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The Article 82 EC Abuse Concept: What Scope is There for Modernization?

On 30 September 2004, Wilmer Cutler Pickering Hale and Dorr LLP, the University of Nyenrode, and *Global Competition Review* co-sponsored a seminar on the reform of Article 82 EC by the European Commission. The seminar raised a great deal of interest amongst members of the legal community and attracted a large attendance. The speakers included some of the most well-known top-level policy makers, academics, and practitioners in the field of competition law.

Over the last two years, there have been numerous calls for modernization of the way in which Article 82 of the EC Treaty is applied by the European Commission and, with decentralization in mind, by 25 national competition authorities and many more national courts. Modernization in other areas has involved a greater focus on the economic effects of the relevant practice. In Article 82 EC cases, enforcement has, however, been more based on the perceived object of a criticized practice with the effect being inferred from market power. Classic positions on fidelity rebates and the special responsibilities of dominant companies have also been reaffirmed recently by the European Court in judgments such as *Michelin II*, *Masterfoods II*, and *BA/Virgin*. The aim of the seminar was to look at the concepts underlying the current law in relation to rebates and tying and bundling to compare how EU and US enforcers deal with such issues and to make suggestions for possible European Commission guidelines on Article 82 EC enforcement practice.

Claus-Dieter Ehlermann (senior counsel, Wilmer Cutler Pickering Hale and Dorr LLP) introduced the proceedings. After welcoming all the speakers and participants, he drew attention to the importance of a reform which, first and foremost, defines what is the "object and purpose" which Article 82 EC pursues and then sets the rules through which this object and purpose is to be achieved. He pleaded for these rules to be based on economic effects rather than form and stressed that any new guideline on the enforcement of Article 82 EC should provide enforcers, companies, and practitioners with a "practicable test." Clear

objectives and practicable tests do not necessarily mean that all *per se* rules or (rebuttable) presumptions should be banned and replaced by economic analysis of each individual case.

The seminar was organized into five panel discussions.

Article 82 EC: The Current Law and Practice

In the first panel, **John Ratliff** (partner, Wilmer Cutler Pickering Hale and Dorr LLP) and **Derek Ridyard** (partner, RBB Economics) outlined the legal and economic principles underpinning the current enforcement of Article 82 EC.

John Ratliff gave an overview of the legal principles and introduced some of the themes that would be discussed later in the day, such as the (currently) underestimated importance of buyer power in assessing dominance and abusive conduct; the extreme difficulty in distinguishing between anti-competitive (exclusionary) practices and normal competition; the unsatisfactory approach to what a dominant firm can do to respond to competitive pressure; and the need to balance more economic analysis while not depriving companies of predictability and legal certainty. He concluded by laying the ground for the discussion on what could be a roadmap for reform. He suggested that the European Commission might distinguish between practices which are clearly not abusive, practices which are presumptively abusive (*e.g.* because of market foreclosing effects, but which may be allowed if they have proven positive effects) and "hardcore" abuses.

Derek Ridyard discussed seven key questions which in his opinion should be addressed by the European Commission in the reform: "Should there be *per se* abusive practices?"; "Can there be an abuse at a threshold below the predation standard?"; "What is a cost (or other "objective") justification?"; "What is an essential facility?"; "When are bundling and tying really abusive?"; and "Should economic effects take a role in the Commission's analysis of unilateral conduct?". Some of these questions may currently involve conflicting answers because the legal standard applied is sometimes problematic if looked at from an economic perspective. He suggested that the reform should rest on two core ideas: no conduct should be considered *per se* abusive and an effects-based standard should rely on workable economic rules of thumb and guidelines.

Rebates after *Michelin II* and *BA/Virgin*

The second panel was chaired by **Michel Waelbroeck** (Emeritus Professor of European Law, Université Libre de Bruxelles and President of the Belgian Competition Commission). He opened the discussion on rebates with an overview of the case-law of the European courts in this area. He took the view that currently there is very little room left for dominant companies wishing to implement a rebate scheme and that he did not expect the Commission to depart considerably from this position, which has been endorsed in its entirety by the European courts.

Doug Melamed (partner, Wilmer Cutler Pickering Hale and Dorr LLP) discussed the current status of the US law on single and bundled rebates, stressing the different approach that US agencies have to rebates compared to their European colleagues. Under US law, he explained that single product rebates are not perceived as a concern if the price remains above costs. He then discussed the recent judgment in *LaPage vs 3M*, where multi-product discounts were considered illegal, even if above costs. He considered that, overall, the opinion in *LaPage* reflected concerns that are more common in the EU, such as a sense of unfairness when a big or multi-product firm seeks to exploit its advantages to the detriment of smaller rivals.

Following on the legal discussion on bundled discounts, **David Sibley** (Deputy Assistant At-

torney General, Antitrust Division, Department of Justice) proposed a test which he thought might offer a workable approach to distinguishing competitive from anti-competitive bundled discounts. His proposal, which he stressed was not representative of the DOJ position, was to compare the bundled price with the stand-alone price of the monopoly product, before the bundling strategy. If the stand-alone price of the monopoly product equals the monopoly price, consumer welfare of the firm's customers over both the monopoly product and the bundled products is higher than under independent pricing. If the stand-alone price of the monopoly product is higher than the monopoly price, consumer welfare over all products falls.

Patrick Rey (Professor of Economics, Institute for Industrial Economics, Toulouse) discussed the economic motivations underpinning the policy on rebates. He distinguished between efficiency motivations and anti-competitive motivations. The first set of motivations includes so-called "Ramsey" pricing (*i.e.*, lowering margins on more elastic demand segments), the manufacturer's goal of providing incentives to retailers and the need of the manufacturer to meet competition. The second set of motivations relates to foreclosure and predation. Since some of the rebate schemes may at the same time generate efficiencies and have some foreclosure effect, he suggested that antitrust enforcers in Europe should move from a form-based to an effect-based approach which is better suited to balance the pro- and anti-competitive effects of such conduct. In order to do so, when reviewing rebate schemes, antitrust agencies should address the following issues: "Has there been an exclusionary effect?"; "Are there significant efficiencies?"; and "Are consumers likely to be harmed?".

The panel discussion was concluded by **Frédéric Jenny** (Vice-President, French Conseil de la Concurrence) who suggested that efficiencies may not be the only factor that antitrust enforcers do (or should) take into consideration when looking at rebates and discounts. He observed that the criticized recent judgments of the European courts on rebates may be justified by the protection of interests other than an efficient allocation of resources. For instance, antitrust agencies may also have an institutional interest in preserving equal opportunities to compete for all the market players. He concluded by saying that the political framework of any reform of Article 82 EC should clarify the factors which should be taken into account, efficiencies being only *one* of them.

Tying and Bundling – from *Hilti* to *Microsoft*

The third panel was chaired by **Walter van Gerven** (Emeritus Professor, Katholieke Universiteit Leuven, former Advocate General at the European Court of Justice). The forum offered a lively debate between **Alex Burnside** (partner, Linklaters) and **Martin Bechtold** (partner, Clifford Chance) on the *Microsoft* decision, with each person advocating one side of the case. The panelists did not contest the appropriateness of the test applied by the European Commission in finding an abusive tying by Microsoft, but rather focused on whether the decision was sufficiently grounded on the facts.

The stage was then taken by **Barry Nalebuff** (Adjunct Professor of Law, Yale Law School) who gave a presentation on tying and bundling in EC and US law. He pointed out that the enforcement of Article 82 EC is much influenced by the purpose of protecting the market from unfair trading practices. He then discussed the approach of US and EC antitrust enforcers towards monopoly leveraging, bundling and tying.

The panel discussion was concluded by a presentation from **John Thorne** (Senior Vice President and Deputy General Counsel, Verizon) on bundling after the *LaPage vs 3M* judgment in the US. Mr. Thorne expressed the US industry criticisms of the judgment saying it introduced uncertainty in this area of law and that this uncertainty could lead to undesired consequences as it might deter price cutting through rebates by domi-

nant firms. He suggested that bundled discounts should be allowed and that courts should recognize that they are not well suited to distinguishing beneficial versus anti-competitive bundles, as this involves setting and monitoring costs, pricing and quantity levels. On a question from the audience, Mr. Thorne also expressed concerns that the legal uncertainty on bundled discounts could lead to an increase in the number of private actions against virtually all American industries as bundled discounts are ubiquitous.

What Scope is there for Modernizing Article 82 EC Abuse Practice?

The fourth panel and first afternoon session was chaired by **Sir Christopher Bellamy QC** (President, UK Competition Appeal Tribunal, former judge at the European Court of First Instance) who stressed the importance of courts in the enforcement of competition rules and that the reform of Article 82 EC will have to provide all enforcers with a manageable number of clear legal rules. This should not be at the expense of flexibility and coherence with economic concepts.

The first two panelists presented their personal views on the modernization of Article 82 EC from the perspective of the Commission. **Emil Paulis** (Director, DG Competition, European Commission) and **Pierre Buigues** (Deputy Chief Economist, DG Competition, European Commission) confirmed that the European Commission is working on draft guidelines on the enforcement of Article 82 EC. They stated this is a difficult and time-consuming process which will concern both the concept of dominance and the concept of abuse.

The purpose of the guidelines will be to offer a comprehensive and systematic approach for distinguishing between legal and illegal conduct. This has become very important for two reasons: facilitating consistency amongst enforcers and fostering transparency and legal security for private companies. Mr. Paulis said that the European Commission is determined to commit the necessary "R&D effort" in this area and is aware that this may entail a revision of the European Commission's current approach as also endorsed by the European courts. Mr. Buigues confirmed that the European Commission is prepared to move away from a legalistic and formalistic approach in favour of enforcement based more on economic principles. This means that the focus of enforcement will be on the effects and not just on the nature of the conduct.

According to both Mr. Paulis and Mr. Buigues, the guiding principles for drafting the guidelines will be "consumer welfare" and "competition on the merits." These principles will have to be properly defined, but it is already clear that they will not only be applicable to dominant firms but to all players equally (*i.e.*, dominant firms must be allowed to compete on the merits, but must also be prevented from limiting other firms' ability to compete on the merits). It is still an open question if the fact that conduct is capable of having exclusionary effects is a sufficient standard for finding an abuse. Further clarifications will be needed in this respect, for instance, should the negative effects on consumers be *actual* or just *likely* and should the competitive harm to consumers be *direct* or does *indirect* harm also suffice.

The Commission will also have to take a position on whether its assessment will take account of long-term or just short-term considerations. Mr. Buigues added that when assessing the impact of conduct on consumers, the Commission may have to look at factors other than price and quantity, such as product quality and availability.

The guidelines will also touch upon the defenses available to dominant firms. Both Mr. Paulis and Mr. Buigues recognized that efficiencies will have to be looked at more closely, but admitted that the balancing of efficiencies with the potential exclusionary effects of certain conduct is a difficult task.

To a question by Claus-Dieter Ehlermann on how the European Commission sees the allocation

of the burden of proof in Article 82 EC cases, Mr. Paulis replied that while the European Commission will look at each case broadly, it is certainly up to the European Commission to provide evidence of the exclusionary effects of conduct and up to the defendant to provide evidence of the countervailing factors, such as business justifications and efficiencies.

Ulf Böge (President, Bundeskartellamt) suggested that the reform of Article 82 EC should look at the conduct of companies in light of the overall economic context; a test balancing pro- and anti-competitive aspects is required although this may be difficult in practice. Already today the Bundeskartellamt is frequently engaged in examining whether and to what extent efficiencies arise from a dominant company's conduct in individual cases. He concluded that the reform should not only introduce more flexible economic rules, but should also strive to make abuse control predictable and manageable, not least to ensure quick proceedings.

William Kolasky (partner, Wilmer Cutler Pickering Hale and Dorr LLP) offered his views on the notion of competition in the US and how it affects enforcement policy against dominant companies. Enforcement in the US is based on a few clear principles, including the following: government intervention should be extremely limited to clearly illegal conduct; rules are not meant to protect inefficient competitors; and antitrust enforcement should not have the effect of stifling incentives to compete and to invest. In the US, two types of conduct are considered abusive: predation and exclusionary conduct. Courts have defined very manageable criteria for predation based on the comparison of prices with average variable costs (AVC): if price is above AVC they are *per se* legal; if they are below AVC, they are illegal if recoupment is likely. As for exclusionary conduct, it is abusive if it leads to exclusion of an equally efficient competitor and if it is likely to harm consumer welfare by sacrificing short term profits in order to exclude rivals.

The last panelist, **Pieter Kuipers** (Deputy General Counsel - Europe, Unilever) welcomed a review of Article 82 EC that would take into account the changes in the economic reality of European markets that have occurred since Article 82 EC was introduced by the Treaty of Rome. He welcomed the fact that, when assessing dominance, the European Commission would examine other factors such as barriers to entry and not just rely on market shares. He also pleaded in favor of a wider recognition of buyer power, particularly at retail level, as a factor negating dominance and noted that countervailing buyer power has been taken into account in many merger control cases.

Closing Remarks and Discussion

The fifth and last panel was chaired by **Karel van Miert** (Chairman of Nyenrode Institute for Competition and former European Commissioner for Competition) who pleaded in favor of a modernization of Article 82 EC which would provide for "clear and practically enforceable rules." He agreed that EC competition law should not protect inefficient competitors, but added that the great differences in the economic structure of European and US markets may still justify a different approach to abuse of dominance cases in the two jurisdictions. In many cases, protecting competitors means protecting competition (he mentioned in particular the newly liberalized markets). There may be no scope for competition at all if small competitors are not protected in newly liberalized markets.

John Vickers (Chairman, Office of Fair Trading) observed that the reform of Article 82 EC will be challenging because it will have to provide legal certainty and introduce economic analysis into this area of law. Those two objectives may not always be convergent. According to Mr. Vickers, a sound reform should depart from the current formalistic approach, which has proved in many cases to be arbitrary and inconsistent. The reform should be based on the acknowledgment that there are no *per se* abuses and that conduct should be reviewed according to its economic effects. However, he was

not in favour of an extreme economic approach which would deprive companies of clear guidance on what is legal and what is illegal conduct.

According to Mr. Vickers, the reform should clearly define the object and purpose of Article 82 EC and anchor the enforcement policy to those. He then discussed the three principles which have been advanced for helping to determine when a dominant firm's conduct is unlawfully exclusionary: the "sacrifice" test (*i.e.*, is the conduct profitable but for its tendency to eliminate competition?), the "as-efficient competitor" test (*i.e.*, does the conduct result in the exclusion of competitors that are as efficient as the dominant company?) and the "consumer harm" test (*i.e.*, does the conduct result in the dominant firm excluding rivals whose presence enhances consumer welfare?).

Alberto Pera (Partner, Gianni Origoni Grippo & Partners) concluded the discussion and the seminar with the lessons to be learned from the reform process that had changed the European Commission's approach to vertical restraints under Article 81 EC in recent years. On that occasion, the need for a reform came from the "inside": the European Courts had laid the ground for the reform in more than one judgment, many NCAs had already embraced the new approach at national level, and the business community was very much in favor of the reform. The reform of Article 82 EC is very different: the need for a reform is coming mainly from the business community who has been very critical *vis-à-vis* recent decisions of the European Commission that have been endorsed by the European Courts. Regardless of the differences compared to the reform on vertical restraints, the current reform of Article 82 EC should learn from that experience and start the revision process from the foundations. The key issues that will have to be tackled include the objectives of Article 82 EC, the legal rules for achieving such objectives, and the correct standard of proof.

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