would be able to match because they bought industrial sugar from British Sugar and would have to include the cost of processing this in their retail price. In addition, British Sugar raised NB's costs indirectly by offering a rebate to buying groups who committed themselves to buying exclusively from it.

From an economic perspective, these practices can be challenged because they raise the cost to the dominant firm's rivals, reducing their output, allowing the dominant firm to act like a monopolist once competitors exit. Professors Krattenmaker and Salop have proposed a two-step analysis for exclusionary

[54] See also *Deutsche Telekom* [2003] OJ L263/9, where the wholesale price of the essential facility owned by the dominant firm was higher than its retail price, preventing profitable entry at the retail level: discussed further in ch. 12.

[55] J. F. Brodley and C. A. Ma 'Contract Penalties, Monopolizing Strategies, and Antitrust Policy' (1993) 45 *Stanford Law Review* 1161, drawing upon P. Agihon and P. Bolton 'Contracts as a Barrier to Entry' (1987) 77 *American Economic Review* 388, and illustrating this with reference to Case C-333/94P *Tetra Pak v. Commission* [1996] ECR I-5951.

[56] *Napier Brown/British Sugar* [1988] OJ L284/41.

practices: first, whether the conduct in question 'unavoidably and significantly increases the costs of its competitors' and, second, whether raising rivals' costs 'enables the excluding firm to exercise monopoly power – that is, to raise price above the competitive level'.[57] The anticompetitive conduct takes place in two stages: in the first stage rivals' costs are raised, in the second, the newly acquired power is exploited. One significant difficulty in translating this method into competition law enforcement is that competition authorities intervene at the first stage. If intervention is delayed until the second stage (only punishing the exploitation of a dominant position, and not the exclusion of rivals) then any remedy is unlikely to restore the market to the status quo ante, as competitors have already exited and new entrants may take time to have an impact. It is imperative for the enforcement action to take place at the time when the dominant firm is excluding rivals. At this stage one should establish whether the practices of the dominant firm are likely to eliminate rivals and give the aggressor the power to raise prices. This creates the risk of Type 1 errors in that the competition authority might punish efficiency-enhancing conduct by dominant firms: often the conduct in question seems to benefit consumers by bringing lower prices. A particularly demanding task is to distinguish harmful from beneficial means of competing.

We have illustrated various strategies for raising rivals' costs that have been deployed by dominant firms in the EC; however, the Community's practice in these cases eschews the kind of analysis proposed by Krattenmaker and Salop. The EC penalises the dominant firm only upon a showing that the costs to rivals have been raised, and often it does so without even quantifying expressly by how much those costs have increased. This is not because the EC presumes that the dominant firm will exploit its dominant position upon proof of anticompetitive exclusion, rather that exclusion in itself is an abuse of dominance, suffocating the economic freedom of market players. However, the Commission's approach requires only slight analytical modifications so as to fit within the economics-oriented framework explained above. First the Commission should quantify the degree of exclusion that the practices are likely to have, and consider whether there are any entry barriers. The Commission should have evidence to show that the exclusion of the rival is sufficient to confer upon the dominant firm the power to raise prices after exclusion. This kind of evidence is not impossible to obtain and would eliminate the risk that Article 82 is used to protect a competitor whose existence on the market is not necessary to guarantee consumer welfare. To exemplify the different kinds of factual evidence that would be required, we may consider the Commission's decision on tariffs for piloting in the Port of

[57] T. G. Krattenmaker and S. C. Salop 'Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price' (1986) 96 *Yale Law Journal* 209, 214. The authors' analysis is based upon cases alleging a breach of s. 1 of the Sherman Act but they suggest that the same type of analysis applies, *mutatis mutandis*, to s. 2 Sherman Act cases (p. 292).

Genoa.[58] The Commission found that the Corporation of Pilots of the Port of Genoa had an exclusive right to offer piloting services and thus a monopoly. Piloting rates discriminated against certain transport firms, with the effect that four firms were quoted rates 65 per cent lower than their competitors. In analysing the anticompetitive impact of this discrimination, the Commission concluded that the effect was to place 'any other operating company or company wishing to gain access to the route at a competitive disadvantage'.[59] This does not go far enough to prove adverse effects because, on the routes in question, there remained a number of competitors. The Commission should investigate further whether the favoured undertakings were behaving in a cartel-like manner, taking advantage of the high entry barriers created by the price discrimination, and whether the price discrimination practised by the port authorities had the effect of excluding potential competitors that would have broken up any anticompetitive behaviour by the four favoured firms.

It is likely that the Commission will be able to find evidence that the rivals' exclusion strengthens the market power of the protected firms, and also evidence that the practices are having an adverse effect on competitors. For instance, in its decision on landing fees in Brussels,[60] the discriminatory fees favoured Sabena over British Midland, which at the time was a new company making heavy inroads into Sabena's market. It would be possible to find evidence establishing that by eliminating British Midland, Sabena's prices would increase, perhaps noting how Sabena's prices changed upon British Midland's entry into the market. Moreover, it would be important to consider not only whether British Midland's costs were raised but also whether there were any other competitors whose costs were equally raised, thereby estimating the true degree of foreclosure achieved by the discriminatory practices so as to gauge the risk of anticompetitive pricing. Instead, in both of these cases the Commission was more interested in showing that the measures were protectionist, designed to favour national firms.[61] While the Commission's concerns over market integration might have led, incidentally, to a result that is consistent with economic welfare, a more explicitly effects-based examination of the facts would render these decisions compatible with an economics-based analysis of abuse. The risk the Commission runs, of course, is that if the economic evidence shows that the discriminatory tactics have no foreclosure effects, then the dominant firm is free to carry out what has been considered the most egregious breach of EC competition law: partitioning the internal market.

A decision which is in line with the approach canvassed above is *Tetra Pak 1*. Here, Tetra Pak, dominant in the market for UHT milk packaging, acquired Liquipak. Liquipak held an exclusive licence over a new method of UHT milk packaging which, prior to the merger, was being developed jointly with Elopak. With the merger, the exclusive licence belonged to Tetra Pak. The effect of the merger was to prevent Elopak from entering the market, where Tetra held a

[58] [1997] OJ L301/27. [59] Ibid. para. 13. [60] [1995] OJ L216/8. [61] Ibid., especially para. 17.

market share of 91.8 per cent in UHT machines and where there were no other likely competitors given the high costs of entry. The Commission concluded that the acquisition of the licence was an abuse because it 'raised considerably or even insurmountably the barriers to entry. The effect of blocking or delaying the entry of a new competitor is all the more serious in a market such as the present one already dominated by Tetra because a new entrant is virtually the only way at the present time in which Tetra's power over the market could be challenged.'[62] Here the Commission's analysis is preferable to that in the other decisions because there is evidence that Elopak would have entered but for Tetra's acquisition of the licence, and that there were no other competitors likely to penetrate the market. Having raised the only rival's costs, Tetra Pak obtained the power to exploit its dominance.[63]

In sum, if the Commission wishes to condemn exclusionary tactics using a more economics-oriented framework, then a dominant firm's tactics which exclude rivals should not be condemned merely upon proof of anticipated exclusion or possible exclusion, or the fact that the conduct is not competitive on the merits. To safeguard economic freedom to such levels is counterproductive because it allows inefficient firms to remain in the market, excluding more efficient market participants. By attempting to promote economic freedom one might stifle it. On the contrary, economic freedom would be maximised by penalising dominant firms only when the evidence shows that the exclusionary tactics may facilitate monopoly pricing. That is, drawing on the second limb of the abuse test set out at page 171, the Commission should prove how far objectionable conduct is likely to have anticompetitive effects.

3.2 Below-cost pricing

Below-cost pricing can exclude or discipline competitors, increasing the market power of the dominant firm. In contrast to the above exclusionary tactics, where harm is caused by targeting the rival (e.g. by dealing with it so as to raise its costs), below-cost pricing harms rivals by encouraging consumers to switch away from the products offered by the rival. In the jargon this technique is known as *predatory pricing* and defined as 'a response to a rival that sacrifices part of the profit that could be earned under competitive circumstances were the rival to remain viable, in order to induce exit and gain consequent additional monopoly profit'.[64] The main challenge in penalising such practices is that it is hard to distinguish between fair, aggressive pricing (which is an

[62] *Tetra Pak 1 (BTG Licence)* [1988] OJ L272/27 para. 47.
[63] For completeness, it should be noted that after the Commission issued a statement of objections, Tetra Pak renounced exclusivity over the licence, but a decision was issued in the interest of establishing a precedent. The nature of the abuse was not raised in the appeal, Case T-51/89 *Tetra Pak Rausing SA v. Commission* [1991] ECR II-309.
[64] Ordover and Willig 'Economic Definition of Predation' p. 9.

essential ingredient of competitive markets) and unfair, predatory pricing. Part of the difficulty in this area is due to fuzzy terminology: literally, to describe a tactic as predatory implies an act of aggression against the competitor, but if this is the case then predatory pricing encompasses *any* pricing strategy which has exclusionary effects; the label is too broad. Accordingly, the discussion here will focus upon *below-cost* pricing, and other sections explore other pricing strategies that might have exclusionary effects.

The US Supreme Court has expressed doubts about the likelihood that firms would engage in below-cost pricing, by considering the Chicago School's critiques. First, a decision to engage in below-cost pricing is very costly, as it is unclear how long the prices have to be set below cost in order to drive out competitors. Second, the last firm standing must be able to raise prices to an anticompetitive level so as to recoup the losses it has suffered. Almost inevitably high prices invite new entrants, reducing the predator's profits, making the strategy unworkable. Given the considerable cost, uncertainty and risk present in any decision to engage in a below-cost pricing campaign, the Supreme Court reached the conclusion that 'predatory pricing schemes are rarely tried, and even more rarely successful'.[65]

This scepticism has been called into question. Consider the following snapshot of scenarios where below-cost pricing is possible.[66] First, when the dominant firm has vast resources with which to finance an aggressive pricing campaign, and the prey only enough resources to fight the predator for a short time, then below-cost pricing is rational. Second, a bout of below-cost pricing may suffice to establish a 'reputation' for below-cost pricing, thereby deterring entry.[67] Here the dominant firm needs to reduce price in only one market, making the victim believe that it is capable of a more widespread pricing tactic. Third, a 'cost signalling' strategy can be designed to make the prey believe that the dominant firm has lower production costs than the prey. Fourth, below-cost pricing might be a tactic to 'soften up' a potential takeover target, lowering its value before launching a takeover bid.[68] The success of these four tactics relies on informational asymmetries: in the first, the dominant firm knows how many resources the prey has, while in the 'reputation' and 'softening up' models, the prey is ignorant of the true costs or motivation of the predator. In the reputation model, it is unnecessary for the dominant firm to be able to

65 *Matsushita Elec. Industrial Co. v. Zenith Radio* 475 US 574 (1986). For a Chicago view, see F. H. Easterbrook 'Predatory Strategies and Counterstrategies' (1981) 48 *University of Chicago Law Review* 263.

66 For a summary but more formal economic exposition, see J. Church and R. Ware *Industrial Organization – A Strategic Approach* pp. 647–58 (Boston: Irwin McGraw Hill, 2000).

67 P. Milgrom and J. Roberts 'Predation, Reputation and Entry Deterrence' (1982) 27 *Journal of Economic Theory* 280; D. Kreps and R. Wilson 'Reputation and Imperfect Information' (1982) 27 *Journal of Economic Theory* 253; G. Saloner 'Predation, Merger and Incomplete Information' (1987) 18 *RAND Journal of Economics* 165.

68 M. R. Burns 'Predatory Pricing and the Acquisition Costs of Competitors' (1986) 94 *Journal of Political Economy* 266.

drive the competitor out of business, but the competitor believes that the dominant firm is able to afford an extensive predatory pricing campaign and this suffices to deter entry. These strategies can lead to the competitor exiting the market, or to it refusing to make new investment and innovate, and at the same time may deter other potential entrants, effects that benefit the dominant firm and reduce economic welfare.[69]

However, these economic insights have had little impact upon legal standards.[70] Courts have suggested that below-cost pricing is abusive when the prices of the dominant firm fall below a certain measure of cost.[71] In the EC, prices below average variable cost (AVC) are always predatory, while prices below average total cost (ATC) (variable costs plus fixed costs, i.e. costs that do not vary according to quantities produced) but above AVC may be predatory when there is evidence of a plan to drive out a competitor.[72] The justification for a cost-based standard is that a firm setting a price which does not cover its variable costs is acting irrationally because it fails to recover any of its production costs. The inference is that it is choosing to suffer a temporary loss as a means of ousting a competitor. When prices are above AVC and below ATC the firm is recovering its marginal costs, which can be a rational short-term strategy, thus an inference of predatory pricing cannot be reached without evidence that the prices are set with the aim of ousting a competitor. Evidence of exclusionary intent includes prices that are unnecessarily low to compete with the other firms, and low prices charged only to customers that are loyal to the competitor while prices to the dominant firm's loyal customers remain high.[73]

If we refer back to the economic models summarised above, there are a number of problems in the decision to use cost as the means to determine predatory pricing. First, the cost-based standard might be over-inclusive because it fails to determine whether the elimination of a rival will reduce economic welfare. Thus it creates the risk of Type 1 errors: after all, consumers benefit when a firm sets low prices, and if the low prices do not lead to monopoly prices in the long term (that is, the dominant firm is unable to exclude competitors with its pricing strategy) then there is no consumer harm.

69 P. Milgrom 'Predatory Pricing' in J. Eatwell et al. (eds.) *The New Palgrave Dictionary of Economics* (London: Macmillan, 1987) pp. 937, 938.

70 Although predation by reputation has now been accepted as a credible strategy by some US courts: *Advo Inc. v. Philadelphia Newspapers Inc.* 51 F 3d 1191 (3d Cir. 1995); *Traffic Scan Network Inc. v. Winston* 1995 Trade Cas. (CCH) 71,044 (ED LA 1995). However, in both the facts did not support the reputation theory.

71 This approach was pioneered by Philip Areeda and Donald F. Turner in their seminal paper 'Predatory Pricing and Related Practices Under Section 2 of the Sherman Act' (1975) 88 *Harvard Law Review* 697.

72 Case C-62/86 *AKZO Chemie BV v. Commission* [1991] ECR I-3359 paras. 71–2. Note that neither the Commission nor the Advocate General used this approach. Most authors take the view that prices below AVC raise a presumption of abuse; however, the language of the Court is absolute.

73 Ibid. paras. 108, 115 respectively.

This is why the US Supreme Court has required that there must be evidence that the predator is able to recoup its losses for a finding of below-cost pricing to stick. This requires a showing that after the below-cost price predatory campaign the predator is able to set supracompetitive prices, or exploit some other advantage so as to recover the losses sustained during the predatory pricing campaign. The amount thus recovered must be 'sufficient to compensate for the amounts expended on the predation, including the time value of the money invested in it'.[74] According to the Court, recoupment is only feasible if the market structure facilitates it: the market should be concentrated and entry barriers high. This requirement sharpens the accuracy of the cost-based test, by minimising the cost of Type 1 errors. Second, the cost-based standard also raises practical questions as to which cost should be taken into account; in the United States the Supreme Court has declined to give guidance and a variety of different tests are used by Federal Circuits. In the EC the AVC standard is generally applied but is modified when it is necessary to take into consideration specific features of an industry.[75] When the cost benchmark is decided, there is the practical difficulty of measuring such costs, so the operational costs of this test are high. Third, the inclusion of an 'intention' requirement in the EC test is ambiguous, for surely most firms wish to see rivals disappear. As the United States Court of Appeals, Seventh Circuit, in *AA Poultry Farms Inc. v. Rose Acre Farms Inc.*, noted: 'Firms "intend" to do all the business they can, to crush their rivals if they can . . . Entrepreneurs who work hardest to cut their prices will do the most damage to their rivals, and they will see good in it . . .'[76] As a result, looking for evidence that the dominant firm planned the rival's demise is unhelpful: that information tells us nothing more than that the dominant firm sees the rival as a competitor to be concerned about. Finally, the gap between economic theory and legal standards is even wider in the EC because there is no obligation to show that predatory pricing will be successful. In *Tetra Pak 2* the appellants had pressed the Court to find that, in addition to below-cost pricing, the Commission should have to prove that the defendant had a reasonable prospect of recouping the losses incurred during the below-cost pricing campaign, but the ECJ was unwilling to take this step. In its view, 'it must be possible to penalise predatory pricing whenever there is a risk that competitors will be eliminated'

[74] *Brooke Group Ltd v. Brown & Williamson Tobacco Corp.* 509 US 209, 226 (1993).

[75] For example, in *Deutsche Post AG* [2001] OJ L125/27 paras. 8–10. Here Deutsche Post had a statutory public service obligation to be the carrier of last resort for parcels, which meant that it had to keep a parcel delivery infrastructure in place even without it operating. The Commission ruled that a price would be predatory if it was below the *incremental cost* of producing the individual service where the firm is accused of pricing predatorily, without including in this cost the running costs of the public service obligation. The effect of this was that in operating the new parcel service, Deutsche Post need not recover any of the variable costs that would have to be spent anyway given its public service obligation. The practical impact of this is that Deutsche Post is able to charge a price below the AVC as calculated following the *AKZO* rule.

[76] 881 F 2d 1396 at 1401–2 (1989).

because 'the aim pursued, which is to maintain undistorted competition, rules out waiting until such a strategy leads to the actual elimination of competitors'.[77] Again here, there is confusion between the elimination of a competitor and the elimination of competition – the disappearance of one firm does not necessarily lead to a reduction in consumer welfare.

The Court's aggressive below-cost pricing standard is more suited to the protection of economic freedom, but fits uncomfortably with economic standards. However, even from an economic freedom perspective the law is too aggressive as it focuses on the harm to a competitor without reflection on whether the competitive process is stifled. A possible compromise is to design a standard that only penalises conduct likely to harm the competitive process, and which is also in line with the Commission's wish to apply competition law to protect consumer welfare, thereby protecting both economic freedom and efficiency. An example might be the model proposed by Professors Bolton, Brodley and Riordan. They suggest a five-step inquiry to test whether below-cost pricing is occurring: (1) a facilitating market structure; (2) a scheme of predation and supporting evidence; (3) probable recoupment; (4) price below cost; and (5) absence of a business justification or an efficiencies defence.[78] The first three steps form part of a first tier of analysis, allowing a court to dismiss an action if the threshold requirements for successful predation are not met. This creates a mechanism to identify the plausible claims at least expense, and leaves for a second stage more complex factual issues. It also allows for an aggressive policy against below-cost pricing, embracing post-Chicago theories. The significant step for this purpose is the second. After establishing that the alleged predator has market power, the authors propose to investigate whether in the circumstances it would be rational for the firm to engage in a predatory pricing campaign. In the context of predation designed to send a signal to the prey so as to discipline it, the authors suggest that the following evidence would serve to demonstrate the plausibility of a predatory strategy based on reputation effects: (a) there must be two markets (either two geographical markets or two product markets) so that the predator can select one market to engage in its predatory strategy and there is a second market where the effects of predation are felt – i.e. the prey is discouraged from entering the other market; (b) if the reputation effect is such that potential entrants fear further predatory pricing by the firm, there should be evidence that recoupment is possible; (c) there should be evidence that the predator is deliberately pursuing a predatory strategy (for example, repetition of localised predation, or the dissemination of information to show unsuccessful entry caused by predation); (d) knowledge by entrants and potential entrants that the market is dominated by a firm with

[77] *Tetra Pak 2* [1996] ECR I-5951 para. 43. The Advocate General was even more categorical. In his view predatory pricing is in itself anticompetitive (para. 78).

[78] P. Bolton, J. F. Brodley and M. H. Riordan 'Predatory Pricing: Strategic Theory and Legal Policy' (2000) 88 *Georgetown Law Journal* 2239.

a reputation for predatory pricing. These facts serve to identify whether the market in question is susceptible to predatory pricing designed to create a reputation for predation. Once the market conditions demonstrate that the dominant firm is acting in a predatory manner, the cost standard is invoked. Even though economists agree that prices above total cost could be predatory, the predatory pricing test must afford a sufficient degree of certainty, especially when it comes to pricing decisions, which every firm will make on a regular basis. The test is necessarily under-inclusive (creating a risk of Type 2 errors) but above-cost predatory tactics are tolerated because it allows for a more workable rule (lowering costs of compliance).

An approach like this can serve to bring the law on below-cost pricing closer to identifying markets where below-cost pricing strategies are more likely to occur and be successful, allowing the abuse doctrine to evolve towards a standard based on consumer welfare, while at the same time offering dominant firms a rule which gives them a degree of certainty. Note that while embracing a post-Chicago theory reduces the protective scope of Article 82, this does not mean that the scope for growing the abuse doctrine is stifled. For example, the Community has not yet used the notion of 'reputation effects' in predatory pricing cases, but the model considered above would allow the Commission to apply Article 82 to these practices in a rigorous manner.[79] And by catching only conduct that damages the competitive process, the standard safeguards economic freedom more effectively than the current law.

3.3 Above-cost discounts

From an economic perspective, predatory pricing could entail above-cost prices also, but the model suggested above required below-cost pricing because it tolerates a Type 2 error for ease of compliance. There is also a risk that penalising above-cost discounts can lead to Type 1 errors: after all, above-cost discounts are efficient. The Commission however also penalises a firm that offers above-cost discounts but only if it does so in a selective manner when it finds evidence that the selective prices are designed to drive a competitor out of the market. Discounts have been found abusive when offered to customers who are likely to switch to a competitor's goods – these might be targeted at certain geographical areas, or at specific customers.[80] The findings of abuse have been restricted to firms that hold a particularly strong position on the market, suggesting that discriminatory discounts by dominant firms with less significant degrees of market power are not abusive. Moreover, in all cases the dominant firm used selective pricing as one tactic among others to exclude

[79] There is a hint of recognition that a dominant firm may create a 'reputation' for certain kinds of conduct in Case 27/76 *United Brands v. Commission* [1978] ECR 207 para. 192.

[80] For example, the 'border rebates' in *Irish Sugar* [1999] ECR II-2969 and the selectively low prices in *AKZO* [1991] ECR I-3359.

competitors, which facilitated the finding that the pricing was designed to exclude new firms. However, even when limiting the scope of the 'selective above-cost pricing abuse' in these ways, the law penalises efficient conduct: if the prices are not below cost, an equally efficient competitor should match the discounts and render the strategy worthless. Accordingly, the law protects the economic freedom of all firms, even those that are less efficient than the defendant.

3.4 Distribution agreements foreclosing entry

The Commission regularly condemns distribution agreements by dominant firms when their effect is to foreclose entry by potential competitors. The most stringent attack has been on discount and rebate schemes offered to distributors. The Commission's investigations are characterised by an extremely detailed examination of the kind of discount and rebate scheme in question, and the cases defy easy classification.[81] However, the Commission's approach is basically a two-step one.[82] First, the detailed analysis of the distribution contracts is designed to answer one question: do the rebates induce loyalty? The answer is inevitably in the affirmative, and is explained in this way: the distributor, before the discount, is already buying a large amount of goods from the dominant firm. As a result, a rebate offered if the distributor buys even more of its supplies from the dominant firm must induce loyalty. Second, loyalty-inducing rebates may be justified only if the discount reflects genuine cost savings. So far no firm has been able to offer such justification.

Applying the first limb, the Commission has found abuse in volume rebates (conditional on the customer obtaining all annual requirements exclusively from one firm);[83] target rebates (conditional on the customer reaching a set number of purchases);[84] and top slice rebates (discount only if the customer buys more than the usual amounts).[85]

Having shown that rebates are loyalty inducing, the rebate is abusive from the day the contract is signed. There is no need to prove likely effects; proof of

[81] For a more detailed analysis, see A. Jones and B. Sufrin *EC Competition Law: Text, Cases and Materials* 2nd edn (Oxford: Oxford University Press, 2004) pp. 419–50; L. Gyselen 'What is an Abuse of a Dominant Position? Rebates: Competition on the Merits or Exclusionary Practice?' in C.-D. Ehlermann and I. Atanasiu (eds.) *European Competition Law Annual 2003: What is an Abuse of a Dominant Position?* (Oxford: Hart Publishing, 2006). The Commission's discussion paper on Article 82 provides yet another means of classifying rebates.

[82] *BA v. Commission* [2003] ECR II-5917 para. 271.

[83] Case 85/76 *Hoffmann La Roche v. Commission* [1979] ER 461 para. 89; Joined Cases 40–8, 50, 54–6, 111, 113 and 114/73 *Suiker Unie v. Commission* [1975] ECR 1663; Case T-65/89 *BPB Industries and British Gypsum v. Commission* [1993] ECR II-389 para. 71.

[84] *Michelin 2* [2002] OJ L143/1.

[85] E.g. *Soda-Ash: Solvay* [1991] OJ L152/40; *Soda-Ash: ICI* [1991] OJ L152/40, annulled because of procedural irregularities (*Slovay SA v. Commission* [1995] ECR II-1821; *ICI plc v. Commission* [1995] ECR II-1846) but a new decision was adopted on the same ground as the earlier ones: *Soda-Ash: Solvay* [2003] OJ L10/10; *Soda-Ash: ICI* [2003] OJ L10/33.

the first two factors shows that rebates have an anticompetitive 'object' and so are unlawful: 'it is not necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned. It is sufficient in this respect to demonstrate that the abusive conduct . . . tends to restrict competition, or in other words, that the conduct is capable of having, or is likely to have, such an effect.'[86] Even unsuccessful attempts are abusive, provided they are *intended* to exclude competitors.[87] Moreover, in the few decisions where harm is discussed, the Court assumes that these tactics reduce consumer welfare without detailed analysis.[88] The level of concern over exclusivity agreements is so strong that the Commission is unwilling to excuse such an agreement even if it is a response to demands of powerful buyers.[89]

The Commission's policy has been criticised for deploying a per se prohibition against many discounting practices which are normal business behaviour.[90] Granted the dominant firm is able to offer discounts, but only if these reflect the dominant firm's cost savings (which would be the case with a discount purely linked with the volume of purchases which would allow the dominant firm to plan production in advance), or because the purchaser confers additional benefits on the dominant firm (e.g. prompt payment, or advertising the firm's goods).[91] Dominant firms may not use price strategically. This is unnecessarily restrictive because it ignores the possibility that a rebate scheme could be the most effective means of giving incentives to distributors to market goods aggressively, and therefore it is a cost-saving strategy. Alternatives might entail visits to distributors to inspect their practices, which are more costly and can breed ill feeling between contracting parties. However, there is an intuitive logic behind the Commission's per se approach, in that exclusivity agreements are important when launching a new product, and dominant firms, by their very dominance, do not need to promote their goods as much as new entrants. Furthermore, some might see the strict approach as a reflection of the economic freedom value in EC competition law whereby any restriction of economic freedom is chastised, an approach which is inconsistent with the economics-based approach that animates contemporary competition law.[92]

86 *Virgin/BA* [2000] OJ L30/1 para. 293; similarly, *Michelin 2* [2002] OJ L143/1 para. 239.
87 *BA v. Commission* [2003] ECR II-5917 para. 294.
88 E.g. *Hoffmann La Roche* [1979] ECR 461 para. 90.
89 *BPB v. Commission* [1993] ECR II-389 paras. 68 and 70 (affirmed by ECJ C-310/93P).
90 D. Ridyard 'Exclusionary Pricing and Price Discrimination Abuses under Article 82 – An Economic Analysis' [2002] *European Competition Law Review* 286.
91 *Hoffmann La Roche* [1979] ECR 461 para. 90; *BA v. Commission* [2003] ECR II-5917 para. 246 ('Quantity rebates are thus deemed to reflect gains in efficiency and economies of scale achieved by the dominant undertaking'). See the Commission's discussion of a settlement reached with Coca Cola, *Nineteenth Report on Competition Policy* (1989) pp. 65–6.
92 Kallaugher and Sher 'Rebates Revisited' are among the many to suggest that the economics-based transformation of Article 81 no longer justifies an economic-freedom-based approach under Article 82.

A simple way of reforming the law, as with other tactics that raise rivals' costs, can be to require that the Commission show that the rebates have an adverse effect on competition, by measuring the degree of foreclosure that results from the rebate. To date, this has not been proven. In *Soda Ash–ICI* we are merely informed that all major customers benefited from the rebates, but this is insufficient to show that ICI's competitors were excluded from the market.[93] Similarly, in *Hoffmann La Roche*, we know that the dominant firm entered into advantageous contracts with twenty-two of its biggest buyers, but there is no additional information about the degree of foreclosure caused by Roche's practices, nor about the minimum amount of sales necessary for competitors to remain in the market.[94] Moreover, in *BA/Virgin* evidence that the complainant's market share had increased during the period of the alleged abuse was deemed irrelevant, and in *Michelin 2* the market share of the dominant firm had been falling during the period of the abuse but this was not considered. The dicta in the leading rebate case, *Hoffmann La Roche*, suggest that the key to the abuse is the condition of loyalty and not the amount of goods that must be purchased exclusively from the dominant firm.[95] Moreover, the Commission never considers the fact that the victim is often not only in competition with the dominant firm, but also with other market players, and their impact is not taken into account. Nor does the Commission consider whether a rival is able to match the discount of the dominant firm or take other steps to increase its market share. Measuring foreclosure would bring the law in line with the approach taken for vertical restraints under Article 81.[96] Moreover, the value of economic freedom would be boosted by this approach because rebates that have no effect on competitors are allowed (so prices to consumers fall).

However, Kallaugher and Sher have argued that merely quantifying foreclosure is insufficient without further proof that the increased entry barriers are likely to lead to anticompetitive harm.[97] They show that in at least one decision, *Deutsche Post*, the Commission has done this.[98] Their suggestion

93 [1991] OJ L152/40 para. 17.
94 See E. M. Fox 'Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity and Fairness' (1986) 61 *Notre Dame Law Review* 981, 1011. Nor indeed is there any information on whether these discounts were forced upon Roche by powerful buyers.
95 *Hoffmann La Roche* [1979] ECR 461 para. 89.
96 See ch. 10. An analogous proposal would suggest that rebate cases should be assessed under Article 81 instead. See E. Rousseva 'Modernising by Eradicating: How the Commission's New Approach to Article 81 EC Dispenses with the Need to Apply Article 82 to Vertical Restraints' (2005) 42 *Common Market Law Review* 587.
97 Kallaugher and Sher 'Rebates Revisited'. The same position is taken by S. Bishop and M. Walker *The Economics of EC Competition Law* 2nd edn (London: Sweet & Maxwell, 2002), according to whom an abuse should be found when the practice causes a reduction in total output (para. 6.36).
98 *Deutsche Post AG* [2001] OJ L125/27 paras. 37–8 (for further detail on this decision see ch. 12 pp. 478–84).

tallies with the approach taken in the US courts. In *Concord Boat v. Brunswick*, for example, competitors of the leading manufacturer of boat engines challenged its rebate scheme but lost because they were unable to show that in the ten years during which the rebates were granted, there had been adverse effects on the market: the dominant firm's market share was receding and new entry had taken place.[99] However, based upon the Community's conception of consumer welfare, this additional step is not necessary. The Community is keen to see the entry of new competitors, on the assumption that their entry enhances consumer interests. The economic approach embraced by the Community is not a total welfare approach based upon maximising efficiency, but a standard premised upon facilitating market access by a plurality of firms. If so, the requirement to measure foreclosure is sufficient. Accordingly, in *Deutsche Post* the relevant finding which should become compulsory for all the commercial contracts is the following:

> Successful entry into the mail-order parcel services market requires a certain critical mass of activity (some 100 million parcels or catalogues) and hence the parcel volumes of at least two cooperation partners in this field. By granting fidelity rebates to its biggest partners, DPAG has deliberately prevented competitors from reaching the 'critical mass' of some 100 million in annual turnover.[100]

In this passage the Commission measures the degree of foreclosure, finding that the dominant firm prevented any entry into the relevant market by offering rebates to all major customers. Conversely, had the rebates been offered to only one customer, leaving the remainder free to utilise other parcel delivery firms, then the rebate should not be deemed unlawful. Under the economic freedom paradigm, modified to ensure consumer welfare via the presence of a plurality of sellers, it is unnecessary to go further and speculate whether the market would be more efficient with more participants.

3.5 Leverage

The practices detailed above harm or threaten to harm competitors in the same market as that of the dominant firm. However, the dominant firm may extend its power into other markets, thereby excluding competitors from a market it does not (yet) dominate. Leveraging is a general term that encompasses a variety of strategies that a firm might use to extend its market power from one market to another, for instance by tying, rebates or predatory pricing.[101] Two issues arise: first whether one should be concerned about leverage, and second whether Article 82 is an adequate legal tool to address this practice.

[99] 207 F 3d 1039 (8th Cir. 2000). [100] *Deutsche Post* [2001] OJ L125/27 para. 37.
[101] *Tetra Laval* [2002] ECR II-4381 para. 156.

3.5.1 Why is leveraging anticompetitive?

Leveraging may take many forms, one of which is tying, with the *Hilti* case providing a classical example.[102] A simplified version of the facts illustrates the economics of leveraging. Hilti manufactures a popular nail gun used in the building trade. To operate it the user has to purchase a cartridge and nails. The cartridge explodes when the nail is 'shot'. Once the nails are used up, a new cartridge and a new set of nails is needed. Cartridges and nails are used in fixed proportions. Hilti was dominant in three separate markets: nail guns, cartridges and nails. The Commission accused Hilti of abuse because it tied the sale of cartridges to that of its nails. That is, consumers wishing to buy a cartridge from Hilti had to buy Hilti nails. The effect of this tactic was to make entry of competing nail manufacturers more difficult.[103]

An economist looking at this factual matrix would say that Hilti is not guilty of anticompetitive practices because there is no evidence that, having eliminated all competing nail manufacturers, prices will increase: Hilti, the monopolist in the cartridges market which seeks to create a monopoly in the market for nails, is unable to obtain any extra profits through leverage because it cannot earn any extra profits on the sale of nails.[104] This conclusion can be explained with a simple example. Let us say that consumers are willing to buy the Hilti gun if the price for the spare parts (nails plus cartridge) is €6. At a higher price, the consumer switches to another nail gun, so €6 is the monopoly price for the two components. Say the market for cartridges is monopolised by Hilti and the market for nails is competitive, and the competitive price for nails is €1 and nails and cartridges are sold separately. In these circumstances, the monopolist will sell the cartridge at €5. If the cartridge price is set higher, consumers switch to another nail gun, making €5 the monopoly price for the cartridge. Tying cannot raise price, because the monopoly price for the tied goods is €6, whether or not there are competing nail manufacturers. So whether the monopolist ties or not, his monopoly profits are the same.

Now, let us say that a new, efficient, nail producer enters the market and sells nails at €0.50. Should this worry Hilti to such an extent that it will want to tie the sale of its cartridge to that of its nails? The answer is no, in fact Hilti should welcome this new, low-cost entrant because it allows Hilti to increase the price of the cartridge to €5.50 (the total price for the consumer is still €6, now Hilti pockets an extra €0.50). If an efficient nail manufacturer comes along, Hilti should shut down its inefficient nail production plant and benefit from the

[102] *Eurofix Bauco v. Hilti* [1988] OJ L65/19.
[103] Effects similar to this may be created less explicitly, for example by offering a discount if the customers agree to buy all their requirements (cartridge and nails) from the dominant firm (*Hoffmann La Roche* [1997] ECR 461), or by withdrawing a guarantee if the customer does not use the supplier's components: *Novo/Nordisk, Twenty-sixth Report on Competition Policy* (1996) pp. 142–3.
[104] A. Director and E. H. Levi 'Law and the Future: Trade Regulation' (1956) 51 *Northwestern University Law Review* 281.

efficient supplier's existence. The upshot of this example is that Hilti has no economic reason to tie the sale of the cartridge to its nails. The maximum price that Hilti can set for nails and cartridges is €6, so it cannot make greater profits by selling both goods. In fact, as the example shows, its profits increase when a more efficient nail seller arrives. Therefore, leverage may injure competing nail manufacturers, but has no adverse welfare consequences.[105] This is the Chicago School position on tying. On this view, tying can only be explained on grounds of efficiency: for instance, it allows the manufacturer to ensure that consumers have the most suitable nails for the gun they buy (removing information costs), or it is actually cheaper for the manufacturer to make the two together than for the buyer to assemble the goods (e.g. shoes are sold in pairs).[106] As a result, it has been argued that the justification given by Hilti, that tying was designed to ensure that the nail gun operated safely, was probably plausible.[107] Moreover, unless the manufacturer has no safety concerns, it will prefer not to tie the cartridge to the nails, because in a more competitive nail market each nail manufacturer will try to make nails that work best with the Hilti gun, and this will increase demand for the monopolised product.

However, this analysis should not be taken to mean that tying is always pro-competitive and that leverage is an unrealistic strategy. Change the facts in Hilti slightly: assume that there are only two firms manufacturing nails for nail guns, and a number of nail gun manufacturers, with Hilti dominant. If Hilti ties sales of its cartridge to those of its nails, this reduces the amount of nails that the rival can sell. Perhaps this causes the rival nail producer to exit the market because the number of sales is too small and Hilti's practices prevent the competitor from realising economies of scale. This then gives Hilti a monopoly in the market for nails, and it can then exploit its monopoly vis-à-vis the consumers who use other nail guns, because now even those who do not use the Hilti nail gun must buy nails from Hilti. Tying is profitable because it gives Hilti monopoly power over customers that it had no market power over before. In this example, leveraging works in the same way as predatory pricing: it weakens rivals as a means of generating more market power for the dominant firm. Generalising from these two hypotheses, we can say that tying is not an effective leveraging strategy when the two goods are bought in fixed proportions and when there are no economies of scale, but that if goods are not bought in fixed proportions and there is a minimum efficient scale, then leveraging is a profitable strategy.

So far we have suggested that leverage is a profit-maximising strategy because when the dominant firm excludes all competition on the tied market it can then set monopoly prices vis-à-vis buyers of that product who do not buy other products made by the dominant firm (e.g. nails to those who buy

[105] H. Hovenkamp *Federal Antitrust Policy* (St Paul, MN: West Publishing, 1994) pp. 371–2.

[106] See further M. L. Katz and C. Shapiro 'Systems Competition and Network Effects' (1994) 8 *Journal of Economic Perspectives* 653, noting that in network markets technical tying can lead to efficiencies.

[107] B. Nalebuff 'Bundling, Tying and Portfolio Effects' (DTI Economics Paper No. 1, 2003) vol. 2 ch. 3.

other nail guns). However, leveraging can also give the dominant firm power to increase prices towards its own customers when the dominant firm leverages into an 'aftermarket'. As we noted in chapter 5, there are certain circumstances where consumers who buy goods do not think about the subsequent costs of spare parts or repair services.[108] In these contexts there is a market for the primary product (e.g. the nail gun in Hilti) and a separate market for the secondary products (e.g. the cartridge and the nails). *Hilti* was not analysed in these terms, but we can use the facts to think about why tying would be profitable if the purchaser of the nail gun did not think about the costs of the spare parts when he bought the gun. Having acquired the gun, this person is locked into the market for spare parts. Now it is profitable to raise the price of nails. Here, in contrast to the Chicago School model, there are two monopoly prices. An example may assist. Let us say that there is a monopoly producer of guns and spare parts and the price for the gun is €100, the cartridges and nails cost €6 and the lifespan of the gun is 100 cartridges, and the consumer notes that the total price for this system is €700 (if the consumer thinks in these terms, then there is no aftermarket). Assume a new entrant comes in selling the cartridge and nails for €3. A Chicago economist would suggest that the monopoly should not tie the gun and the nails but just raise the price of the gun and maintain the same amount of profit. (On the numbers above, the gun can be sold for €400, and the consumer still gets a 'system' of gun plus parts for €700.) However, this suggestion only works if the consumer thinks about the gun and the spare parts as one 'system', one single product. If, however, the consumer's choice of gun depends only on the price of the gun and the consumer does not take into account the price of the parts, then the price of the gun cannot go up in response to entry in the spare parts market. The gun's monopoly price is set independently from the monopoly price of the spare parts. Thus, when the new, more efficient entrant comes into the parts market, the incumbent loses profits on that market and cannot compensate by increasing the price of the gun. In these circumstances, leveraging to gain monopoly in the parts market is profitable because it is a new, distinct market which is worth monopolising.

Leveraging, therefore, can help extend a dominant position from one market to another. However, the effect this has on consumers can be more than just a higher price. In the Commission's decisions two additional harmful effects are identified: the consumer's reduced choice and the harm to innovation. These aspects are explored in some detail in the *Microsoft* decision.[109] Microsoft was

[108] See pp. 148–50.

[109] Decision of 24 March 2004. In what follows we assume that the Commission's findings of fact are correct. Much of the literature which criticises the Commission's decision is premised upon the view that the Commission did not understand the market. This may be true, but what is of more general interest is how the Commission, in contrast with the earlier tying cases, examined the adverse effects of tying. (The literature includes: K.-U. Kühn, R. Stillman and C. Caffarra 'Economic Theories of Bundling and their Policy Implications in Abuse Cases: An Assessment in the Light of the *Microsoft* Case' (2005) 1 *European Competition Journal* 85; Nalebuff 'Building'; M. Dolmans and T. Graf 'Analysis of Tying under Article 82 EC' (2004) 27 *World Competition* 225.)

found to have abused Article 82 in tying its operating system with Windows Media Player (WMP), making market access for competing media player software more difficult. The Commission reasoned that because consumers would find WMP pre-installed, they would use it and not install other competing media player software. The effect is that content providers (e.g. music companies) would wish to format their music so it could play on WMP and fail to format music to be played on other media player formats, thereby giving Microsoft a competitive advantage that had nothing to do with the quality of WMP but everything to do with Microsoft's dominance of the operating systems market.[110] The Commission's concern was that this would stifle competition in innovation in this market. According to the Commission, the 'normal competitive process' is for several firms to participate to invent better and better media player software, and tying would foreclose market access because nobody would be interested in investing resources in competing software which cannot be sold as a result of the tie.[111] More generally, the Commission also feared that tying in this market would reduce investment in other types of software because the profitability of new software developments would be stifled if Microsoft were to design a competing product and tie it to the operating system.[112] In the Commission's colourful language, tying

> shields Microsoft from effective competition from potentially more efficient media player vendors which could challenge its position. Microsoft thus reduces the talent and capital invested in innovation of media players, not least its own, and anticompetitively raises barriers to market entry. Microsoft's conduct affects a market which could be a hotbed for new and exciting products springing forth in a climate of undistorted competition.[113]

While readers with greater technological awareness than this author will be able to contest the truth of the facts upon which this analysis is built, the most significant aspect of the decision is the Commission's choice to explore the ways in which tying would cause harm to consumer welfare. The methodology is much closer to the economic models of leveraging than that displayed by the Commission in its earlier tying case law (e.g. *Hilti*). In contrast to the earlier cases where it was not clear what specific harm the consumer or society suffered when cartridges and nails were sold jointly, here the economic welfare losses of tying are set out in detail.

So far we have explored leverage from a dominated market *into* a new market. However, some have suggested that another common reason for tying is to practise 'defensive leverage':[114] that is, using tying to protect the monopoly position in the market which is already dominated. The facts of *US v. Microsoft* help explain how this may occur. Microsoft dominated the

[110] *Microsoft*, 24 March 2004, para. 891. [111] Ibid. para. 980.
[112] Ibid. para. 983. [113] Ibid. para. 981.
[114] R. C. Feldman 'Defensive Leveraging in Antitrust' (1999) 87 *Georgetown Law Journal* 2079.

operating systems market and tied sales of its internet browser (Explorer). The effect was to exclude other browsers. Competing browsers would have given consumers the opportunity of surfing the web and downloading applications that Microsoft would normally sell with its operating system. In the long term, this meant that consumers did not need to buy a Microsoft operating system because they would just use the Internet to obtain the software they wished. Documentary evidence obtained from Microsoft showed that this was precisely what the company feared. Thus, tying the operating system with the internet browser was necessary to maintain Microsoft's dominance in the operating systems market.[115]

Another defensive strategy can be suggested in leveraging in aftermarkets. Change the facts of *Hilti* slightly: assume that at first Hilti has a monopoly in the market for both cartridges and nails and is faced with a new entrant selling cartridges. In this context, tying is a strategy that allows the monopolist to eliminate the new entrant. Either the new entrant starts to manufacture both nails and cartridges, or it must exit the market because nobody wishes to buy an empty cartridge.[116] In this respect the abuse in the nail market is designed to protect the monopoly in the cartridge market. This is akin to the raising of rivals' costs strategies we have seen earlier.

In sum, there are plausible economic reasons for being worried about leveraging. However, it must be borne in mind that from an EC perspective, the anticompetitive nature of tying is not based only upon concerns over efficiency. In *Tetra Pak 2* for example, tying is characterised as an abuse because it 'deprives the customer of the ability to choose its sources of supply and denies other producers access to the market'.[117] It is important to note that this passage embodies two distinct concerns. First, the harm to consumers is associated with the *exploitation* of a dominant position.[118] However, the Commission, until *Microsoft*, never investigated in detail what the nature of this harm entailed, so that it seems as if 'consumer choice' is beneficial in itself; thus even if it were shown that prices would be higher with more competitors in the market, the Commission would still find an abuse. Second, the passage refers to the exclusionary potential of tying but there is no attempt to test how far the exclusion of rivals harms consumers.

The themes of this discussion are similar to those we have broached earlier: there are competing economic theories about when tying harms consumer welfare, but the Commission's decisions (except for *Microsoft*) are not based

[115] For a helpful account, see M. D. Whinston 'Exclusivity and Tying in *US v. Microsoft*. What We Know, What We Don't Know' (2001) 15 *Journal of Economic Perspectives* 63. See also G. Monti 'Article 82 and New Economy Markets' in C. Graham and F. Smith (eds.) *Competition, Regulation and the New Economy* (Oxford: Hart Publishing, 2004) pp. 36–40.
[116] M. D. Whinston 'Tying, Foreclosure and Exclusion' (1990) 80 *American Economic Review* 837.
[117] Case T-83/91 *Tetra Pak v. Commission* [1994] ECR II-755 para. 137 (see also *Hoffmann La Roche* [1979] ECR 461 paras. 89–90).
[118] *Eurofix Bauco v. Hilti* [1988] OJ L65/19 para. 75.

upon any of these models. Embracing economic analysis does not mean that the decisions in *Hilti* and *Tetra Pak 2* would be different, but it requires a different analytical method to establish the anticompetitive effects of the practices in question.

3.5.2 Extending the concept of abuse

Having determined that, whether for economic or political reasons, some forms of leveraging are of concern, we must confront one legal issue. Leveraging occurs in a different way from the other abuses. In the case of 'defensive leveraging', the firm dominant in market A carries out activities in market B to protect market A. In cases where leveraging is used to extend dominance into another market, the dominant firm has two options. First, assume that market A is a raw material and the dominant firm is the sole manufacturer; it can then leverage into market B by refusing to supply the raw material to other downstream firms. Here the abuse is committed in the dominated market, but the effects are felt in the non-dominated market. Second, consider the situation where a tie of products A and B leads to the elimination of competitors in market B. Here, dominance in market A is abused to gain power in market B. Can competition law apply when dominance and the benefits from the abuse occur in separate markets?

Leveraging claims have been greatly facilitated by two early rulings of the ECJ: *Commercial Solvents* and *Continental Can*. In the first the Court held that Article 82 applies to an abuse in one market causing anticompetitive effects in a downstream market. The second judgment was even more sweeping as the ECJ ruled that Article 82 could block as abusive a merger by which a dominant firm increased its dominance, while denying any need to show that the dominant position had to be used to achieve the abuse.[119] These two cases sever causal links between the dominant position and the abuse – making it possible to develop Article 82 to address leveraging practices. These two rulings came at a time when the Court of Justice was widening the reach of Community law more generally, and there is a risk that reading them literally would extend the scope of Article 82 too far, so it is worth considering how the later case law has interpreted them.

In *Tetra Pak 2*, Advocate General Colomer reconsidered the seminal cases and proposed a helpful analytical structure we reproduce schematically opposite.[120] He had no qualms in saying that the abuse doctrine could apply in the first three categories, as the case law had already established this. This is sufficient to allow

[119] Joined Cases 6 and 7/73 *ICI and Commercial Solvents v. Commission* [1974] ECR 223; Case 6/72 *Europemballage Corporation and Continental Can v. Commission* [1973] ECR 215. The same point was repeated in *Hoffmann La Roche* [1979] ECR 461 para. 91, where the Court held that abuse does not imply that the dominance is the means by which the abuse is brought about.

[120] *Tetra Pak* [1996] ECR I-5951 paras. 34–62. For a similar tabular analysis, see R. Whish *Competition Law* 5th edn (London: Lexis Nexis, 2003) pp. 200–2.

Table 6.1 Dominance, abuse and anticompetitive effects

	Dominance	Abuse	Effects
1	Dominance in market A	Abuse in market A	Effect in market A
2	Dominance in market A	Abuse in market A	Effect in market B where firm has no dominance
3	Dominance in market A	Abuse in market B where the firm is not dominant	Effect is to strengthen dominance in market A
4	Dominance in market A	Abuse in market B where the firm is not dominant, and where B is a market related to A	Effects felt in market B
5	Dominance in market A	Abuse in an unrelated market B	Effects in market B

some leveraging claims. The second category allows the Commission to catch leveraging when it is practised by a refusal to supply,[121] and also when leveraging is accomplished through tying: the tie is an abuse of dominance in the dominated market which allows the firm to make gains in the non-dominated market. The third category allows the Commission to catch 'defensive' leveraging, as the CFI ruled in *British Gypsum*.[122] Here the firm was dominant in the market for plasterboard (market A) and offered preferential treatment to customers on the separate market for plaster (market B) who were loyal to it on the market for plasterboard. The conduct on the plaster market was designed to safeguard the firm's position on the dominated market.

Consider now the fourth and fifth categories. Can we extend the abuse doctrine when the abuse and the benefits take place in non-dominated markets? The Advocate General in *Tetra Pak 2*, with whom the Court agreed, held that the abuse doctrine could apply to category four, but not to category five. The facts of *Tetra Pak 2* are necessary to understand the Court's wish to draw a line between categories four and five. Tetra Pak was dominant in the market for aseptic packaging (which is used for packaging liquid and semi-liquid food products), which consists of two distinct markets: that for aseptic packaging machines and that for aseptic cartons that can be used on the machines. Its market shares in these two markets were very high (92 per cent and 89 per cent). Tetra Pak also had a strong, but not dominant, position in the markets for non-aseptic packaging (52 per cent of the market for non-aseptic machines and 48 per cent of the market for non-aseptic cartons). Two of the abuses carried out by Tetra Pak took place in the non-aseptic markets: it tied the sale

[121] *Commercial Solvents* [1974] ECR 223.

[122] Case T-65/89 *BPB Industries and British Gypsum v. Commission* [1993] ECR II-389, upheld on appeal in Case C-310/93P *BPB Industries and British Gypsum v. Commission* [1995] ECR I-865.

of machines to the sale of cartons and it engaged in below-cost pricing of non-aseptic machines in the UK.

The Court found that the abuse doctrine could apply to acts committed on the non-dominated market because there was a close relationship between the aseptic and non-aseptic sectors. The Court noted that there were 'associative links' between the two packaging systems: many customers bought both systems and Tetra Pak's closest competitor was active in both markets.[123] Moreover, the combined market shares gave Tetra Pak 78 per cent of the total packaging market, seven times more than its nearest competitors, and its 90 per cent share of the aseptic market made it a 'favoured' supplier of non-aseptic systems.[124] As a result, it was as if Tetra Pak held a dominant position on the packaging market taken as a whole.[125] The Court was careful to suggest that all the special circumstances that were found in this market were necessary to justify the application of Article 82 to acts in a market where the firm has no dominance and which are designed to benefit the firm on that non-dominated market.

This ruling does not allow for the application of Article 82 where a firm, dominant in the market for, say, postal services, decides to enter the market for toothpaste and engages in below-cost pricing on the toothpaste market, using its high profits in the postal services market to finance an aggressive pricing campaign. This limitation is not entirely logical. On the one hand, it is normally the case that a dominant firm will try to leverage its market power in a closely related market, because that is commercially the most advantageous way to extend one's market power. A manufacturer of a technologically complex product will try to leverage its position in the market for repair,[126] a seller of goods which require specialist transportation might sell its goods only by delivery contracts so that it can strengthen its position in the market for delivery,[127] but this is not necessarily the case: a conglomerate firm dominant in a wide range of products might set predatory prices in a market it seeks to dominate and recoup those losses in another, wholly unrelated market where it holds a dominant position. Similarly the Court's ruling may preclude a finding of leverage where a firm dominant in one geographical market attempts to extend that dominance in another geographical market, by predatory or discriminatory pricing. However, this practice has been witnessed in the US. For instance, in *US v. Griffith* a regional cinema firm had the only cinema in certain cities and used this monopoly position to force film distributors to grant it favourable dates for films in towns where it competed with other cinemas.[128] Comparable attempts to conquer new geographical markets should be covered by Article 82 given that their potential anticompetitive effects are no different from other leveraging strategies.

[123] *Tetra Pak 2* [1996] ECR I-5951 para. 29. [124] Ibid. para. 28. [125] Ibid. para. 31.
[126] E.g. *Eastman Kodak Co. v. Image Technical Services Inc.* 504 US 451 (1992).
[127] *Napier Brown/British Sugar* [1988] OJ L284/41. [128] *US v. Griffith* 334 US 100 (1948).

However, Advocate General Colomer in *Tetra Pak 2* suggested that it would be undesirable to extend the abuse doctrine where there is no link between the dominated market and that where the abuse occurs. In his view the presence of dominance on an unrelated market does not necessarily give a firm an advantage. If on market B there are two multinationals that are in competition, Company 1 which is dominant in market A and Company 2 which has a significant market share in a range of other markets but no dominance, then it seems unfair to deprive Company 1 of the advantages it can reap from its dominant position, while leaving Company 2 free to draw upon its resources from other markets to mount aggressive pricing campaigns in market B. To apply competition law to Company 1 would deprive it of the ability to compete under conditions of equality, and would not contribute to maintaining undistorted competition.[129] This argument is not particularly compelling because if a firm has a monopoly and has exploited it to gain significant revenue which it then invests in a new market, then it is not in the same position as other competitors in that new market. Arguably in this context, however, competition law should prohibit the firm's excessive prices in the dominated markets, rather than its ventures in new markets. Nevertheless, if a dominant firm has a special responsibility not to hinder the competitive process, it might be argued that this extends to any of its corporate activities.[130]

4 Harm to other market participants

A dominant firm also abuses its dominant position when it restricts the freedom of non-competitors. This occurs in distribution agreements where the harm is the distributors' inability to exercise their commercial freedom to look elsewhere for goods, to diversify their business and to look for other suppliers. Often, the primary basis for penalising the dominant firm is the foreclosure of competitors, but regular mention is also made of the injury which distributors suffer. For example, in *Michelin* the ECJ held that abusive discounts 'tend to remove or restrict the buyer's freedom to choose his sources of supply' and as a result 'bar competitors from access to the market'.[131] The general principle animating the protection of other market participants was explained by Arved Deringer:

> The purpose of the competition rules is to preserve the freedom of choice of those who transact business in the market as well as the free interplay of supply and demand in competition. The exploitation is therefore an abuse where the

[129] AG Colomer in *Tetra Pak 2* para. 42.
[130] For example, the CFI in Case T-175/99 *UPS Europe SA v. Commission* [2002] ECR II-1915 para. 55 suggested that if a firm subsidises a merger through excessive profits made in a sector where it has a statutory monopoly, this might give grounds for challenging the merger.
[131] *Michelin 1* [1983] ECR 3461 para. 73.

dominant position is used to restrain or eliminate the freedom of decision in competition either of competitors or the consumers.[132]

A dominant firm may be penalised for causing harm to distributors *independently* of any effect on consumer welfare. As the ECJ put it in *United Brands*, it is important to preserve 'the independence of small and medium sized firms in their commercial relations with the firm in a dominant position'.[133] The most remarkable exemplification of this approach can be found in the *Michelin 2* decision. The Commission found that specialised tyre dealers were 'placed despite themselves in a situation of economic dependence that makes Michelin an unavoidable partner'.[134] Having established such power over retailers, the Commission went on to condemn a raft of rebate schemes as unfair – some rebates were awarded so late that dealers were forced to sell at a loss, placing them in a precarious situation also with respect to subsequent negotiations with Michelin.[135] Moreover, the Commission found that dealers' experience of Michelin's bonus scheme was arbitrary. For example, the contracts with dealers included a 'service bonus' linked to the quality of service offered by the dealer to his customers, and the level of quality was something that Michelin would measure. This was condemned because it 'allowed the manufacturer's representative to put strong pressure on the dealer as regards future commitments and allowed him, if necessary, to use the arrangement in a discriminatory manner'.[136] In these passages the Commission is condemning unfair contractual practices that harm distributors, not anticompetitive practices.

Article 82(c) provides a specific example of abuse that is designed to protect customers of the dominant firm, whereby abuse may consist in 'applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage'. This provision is often applied in cases where anticompetitive rebates are found, because the rebates discriminate among dealers, thereby placing them at a competitive disadvantage vis-à-vis each other.[137] For example, in *Irish Sugar* the seller (dominant in the sugar market) granted rebates to sugar manufacturers who exported their processed products, but the rebates varied among customers and were not awarded to manufacturers who sold in Ireland. The discrimination was twofold: between different exporters, and between exporters and non-exporters. The Courts assume that if there is discrimination then the distributor who receives the higher price is placed at a competitive disadvantage.[138] This assumption stems from the economic freedom roots of the abuse doctrine.

[132] A. Deringer *The Competition Law of the European Economic Community* (Chicago: CCH, 1968) para. 533 pp. 166–7.
[133] *United Brands* [1978] ECR 207 para. 193. [134] [2002] OJ L143/1 para. 204.
[135] Ibid. paras. 218–25. [136] Ibid. paras. 250–3.
[137] *Suiker Unie* [1975] ECR 1663 paras. 522–5; *BA v. Commission* [2003] ECR II-5917 para. 235.
[138] *Irish Sugar* [1999] ECR II-2969 para. 138.

Another manifestation of the Community's concern with the protection of customers is found in *United Brands*. The dominant firm's termination of the contract with its Danish supplier (Olesen), on grounds that Olesen had failed to promote United Brands' bananas effectively, was declared a breach of Article 82. The Court articulated a general principle that a firm with a well-known product was not entitled to cease supplying a long-standing customer who abides by normal commercial practice if his orders are in no way out of the ordinary. While the Court also noted that *consumers* might suffer harm as a result, it is hard to see how this damage would result on the facts of the case, since Olesen did not disappear from the market, and since there is no evidence that consumer prices rose. It has been suggested that United Brands' abuse was the request that Olesen distribute UBC's bananas on an exclusive basis, but the judgment is cast in wider terms. Perhaps the Court's concern is about the signal that UBC's termination might send to other distributors who would now be more careful and seek not to upset UBC's practices. In this light the termination might be a strategic move to discipline all distributors and force them to remain loyal to UBC. However, this possible strategy is not explored, and UBC is punished for terminating a contract with a long-standing customer without justification.[139]

That competition law should regulate contractual practices vis-à-vis contracting parties appears odd at first sight – it seems as if competition law is taking the place of contract law, where we also find principles that seek to protect weaker contracting parties. However, this kind of regulation is intimately related to the economic freedom paradigm that guides competition policy in the EC. On the other hand, Professor Gerber has argued that these decisions manifest a concern about 'relational' market power whose exercise could harm economic welfare as well as individuals subjected to that power.[140] Of course it is possible to articulate ways in which discriminatory treatment of dealers might harm economic welfare: if some are forced to exit from the market, intrabrand competition is reduced; if enough leave the market, the distribution network may become inefficient. However, no theory of economic harm is presented in the case law, whose reasoning fits more comfortably within the economic freedom paradigm.

An American reader might see little to distinguish some of the case law summarised above from that under the Robinson–Patman Act.[141] This statute prohibits price discrimination when this would harm competitors. In a majority of Appellate Circuits, defendants are not able to plead that even though price discrimination caused damage to one buyer, the market is still competitive because Congress intended 'to protect individual competitors, not just

[139] *United Brands* [1978] ECR 207 (a discreet mention of the signalling theory is in para. 192).
[140] D. J. Gerber 'Law and the Abuse of Economic Power in Europe' (1987) 62 *Tulane Law Review* 57, 93–4.
[141] 15 USCA s. 13(1).

market competition'.[142] This Act has been roundly criticised as inappropriate in a sound competition system but shows it is possible for a system of competition law to embrace both economic and populist considerations, in so far as the legislative intent to do so is clear. The US thus shares a tension similar to that currently facing the EC: the majority of the case law is concerned with monopoly that harms consumers, but certain strands have a wider protective scope. The case law also shows, however, a reluctance by the Supreme Court to afford this statute too much scope, by interpreting it, so far as possible, in a manner broadly consistent with antitrust policy, and so it has recently refused to apply it when the firm accused of price discrimination was active in a competitive market.[143]

5 Market-partitioning abuses

Market integration is a core value for EC competition policy and the abuse doctrine extends to these practices. Infringements that 'jeopardize the proper functioning of the single market, such as the partitioning of national markets' are very serious and deserve the highest fines.[144] We distinguish between two types of cases: first those where the disintegration of the market is a factor that aggravates an abuse, and second those where market disintegration is the reason for a finding of abuse, and where the principles underpinning Article 82 are extended to facilitate the integration of the common market.

5.1 Market disintegration as an aggravating factor

Many of the decisions reviewed above are based not only on damage to market players, but also on market-partitioning effects. For instance, the rebate schemes in *Michelin 2* were penalised for their loyalty-inducing effects and for their market-partitioning effects. The latter were explained as follows: the rebates were available only from purchases made via Michelin France and not from other subsidiaries; moreover the high level of prices in France before the rebates discouraged purchases in France from abroad, especially as the rebates were not available to dealers outside France. The upshot was that dealers in the French market were even more dependent upon Michelin France.[145] It is easy to see how sealing off the French market from imports would serve to facilitate

[142] *Chroma Lighting v. GTE Products Corp.* 111 F 3d 653, 657 (9th Cir. 1997).

[143] *Volvo Trucks North America Inc. v. Reeder-Simco GMC Inc.* 546 US __ (2006). The ratio decidendi was that Volvo had not engaged in discrimination, by giving the concept a very restrictive meaning, but obiter it also noted a lack of market power, suggesting that even if the plaintiff's discrimination argument was correct, the court would resist an interpretation of the Act that would protect existing competitors; rather the law should stimulate competition.

[144] *Guidelines on the Method of Setting Fines Imposed Pursuant to Art. 15(2) of Regulation 17* [1988] OJ C9/3.

[145] *Michelin 2* [2002] OJ L143/1 paras. 240–6.

anticompetitive behaviour, for Michelin's dominance is consolidated. Less clear is the anticompetitive effect on dealers outside France. Clearly their freedom to select Michelin tyres from the French subsidiary is restricted but there is no explanation of any adverse welfare effects on markets outside France, though such proof is unnecessary given the importance attached to the ability to buy goods across borders. Similarly in *Deutsche Post*, the gist of the abuse was a rebate scheme that foreclosed access to the German parcel delivery market, but because the excluded competitors were from outside Germany, this aggravated the abuse: 'this walling off of a national market affects the development of trade to an extent highly inimical to the Community's interests'.[146]

5.2 Market disintegration as the reason for the finding of abuse

As we shall see in the following chapter, the EC is chary of taking action in excessive pricing cases. Of the few decisions targeting excessive pricing by dominant firms, the real motivation seems to have been the concern that prices contribute to the partitioning of the single market. Some decisions targeted the car industry where, until 1993, national approval systems were in place to ensure that imported vehicles conformed to domestic safety standards.[147] In some Member States manufacturers had the exclusive right to issue certificates of conformity for cars manufactured abroad. In *British Leyland* for example, the fee for the issue of a certificate of conformity set by British Leyland for imported Metro models was three times higher than the fee for Metro models sold directly in the UK. It is apparent from the ECJ's judgment that the principal concern was the fact that the higher fee would stifle the export of Metro models from mainland Europe to the UK. The ECJ held that the 'fee level suggests that it was fixed solely with a view to making the re-importation of left hand drive vehicles less attractive'.[148] Moreover, the higher fees were only part of British Leyland's market-partitioning strategy, which included the refusal to issue certificates of conformity. The ECJ used the parties' intention as a way of explaining why the prices were excessive, a formulation which would not sit easily in standard determinations of excessive pricing under Article 82. Moreover, the Commission manufactured a narrow market definition to allow it to apply Article 82, stating that British Leyland had an administrative

[146] *Deutsche Post* [2001] OJ L125/27.

[147] The EC has agreed a uniform set of technical requirements: Council Directive No. 92/53/EEC of 18 June 1992 amending Directive 70/156/EEC on the Approximation of the Laws of the Member States relating to the Type-Approval of Motor Vehicles and their Trailers [1992] OJ L225/1 (as amended). See F. Verboven 'International Price Discrimination in the European Car Market' (1996) 27 *RAND Journal of Economics* 240.

[148] Case 226/84 *British Leyland plc v. Commission* [1986] ECR 3263. See also Case 26/75 *General Motors Continental NV v. Commission* [1975] ECR 1367, but here the Commission's claim was not successful.

monopoly in the issue of certificates of conformity in its own cars! However, the market for cars was in no way dominated by British Leyland and when it argued that its practices had not had a real impact on imports of Metro cars from Belgium, the EC rejected this evidence as irrelevant because its tactics *might* have had an adverse effect on imports, and that was sufficient for an infringement.[149] All this evidences a concern over market integration, and the abuse doctrine is moulded to allow for such a finding.

More recently, the policy of market integration has appeared in decisions where the Commission investigates sectors that have been liberalised by Community law. For instance, in a Directive on access to the groundhandling market at Community airports (that is, the provision of services like cleaning, refuelling and baggage handling), the EC had sought to allow free access to competing groundhandling services, in accordance with the Treaty's provisions on the free movement of services (Article 49 EC).[150] In France, access for groundhandlers at Orly Airport is regulated by Aéroports de Paris and it charged different fees to different operators, whereby the highest fees were paid by AFS, a company based in the UK. This benefited the French operator (OAT, a subsidiary of Air France), whose running costs were considerably lower. The Commission found that the price discrimination was an abuse which in the first instance harmed OAT's competitors, and in the second instance caused harm between competing air transport services because the higher groundhandling costs would be passed on to them.[151] Overall then, the price discrimination 'impaired the smooth functioning of the single air transport market'.[152]

Two aspects of this ruling are of note. The first is that competition law is used to ensure the functioning of the internal market which the Community sought to create by legislative means. Second, the dominant firm was not present in the markets where the abuses took place.[153] This unusual aspect deserves some explanation. The source of the Court's approach lies in a series of cases designed to thwart protectionist measures by Member States developed in the context of Article 86 EC which we will consider more fully in chapter 12.[154] This provision gives the Commission powers to issue decisions

149 *British Leyland* [1986] ECR 3263 para. 20.
150 See Article 6(1) of Directive 96/67 [1996] OJ L272/36 and see further ch. 7 pp. 235–7.
151 *ADP/AFS* [1998] OJ L230/10, point 126, affirmed by the European Courts: Case T-128/98 *Aéroports de Paris v. Commission* [2000] ECR II-3929, Case C-82/01P *Aéroports de Paris v. Commission* [2002] ECR I-2613.
152 *Twenty-eighth Report on Competition Policy* (1998) p. 144.
153 In fact, in its defence ADP had also claimed that it had no commercial interest in harming AFS, but this was deemed irrelevant by the Court, because intention is not a necessary element to prove the existence of an abuse: Case T-128/98 *Aéroports de Paris v. Commission* [2000] ECR II-3929 paras. 173–5.
154 Article 86(3) reads: 'The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.'

in respect of public-sector firms when these infringe the Treaty rules, specifically the competition rules, and the rule against discrimination (Article 12 EC). It will often be the case that a publicly owned firm is placed in the role of gatekeeper to a market, as ADP was. If so, it has an obligation under EC law to ensure equality of opportunity between various economic operators, regardless of whether it is present in the market.[155] For example, in another case in the airline industry, in Portugal this time, airport charges were administered by a public company. The Commission found that the charges were significantly lower for the two Portuguese-based airlines, and that the public company had abused its dominant position in the market for aircraft landing and take-off services (without access to which no aircraft could operate in Portugal). The charge in question was levied pursuant to a state measure, which meant that Portugal was in breach of Article 86(1), read in conjunction with Article 82.[156] This approach was necessary to attack protectionist actions by Member States keen to shield domestic industry from the effects of the single market. This line of attack is consistent with the ECJ's approach to national *legislation* which discriminates in favour of local transport firms and is thereby in breach of Article 49 EC.[157]

In *Aéroports de Paris*, we find the principles described above extended to complement the single market rules, by creating non-discrimination obligations on firms (public or private) that are in a position to regulate access to transport markets. The implications of this kind of approach are controversial. On the one hand, these decisions lead to more competitive markets, thus the imposition of a non-discrimination obligation on the firm controlling access is desirable. On the other hand, the reasoning of the Court is based not upon the beneficial economic consequences, but on the need to safeguard the rights of economic operators in the Community. The provisions ensuring free movement of goods, persons, services and capital are 'fundamental Community provisions and *any restriction*, even minor, of that freedom is prohibited'.[158] Competition law then is stretched to ensure that these fundamental freedoms are not hampered by the behaviour of the dominant firms, even when these firms have no presence in the relevant market.

This approach resonates with the economic freedom rationale for competition law and the Court seems to suggest that the same reasoning applies to the non-discrimination obligation in Article 82. Advocate General van Gerven in particular espoused this view: 'It appears implicitly from the Community case-law, in particular the judgments in *United Brands* and *Merci*, that the Court

155 Case C-202/88 *France v. Commission* [1991] ECR I-1223 para. 51.
156 Case C-163/99 *Portugal v. Commission* [2001] ECR I-2613; see also *Finnish Airports* [1999] OJ L69/24. The first decision concerned *Landing Fees at Brussels National Airport* [1995] OJ L216/8, based on Article 86(3) EC. All these decisions rest on the seminal judgment in Case C-18/93 *Corsica Ferries Italy* [1994] ECR I-1783.
157 Case C-381/93 *Commission v. France* [1994] ECR I-5145 para. 21.
158 Case C-49/89 *Corsica Ferries France* [1989] ECR 4441 para. 8 (emphasis added).

does not interpret that phrase [Article 82(c)] restrictively with the result that it is not necessary that the trading partners of the undertaking responsible for the abuse should suffer a competitive disadvantage. . .'[159] The risk of this kind of assertion is that the wide approach to non-discrimination obligations under Article 82, which applies in the restricted circumstances when a gatekeeper is entrusted with the task of guaranteeing access to a newly liberalised market, is translated into a rule of *general* application where the economic benefits are not as clear. For example, *United Brands* was found to have abused its dominant position in the banana market by setting different prices in each Member State, thereby creating an obstacle to the free movement of goods.[160] However, Bishop noted that such price discrimination does not necessarily reduce economic welfare, in fact in his view it is usually efficient to price discriminate, on the basis that more sales can be achieved, to the benefit of consumers (for instance by selling more cheaply in poorer Member States). Moreover, the judgment also fails to achieve the aim of market integration. The dominant firm, which is not allowed to price discriminate, sets a uniform average price, thereby increasing the prices of bananas in those poor countries where United Brands was selling more cheaply, resulting in a worse misallocation of resources than previously.[161] In this view, while market integration might have motivated the decision, its effects are inconsistent with that objective. Partly as a response to this strong critique, it has been suggested that the reasoning in *United Brands* should not be read to prohibit all geographical price discrimination by dominant firms, but to apply when this practice is combined with other mechanisms put in place by the dominant firm to prevent arbitrage, thereby damaging competition among distributors. For instance, in *United Brands* the dominant firm had imposed other restrictions on export.[162] However, even this limitation does not escape the criticism that the decision is based upon dubious economic grounds and fails to create the right incentives for market integration.

This review of how market integration is pursued under Article 82 suggests that using competition policy to integrate the single market is a subtle task, beyond merely ensuring that goods and services are allowed to move freely without contractual restrictions by dominant firms. In addition, obligations are also imposed upon dominant firms that are in a position to regulate access to foreign markets. Moreover, the importance accorded to the goal of market integration is such that an abuse will be found even if there have not been any

159 Case C-18/93 *Corsica Ferries Italy* [1994] ECR I-1783.
160 The same approach is found in Article 81 cases, e.g. *Glaxo* [2001] OJ L302/1.
161 B. Bishop 'Price Discrimination under Article 86: Political Economy in the European Court' (1981) 44 *Modern Law Review* 282.
162 M. Waelbroeck 'Price Discrimination and Rebate Policies under EU Competition Law' 1995 *Fordham Corporate Law Institute* 147 (Hawk ed. 1996). However, others suggest that if a dominant firm imposes different prices in two Member States forming part of the same geographical market, this may count as an abuse.

actual effects on the movement of goods, raising free movement to a fundamental right, so that there is no need to show adverse economic effects. However, a more cautious approach is warranted: market disintegration should be the basis of an abuse only in cases where the dominant firm is a gatekeeper to a market – in this context competition law complements the free movement principles and it can be assumed that market access will increase economic welfare. In other cases, like *United Brands*, market segmentation should not be a sufficient basis for a finding of abuse because we cannot presume that economic welfare is diminished as a result of the dominant firm's actions.

The blind adherence to market integration shown in *United Brands* is reminiscent of some other Commission initiatives we explored in chapter 2, for example in the pharmaceutical sector, where the interpretation of the concept of 'agreement' was driven by the wish to integrate markets. The politics of integration has a profound effect on the interpretation of competition law. It remains to be seen whether the case law reviewed in this section will be abandoned now that the Commission has announced an interest in focusing on consumer welfare. If the reform of Article 81 is any guide, it is unlikely that the Commission will abandon its policy: the pursuit of market integration has remained a core value and the Commission has continued to use Article 81 as a means to integrate markets because it takes the view that integrated markets are the means to generate greater economic welfare.

6 Defences

It might seem strange to indicate that there are defences to a finding of abuse because there is no provision in the text of Article 82, especially if we contrast it with Article 81, where Article 81(3) might be said to provide a defence for an otherwise unlawful agreement. Nevertheless, the Court has said that certain practices are abusive unless objectively justified. In technical terms, this seems to reverse the burden of proof from the Commission to the defendant. However, there is little to support this conclusion. It is best to say that there is a space within the context of the definition of abuse for the dominant firm to bring evidence to show that the acts in question do not constitute an abuse.[163] This is the way in which the concept of 'defences' is understood in this section. One of the more interesting features of the Commission's discussion paper on Article 82 is the extensive discussion of defences. This is remarkable because, at least in so far as the case law of the Court is concerned, no firm has yet managed to defend itself successfully. In what follows a taxonomy of defences is set out which departs somewhat from that in the Commission's discussion paper.

163 In a similar vein, see Opinion of AG Jacobs in Case C-53/03 *Syfait and Others v. Glaxosmithkline AEVE* (28 October 2004) para. 72. On defences generally, see the excellent paper by E. Rousseva 'The Concept of "Objective Justification" of an Abuse of a Dominant Position: Can it Help to Modernise the Analysis under Article 82 EC?' (2006) 2 *Competition Law Review*.

6.1 Economic justification

The abuse doctrine applies to distribution agreements in two main circumstances: when these are loyalty inducing and/or when they discriminate among dealers.[164] The Court has regularly suggested that price incentives may be objectively justified on economic grounds. For example, in *Michelin 2* the CFI stated that: 'a rebate system in which the rate of the discount increases according to the volume purchased will not infringe Article 82 EC unless the criteria and rules for granting the rebate reveal that the system is not based on an economically justified countervailing advantage but tends, following the example of a loyalty and target rebate, to prevent customers from obtaining their supplies from competitors'.[165] The gist of the Court's approach is to consider whether the rebate was linked to any cost savings that the dominant firm made, so that 'if increasing the quantity supplied results in lower costs for the supplier, the latter is entitled to pass on that reduction to the customer in the form of a more favourable tariff'.[166] On the facts, Michelin failed to show that the rebates were in proportion to the cost savings it had made.

While in almost all cases the dominant firm has failed to justify its discounting policy, several informal settlements suggest that economic justification is not a dead letter in the context of distribution agreements. For example, in the aftermath of *BA/Virgin* the Commission and British Airways agreed on a set of principles that would allow BA (and indeed any other dominant airline) to continue to offer some forms of rebate to travel agents. The principles suggest that the commissions which travel agents receive can be differentiated if these differences reflect: (1) the differing costs of distribution through different travel agents; or (2) differences in the services that travel agents provide. Rebates may be granted at a rate reflecting savings on BA's costs or an increase in the value of services that the travel agent provides. Moreover, commissions must relate to sales made by travel agents in a period not exceeding six months, there must be no sales targets, and the commission paid on any ticket is designed to reward the agent for making the extra sale, not for achieving a given sales target.[167] In a dispute arising from Coca Cola's distribution agreements on the Italian market, the Commission reached a settlement whereby Coca Cola amended its rebate policy and was allowed to offer rebates to distributors that purchased a series of sizes of the same product and to distributors that agreed to carry out additional services (e.g. rearranging and resupplying shelves or carrying out promotional activities). On the contrary, the Commission objected to rebates granted in exchange for exclusivity and rebates conditional on the purchase of other products.[168] A similar settlement

164 E.g. *Michelin 1* [1983] ECR 3461 para. 85. 165 *Michelin 2* [2003] ECR II-4071 para. 59.
166 Ibid. para. 98.
167 The Commission set out its policy on commissions paid by airlines to travel agents in IP/99/504 (14 July 1999).
168 Coca Cola (IP/88/615, 13 October 1988).

was reached with Interbrew regarding its beer distribution agreements whereby it agreed to eliminate the loyalty-inducing aspects of its distribution system and to redesign its system of financial incentives given to wholesalers that engage in promotional activities. These incentives are to be made available to any wholesaler, and they may not be conditional on buying beer exclusively from Interbrew.[169] And in the aftermath of a finding of abuse in the plasterboard sector, the firm submitted and obtained negative clearance for a series of rebate schemes which were granted in exchange for extra benefits that were received (e.g. additional customer services, reductions in advertising costs and accessing new markets).[170]

In these four cases the Commission guided the parties towards designing distribution agreements that were economically justified. However, there are drawbacks to this procedure whereby objectively justified distribution agreements are obtained by negotiation. First, the Commission has the upper hand in the bargaining process: the fines for an infringement are high and the Court's jurisprudence is strict, so parties prefer to settle rather than face the almost certain adverse finding by the Commission. This allows the Commission to extract settlements that may be more severe than necessary to avoid anticompetitive effects. Second, the early settlements are highly fact specific so they may not be relied upon as precedents in subsequent cases in different markets.[171] Perhaps as a way of offering wider guidance, the settlement with BA provides something akin to a 'Block Exemption' for all dominant airlines. This is a creative approach that provides legal security for several firms but it deprives other dominant airlines of the freedom to negotiate the kinds of distribution agreement that they think is suitable.

6.2 Meeting competition

In the United States, there is a 'meeting competition' defence in the Robinson–Patman Act. The Act forbids price discrimination but provides that such discrimination is lawful when it is applied in order to meet competition from other firms. As we have seen in earlier chapters, references to phrases taken from US antitrust law have done more harm than good in the development of EC competition law, so one should be cautious about this phrase. In particular, the Robinson–Patman Act has been read restrictively in recent years, with the Supreme Court suggesting that its interpretation should be aligned to that of section 2 of the Sherman Act.[172] Given this, the lower courts'

169 'Commission Closes Probe concerning Interbrew's Practices towards Belgian Beer Wholesalers' IP/04/574 (30 April 2004).
170 *British Gypsum* [1992] OJ C321/9. Four schemes were granted negative clearance.
171 For example, in *Michelin 2* [2003] ECR II-4071 the applicant sought to rely on some earlier statements by the Commission on the rebate schemes agreed between British Gypsum and the Commission (see paras. 82–4).
172 *Brooke Group* 509 US 209 (1993).

case law on the defence may provide little insight. Moreover, the statutory defence applies a standard that does not fit neatly into EC competition policy. The Act provides that the defence applies if the discount offered by the defendant was 'made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor'.[173] The good faith requirement imports a novel concept into EC competition law which seems unnecessary given that the principle of 'proportionality' can offer a comparable standard. Nevertheless, one can appreciate the sentiment behind this kind of defence: a firm should be able to defend its position in the market when challenged by others. In EC competition law, a non-dominant firm is free to defend itself provided it does not infringe Article 81, but in the context of dominant firms the defence is more complex because a dominant firm's very existence presupposes that it has market power, and any attempt to defend its position means that it will retain the power to harm consumers. However, this defence has been supported because it is necessary to mitigate the harshness of the abuse doctrine, in particular when it comes to discounts offered by dominant firms.[174] The Court has regularly said that a dominant firm is free to defend itself from challenges to its position, but it has yet to identify a scenario where the defence applied. This is because, as Ekaterina Rousseva has put it, the meeting competition defence is a sham.[175] This is clear by considering the Court's oft-repeated phrase:

> the fact that an undertaking is in a dominant position cannot disentitle it from protecting its own commercial interests if they are attacked, and that such an undertaking must be conceded the right to take such reasonable steps as it deems appropriate to protect its interests, provided however that the purpose of such behaviour is not to strengthen this dominant position and abuse it . . . However, the justifications permitted by the case-law in respect of Article [82] of the Treaty cannot result in creating exemptions from the application of that provision. The sole purpose of those grounds of justification is to enable a dominant undertaking to show not that the practices in question should be permitted because they confer certain advantages, but only that the purpose of those practices is reasonably to protect its commercial interests in the face of action taken by certain third parties and that they do not therefore in fact constitute an abuse.[176]

The 'meeting competition defence' is evidence that the practice in question is not an abuse of a dominant position. However, what is puzzling from the Court's case law is that the fact that a dominant firm appears to react to the challenges of competitors can easily become evidence that it intends to abuse

[173] 15(1) USC 13(b).
[174] See J. Faull and A. Nikpay *The EC Law of Competition* (Oxford: Oxford University Press, 1999) p. 172; R. O'Donoghue 'Over-Regulating Prices: Time for a Rethink on Pricing Abuses under Article 82 ?' in Ehlermann and Atanasiu *European Competition Law Annual 2003*.
[175] Rousseva 'Concept of "Objective Justification"'.
[176] Joined Cases T-191/98, T-212/98 to T-214/98 *Atlantic Container Line AB and Others v. Commission* [2003] ECR II-3275 paras. 1113–14.

its dominant position. For example, in *AKZO* the dominant firm set a price below ATC but above AVC in what it said was an attempt to win new customers in response to the aggressive tactics deployed by ECS. However, the Court held that the low prices were evidence of an intention to damage ECS because they were 'well below' those charged by the competitor, which 'shows that AKZO's intention was not solely to win the order, which would have induced it to reduce its prices only to the extent necessary for this purpose'.[177] Moreover, *AKZO* seems to suggest that even 'reasonably low prices' would constitute an abuse if these were not offered on a non-discriminatory basis. The Court held that because AKZO gave deeper discounts to ECS customers, this 'shows that AKZO's intention was not to pursue a general policy of favourable prices, but to adopt a strategy that could damage ECS'.[178]

So a dominant firm can quote low prices, but not too low: an impracticable standard. It is not clear from the judgment if AKZO would have avoided a finding of abuse had the price been slightly lower than that charged by ECS but still below ATC and above AVC, or whether AKZO could merely 'match' the prices charged by ECS. And anyway, it is lawful to set low prices only provided these are available on a non-discriminatory basis. AKZO complained that these prohibitions prevented it from ever doing anything in response to competitors' inroads into its market. It said that if ECS approaches an AKZO customer, then it has two choices: either align its prices to those of ECS and offer the same prices to all other comparable customers (i.e. to offer non-discriminatory discounts) or lose the customer. The Court's reply reveals the poverty of its reasoning. In the Court's view AKZO can make 'defensive adjustments, even aligning itself on ECS's prices, in order to keep the customers that were originally its own'.[179] So a dominant firm can give a selective discount (presumably provided the price is not below AVC) only if the price is aligned to that of ECS (so that it is not lower) and only in order to retain a customer. It is not clear how one can be sure of keeping an order if the price must be the same as that of the competitor, nor is it always going to be possible for the dominant firm to find out which of its customers is being targeted by ECS unless the customer informs AKZO. (And in this context it is worth recalling that a dominant firm would probably abuse its dominant position if it inserted a clause in its contracts which entitled the customer to inform the dominant firm of competing offers from others which the dominant firm promises to match).[180] Moreover, if a dominant firm can reduce prices to meet competition, this can deter competitors' incentives to offer lower prices.[181] Thus, not only is the meeting competition defence a sham because there is no defence, but the process of meeting competition is doomed to fail if the response entails below-cost pricing.[182]

[177] *AKZO* [1991] ECR I-3359 para. 102.
[178] Ibid. para. 115.
[179] Ibid. para. 156.
[180] *Hoffmann La Roche* [1979] ECR 461.
[181] Bishop and Walker *Economics* para. 6.43.
[182] Discussion paper on Article 82, para. 83.

However, what of above-cost discounts? As we suggested above, there is little reason to consider above-cost selective discounts as an abuse of a dominant position; however, they have been found abusive when the firm is very powerful and when the firm's conduct partitions the internal market and thus harms one of the core values of EC competition law. In *Irish Sugar*, the defendant sought to justify its discriminatory rebates on the ground that it was responding to competition and the Court said that this was what had to be proven:

> Thus, even if the existence of a dominant position does not deprive an undertaking placed in that position of the right to protect its own commercial interests when they are threatened, the protection of the commercial position of an undertaking in a dominant position with the characteristics of that of the applicant at the time in question must, at the very least, in order to be lawful, be based on criteria of economic efficiency and consistent with the interests of consumers. In this case, the applicant has not shown that those conditions were fulfilled.[183]

Thus, firms that have a significant dominant position have a much harder task than other dominant firms when justifying their responses to competitors' challenges: the response must be efficient and in the interest of consumers. This is very different from the criteria set out in *AKZO* or in the rebate cases. In those cases there is no need to show a benefit to consumers. However, even in this context the Commission has yet to find a single instance where aggressive competition in response to new entry can be justified.

6.3 Economic efficiency

The discussion paper on Article 82 suggests that there can be an efficiency defence in Article 82, modelled upon Article 81(3). This defence differs from the other two we have considered so far in that it would allow the dominant firm to bring to the table certain benefits that result from its actions to justify what may otherwise constitute an abuse. This defence is not consistent with the CFI's dicta in *Atlantic Container* cited above, which suggest that the only way to escape a finding of abuse is to prove that the conduct is not an abuse. Nevertheless, the law must be capable of evolution, and it is worth setting out the Commission's case. Moreover, there is good reason why economic efficiency should play a role in Article 82: the core values of EC competition law are shifting. The current core aims are the promotion of consumer interests and the creation of efficiencies. If so, dominant firms must be able to continue those activities which promote these values even if they cause some harm to the competitive process.

The Commission's suggestion is to apply the same four conditions as under Article 81(3). This requires proof of the following: efficiency; that there is no other way of achieving the efficiency so that the abuse is indispensable; that

[183] *Irish Sugar* [1999] ECR II-2969 para. 189.

the efficiencies benefit consumers; that the abuse does not eliminate competition. The third and the fourth conditions are worth a closer look. In the Commission's eyes consumer benefit is not sufficient: the dominant firm must show that the efficiencies 'outweigh the likely negative effects on competition and therewith the likely harm to consumers that the conduct might otherwise have'.[184] According to the Commission, this occurs when the efficiencies enhance the ability and the incentive of the dominant firm to act to the benefit of consumers. This incentive will not exist when there is little competitive pressure on the firm. This suggests that the efficiency defence is likely to be more successfully invoked when the degree of market power is on the low side. The fourth condition supplements this as the Commission repeats the approach in Article 81(3) by stating that the protection of rivalry and the competitive process is more important than efficiencies, so that if the dominant firm's efficient conduct eliminates all competitors, then the defence will not apply. It is hard to see how these two conditions can be met in a realistic manner. If a firm's dominance is based on its ability to reduce output and increase price, what incentive will it ever have to pass on efficiency gains to consumers? The only way for the defence to play a meaningful role is if we define the concept of dominance as meaning the presence of commercial power to respond to competition. Thus, in a case like *United Brands* where the firm's dominance is proven by its ability to defend its position, an efficiency defence might provide a means to justify otherwise abusive behaviour. However, as we indicated in chapter 5, the correct view is to find that firms that merely have commercial power should not be found dominant. Thus, an 'Article 82(3)' defence has a purpose only when the Commission interprets Article 82 too broadly. If Article 82 is reduced in scope by tightening the concept of dominance and narrowing the notion of abuse, then an efficiency defence is unnecessary.

In the discussion paper, the scope of application of the efficiency defence is limited to rebate and tying abuses. It has been argued that rebates should be justified because they provide dealers with an incentive to market the products more intensely, which is to the benefit of consumers. However, the Commission has not accepted this argument. A rebate can only be efficient when it is granted to a dealer who has market power, and when the rebate convinces the dealer to reduce prices.[185] In the context of tying, the Commission's interpretation of the efficiency defence is almost identical to the Commission's interpretation of the application of Article 81(3) in the *Guidelines on Vertical Restraints*.[186] This suggests that an alternative way of applying the efficiency defence could be to apply Article 81 when a firm

[184] Discussion paper on Article 82, para. 87. The same interpretation has been given of this condition in Article 81(3): see *Guidelines on Article 81(3)* [2004] OJ C101/97 para. 85.

[185] Discussion paper on Article 82, para. 174.

[186] Compare ibid. para. 206 with *Guidelines on Vertical Restraints*, para. 222.

engages in tying or rebates. The Commission, as we will see in chapter 10, has already established a framework to consider efficiencies in the context of distribution agreements, so rather than trying to invent an efficiency defence, it might be simpler to avoid applying Article 82 in cases of vertical restraints.[187]

6.4 Public policy

In chapter 4, we noted how in certain circumstances the ECJ has ruled that Article 81 was inapplicable even if the agreement was a patent restriction of competition because the agreement was necessary to promote or safeguard a Community or a national public interest.[188] There is no comparable case law on Article 82; however, the same principles which the Court recognised for Article 81 should apply here, *mutatis mutandis*. First, the EC Treaty provides that if a firm is entrusted with the provision of a service of general economic interest, then it is exempt from the Treaty obligations in so far as this is necessary to provide the service in question, on the basis of Article 86(2), which we consider in more detail in chapter 12. This provision has led to a statutory exemption for several state-created monopolies. Second, when the Court in *Wouters* decided that Article 81 was inapplicable, it did so by reference to its case law on the internal market, suggesting that there is a general principle of Community law whereby the Treaty obligations are inapplicable when their enforcement would undermine legitimate national concerns. Moreover, as some have suggested, *Wouters* is about the relationship between competition law as a whole and other public interest considerations, and is authority for the proposition that there are circumstances where other public interest considerations trump the application of competition law.[189]

An example of the unsuccessful attempt to rely on public policy considerations in the Article 82 context is the argument put forward by Hilti and Tetra Pak that tying agreements were necessary to protect the consumer from harm that could result if the product that these companies sold (nail guns and packaging machines respectively) was not used together with the firms' own brand of parts (nails and cartons respectively). The Court of First Instance held that the tie was a disproportionate way to safeguard the interests of consumers. In both cases the Court said that there are national laws that are designed to protect consumers from unsafe goods, and it was not up to the firm in question to choose to protect consumers unilaterally, because to do so would allow the firm to regulate the market, a job which was for the relevant regulatory authorities. The most that the dominant firm could do was to notify the national authorities of its concerns about the risks to consumers should they

187 As already suggested by Rousseva 'Modernising by Eradicating'.
188 See ch. 4 pp. 110–13.
189 A. P. Komninos 'Non-Competition Concerns: Resolution of Conflicts in the Integrated Article 81 EC', Working Paper (L) 08/05 Oxford Centre for Competition Law and Policy (available at www.competition-law.ox.ac.uk/competition/portal.php).

utilise certain components.[190] These two decisions confirm that the dominant firm may take steps to safeguard a public interest when this is the only way to achieve this, but that when there are other, less restrictive measures in place to protect the public interest, then the firm's actions do not merit reprieve.[191]

7 Conclusion: Article 82 redux[192]

7.1 Novel policy directions

The key policy that has underpinned the Community's regulation of dominant firms is to protect the economic freedom of other market participants. The early case law's focus was upon considerations of fairness to those who traded with the dominant firm, while the case law since the 1980s has placed more emphasis upon the elimination of rivals.[193] In ensuring that dominant firms do not thwart the freedom of rivals or other firms, the Court of Justice has expanded the meaning of abuse to ease the burden of proving an infringement, and some recent decisions of the CFI have continued this trend by indicating that an abuse may be found even before the exclusion of rivals can be felt. In *DSD* the Commission summed up its perception of Article 82 in this way:

> The Court has stated in this matter that 'a system of undistorted competition, as laid down in the Treaty, can be guaranteed only if equality of opportunity is secured as between the various economic operators'.[194] Such equality of opportunity is particularly important for new market entrants on a market in which competition is already weakened by the presence of a dominant undertaking and other circumstances. In particular, small competitors should not be the victims of behaviour by a dominant firm, facilitated by that firm's market power, which is designed to exclude those competitors from the market or which has such exclusionary effect.[195]

Equal access to the market is a right valuable in itself, without the need to demonstrate that economic gains flow from its guarantee. However, economic benefits are perceived to flow on the basis that greater numbers of market participants create the disciplined capitalism which lies at the heart of the Community's economic constitution. In addition, the case law suggests that other policies are in play in the application of the abuse doctrine, in particular the protection of a single market. Economic efficiency and consumer benefits

190 Case T-30/89 *Hilti AG v. Commission* [1991] ECR II-1439 paras. 115–19; Case T-83/91 *Tetra Pak International SA v. Commission* [1994] ECR II-755 paras. 138–40.
191 In a similar vein, Rousseva 'Concept of "Objective Justification"'.
192 Redux means to be brought back, restored. The title is inspired by John Updike's *Rabbit Redux*.
193 T. E. Kauper 'The Problem of Market Definition under EC Competition Law' (1997) 20 *Fordham International Law Journal* 1682.
194 Case C-208/88 *France v. Commission* [1991] ECR I-1271 para. 51.
195 *DSD* [2001] OJ L166/1 para. 114.

might be an 'indirect' result of the application of Article 82,[196] but they are not the central goals of the abuse doctrine.

The current protective scope of Article 82 is at odds with the changing paradigm of EC competition policy, which has the interests of the consumer at its centre. In some of the case law the Commission and Courts have begun to move towards considering how abuse harms consumer interests, so that the Commission's reform of Article 82 should be seen as an incremental reconsideration of the abuse doctrine.

There is no major 'legal' obstacle to an incremental shift away from the current law. First, as we have noted, the classical and oft-repeated definition of abuse can be reinterpreted in much the same way that Article 81 has been re-read. The fact that abuse 'has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition'[197] can be interpreted afresh as meaning that abuse has to foreclose rivals. This is the clever re-reading which the Commission offered in its discussion paper on Article 82, and which tallies with the reinterpretation of Article 81 in the Guidelines on the application of Article 81(3). Second, there is nothing in Article 82 itself that limits the protective scope of that provision. Third, it is possible to embrace a more extensive list of 'defences' so as to afford the dominant firm the opportunity of justifying what appears to be anticompetitive behaviour. The law is sufficiently elastic for incremental reform to occur as the policy priorities shift.

The first of the major challenges is whether the Commission is truly committed to relying solely upon an economic paradigm. The implications of this could be that the scope of the abuse doctrine is curtailed significantly and many of the findings of abuse in the seminal cases would no longer be representative of the law. It is submitted that the Commission is not willing to transform Article 82 to such an extent as to abandon some of the fundamental notions that underpin the abuse doctrine. First, it does not accept a total welfare analysis of markets. Conduct which is economically efficient can be prohibited when that conduct would harm the competitive process. Ultimately the economic freedom roots are too strong to give way to a full economic analysis. Second, as noted earlier, the Commission's consideration of 'consumer' welfare can give it the discretion to attack conduct which is not harmful to consumers' economic interests but which the Commission thinks is harmful (rebates that lower prices but reduce choice are harmful to consumer welfare because there is less choice). Third, changing the scope of application of Article 82 risks damaging the interests of the Community. In many cases discussed above the aggressive use of Article 82 has been deployed in markets which have been recently liberalised, and action has been taken to accelerate competition. This policy might be threatened if we reduce the protective scope of Article 82.

196 AG Kokott in *BA v. Commission* (Opinion of 23 February 2006) para. 68.
197 *Hoffmann La Roche* [1979] ECR 461 para. 91.

These are policy barriers that limit a complete application of economic standards.

The second challenge is institutional. Under Regulation 1/2003 enforcement of EC competition law is decentralised, and this makes it more difficult for a policy change to occur given that there are several loci of enforcement. Had the Commission remained the sole enforcer of Article 82, it would be relatively unproblematic to announce a change of direction in its policy and publish guidelines that explain its new policy priorities. However, with decentralisation it is trickier to ensure that all enforcers apply new principles. The technique that was used in Article 81 was to publish a number of exemption decisions in a range of sectors and to publish Guidelines to aid national authorities. It remains to be seen whether the Commission will embark on a comparable strategy by bringing fresh Article 82 cases and applying novel methods. The discussion paper has already been published in the form of Guidelines, so a similar pattern of coordination is emerging.

The third challenge is whether, bearing in mind the Commission's reluctance to rely solely upon economic analysis, it should deploy a unified economic standard for the abuse doctrine. We consider this in the section below.

7.2 A unifying economic paradigm?

The Commission's reconsideration of the abuse doctrine chimes with a similar debate in the United States over the role of s. 2 of the Sherman Act, and competing economic models have been presented.[198] Those who propose a unified test to identify exclusionary behaviour share the following starting points. First, exclusionary tactics are a two-stage strategy: in the first stage the dominant firm embarks on a strategy to harm competitors, and once it has damaged them by eliminating them, or by raising their costs, or by deterring them from entering the market, then in the second stage the dominant firm will exploit its newly acquired market power. Second, the law must punish only exclusionary behaviour that reduces consumer welfare. The aim is to protect consumers, not competitors. Third, because economists view exclusionary behaviour as a strategy that takes time to play out, then competition law must intervene before this strategy is successful. That is, we want to catch exclusionary behaviour before there has been exclusion. The reason is that if we intervene after the dominant firm has eliminated competitors, there is no remedy for the market failure, so intervention can only be effective if it prevents the elimination of competitors. However, early intervention creates a risk of being over-inclusive. Thus, what we need is a test that allows us to predict with some precision whether the dominant firm's conduct will harm

198 See T. O. Barnett 'The Gales of Creative Destruction: The Need for Clear and Objective Standards for Enforcing Section 2 of the Sherman Act' (speech, 20 June 2006) (available at www.usdoj.gov) introducing the Section 2 Hearings.

competition. Taking these premises as given, commentators have suggested three approaches.[199] One is to ask whether the conduct is likely to harm consumer welfare. Two other approaches suggest that the harm to consumer welfare question can be asked in a less direct manner, either by asking whether the dominant firm's conduct can eliminate a competitor that is at least as efficient as the dominant firm, or by asking whether the dominant firm's conduct makes no economic sense but for its tendency to harm competition (the 'sacrifice test').[200] Below, I explore each of these tests briefly in the context of predatory pricing.

The no-economic-sense test is proposed by several American commentators and it asks whether the conduct makes no economic sense but for the tendency to harm competition.[201] Put another way, it asks whether it is possible to explain that the conduct of the dominant firm can benefit consumers. If there is no consumer welfare explanation, then the behaviour is harmful. The test clearly applies to predatory pricing: prices below AVC when recoupment is possible make no economic sense unless the prey exits the market. The as-efficient-competitor test instead provides that the abuse doctrine should prohibit conduct that is capable of eliminating rivals who are no less efficient than the dominant firm. This standard works comfortably with below-cost pricing but does not require proof of recoupment: if the dominant firm prices below cost and can do so because it has superior financial resources (e.g. a deep pocket) then its behaviour can eliminate a rival who is as efficient as it (that is, a firm with identical production costs). In sum, the as-efficient-competitor test probably allows one to find abuse more easily than the no-economic-sense test, and sits comfortably with the current EC doctrine, based as it is on foreclosure. These methods are preferable to attempts to determine harm to consumers directly. The difficulty with a consumer welfare standard is about what standard of proof one selects. Must one show that the conduct tends to harm consumers, or must one show that harm to consumers is highly probable? A low standard of proof leads one to make Type 1 errors, but too high a standard of proof can cause Type 2 errors.

However, there is another perspective through which to consider the reform of Article 82 if one is minded to look for a common denominator. These cases, broadly speaking, have three limbs: dominance, abuse and a lack of objective justification. The three tests above try to refine the second and the third limbs. The no-economic-sense test in particular seems to invite the defendant to prove why its conduct makes economic sense. These models often ignore the

199 The following discussion is based largely on J. Vickers 'Abuse of Market Power' (2005) 115 *Economic Journal* F244.

200 For a succinct explanation, see G. J. Werden 'Competition Policy on Exclusionary Conduct: Toward an Effects-based Analysis?' (2006) 2 *European Competition Journal* (Special Issue on Article 82) 53.

201 See e.g. A. D. Melamed 'Exclusive Dealing Agreements and Other Exclusionary Conduct – Are there Unifying Principles?' (2006) 73 *Antitrust Law Journal* 375.

starting point: Article 82 is infringed only when a firm is dominant. The reason this is ignored is because for economists dominance is irrelevant. Exclusionary conduct either is or is not deleterious for consumers. However, because in EC competition law Article 82 can be invoked only if the firm is dominant, then reform of the dominance test might affect how we think about abuse. As I suggested in chapter 5, dominance is found too easily, merely upon proof of commercial strength. If dominance instead meant the power to reduce output and increase price, then the scope of Article 82 would be reduced significantly, applying only to firms who already have the power to harm consumers. Then, in this regime we might be willing to tolerate a strict 'abuse' doctrine where proof of likely foreclosure is sufficient to find an abuse. Applied to predatory pricing, this allows the competition authority to take into consideration post-Chicago theories of predation (e.g. predation by reputation) and it justifies not asking whether recoupment is feasible because the firm is already able to price above cost before the abuse. As the Commission states repeatedly, rivalry is the key to a healthy competitive process. Foreclosure that stymies rivalry could be a blunt test to apply at the start of all abuse cases, but the risk of Type 1 errors is reduced by shrinking the scope of application only to firms with real market power.