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The “Effects-Based” Approach of the
Commission to the Application of
Article 82 to Exclusionary Abuses: Is
the New Approach Really Economics
Friendly?

Master thesis
15 credits (15 ECTS)

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Master's Programme in European Business Law

2008-2009, Spring

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Summary

The purpose of this thesis is to criticize the Commission's approach to the application of Article 82 to the exclusionary abuses of the dominant firms. It is a very interesting and hot topic as the attitude of the Commission and the European Courts have many implications on the consumer welfare and total efficiency in common market and innovation capacity and the economic development of the European Union. The old approach of the Commission towards the Article 82 has been criticized harshly as it does not utilize the new economic theories and the analysis used by the Commission and the European Courts was based on the formalistic definition of the abuses rather than the actual effect of the conduct on efficiency and consumer welfare.

The new economic theories suggest that the exclusionary conducts of the dominant firms which are defined as abuse under the formalistic approach are actually efficiency and consumer welfare enhancing. Therefore, the intervention of the Commission in this area protects the competitors while it actually hampers the consumer welfare, efficiency and competition in the EU. This has affected the economic performance of the EU and the Commission was blamed because of its significant intervention in the business activities of the dominant firms. After all these criticisms, the Commission decided to modernize the approach towards the application of Article 82 to the exclusionary conducts. Therefore, the Commission published a Discussion Paper¹ in December 2005 which aims to bring an effects-based and economics friendly approach to the exclusionary conducts of the dominant firms. The Commission put the interests of the consumers and the efficiency consideration over the interests of the competitors. The efficiency and consumer welfare enhancing role of the exclusionary conducts and the importance of focusing on the actual effect on the market instead of the formalistic definitions of the conducts are stressed in the Discussion Paper. However, the analysis proposed by the Commission was actually in line with the formalistic approach while the focus was on the anti-competitive effects of the exclusionary conducts of the dominant firms. This thesis will show that the Commission actually failed to bring an economics-based analysis in the application of Article 82. Three years after the Discussion Paper, the Commission published a Guidance Paper² for an improvement in the formalistic approach but it is mostly inline with the Discussion Paper.

¹ DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, 19 December 2005, IP/05/1626

² Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, 13 December 2008, IP/08/1877

Abbreviations

ECJ	European Court of Justice
EC	European Community
EC Treaty	Treaty establishing the European Community as amended in accordance with the Treaty of Nice
The Community Courts	European Court of Justice and the Court of First Instance
ECR	European Court Reports
OJ	Official Journal of the European Union

1. Introduction

1.1. Purpose

The purpose of this thesis is to criticize the approach of the Commission to the application of Article 82 regarding the exclusionary conducts of the dominant firm. The European Approach to dominant firms has significant implications on the consumer welfare, total efficiency in the EU, innovation and economic development of EU. For that aim, the Commission has published a Discussion Paper which aims to bring an effects-based approach which is compatible with the new economic theories and to update the analysis of exclusionary conducts of the dominant firm. This thesis aims to investigate whether the new approach of the Commission is really economics-based and whether the Commission is successful in increasing consumer welfare and efficiency in European market and in promoting innovation and economic development with the new approach to Article 82.

1.2. Method and Material

In order to analyze the old and new approach of the Commission to Article 82, I have relied on EC Treaty provisions, case law of the Community Courts, the Commission's documents mainly the Discussion Paper published in 2005 regarding the Article 82 and literature about the competition theories and the European Approach to competition law and Article 82. I will firstly provide the theoretical framework and compare the main competition theories with the European Approach to competition law. Then I will provide an explanatory part regarding the old attitude of the Community Courts and the Commission towards the application of Article 82 to the exclusionary abuses based on the case law and EU legislation. In the third chapter, the new approach of the Commission towards the application of Article 82 to the exclusionary abuses will be criticized. To illustrate the issues in which the Commission failed to bring a real effects-based approach, the analysis proposed by the Discussion Paper will be examined and criticized based on the reports and commentaries published. Moreover, the Guidance Paper will be analyzed briefly to show that the Commission is insistent on its formalistic approach regarding the exclusionary abuses of the dominant firms. In the last part, the suggestions will be provided for the Commission to revise the application of Article 82 to exclusionary abuses. In this part, mainly the Federico Etro's theory of market leaders will be utilized.

1.3. Delimitations

This thesis criticizes the Commission's attitude towards the application of Article 82 to the exclusionary abuses. For that aim, firstly three main competition theories are selected to analyze as these theories are the most important ones having the most significant effect on the competition law. In this section, the purpose is not to provide very basic economic concepts such as the characteristics of perfectly competitive or monopolistic markets. In the analysis of the new and old approach of the Commission to the Article 82, the exclusionary conducts of the dominant firms are focused and the conducts of the monopolists and the other types of abusive conducts of the dominant firm are held out of the scope of this thesis. An explanatory and detailed analysis of the Commission's approach in Article 82 will not be provided instead the weak points of the Commission' new approach suggested by the Discussion Paper will be discussed based on the arguments of the new economic theories.

1.4. Disposition

In order to examine the new approach of the Commission, I start with presenting the basic competition theories and the European Approach to competition law. To examine the attitude of the Commission and the Community Courts towards Article 82 and how the European Approach is formed, three main competition theories and their different level of effect on the European approach will be compared. Firstly, the Harvard School which has the most significant effect on the traditional EU approach to Article 82 and which is the most formalistic one will be examined. Secondly, the Chicago School's liberal and effects-based approach will be presented as it is utilized as a guiding star in the modernization of Article 82. Post-Chicago School is selected as the third competition theory because it has also significant on effect on the European Approach. Lastly, the European Approach to competition and the objectives of the Commission in the formation of its approach will be analyzed.

Then, I will analyze the traditional approach of the Commission to the Article 82. Therefore, the Commission's and the Community Courts' attitude towards market definition, dominance and exclusionary abuses are analyzed with a focus on case law. The aim is to provide a brief analysis of the EU's attitude to the abuse of dominant position.

To examine the new approach of the Commission to Article 82, the Discussion Paper will be analyzed in detail in the third chapter. Firstly, the aim of modernization and the reason why the Commission intended to bring an effects-based approach to Article 82 will be presented. The Commission aims to modernize the application of Article 82 to exclusionary abuses in the light of the new economic theories. Therefore, Discussion Paper provides a new way of analysis in defining the relevant market, dominance

and exclusionary abuses of the dominant firm. This thesis aims to prove that the Commission's new approach defined in the Discussion Paper is actually conflicting with the suggestions of new economic theories and with the purpose of bringing effects-based approach to Article 82. For that aim, the suggestions of the new economic theories and the proposed analysis in the Discussion Paper are compared with regard to market definition, determination of dominance, exclusionary abuses and objective justification and efficiency defense. The aim is to show that the Commission was still loyal to the old formalistic approach in the application of Article 82 to exclusionary abuses of the dominant position despite the fact that the aim of the Discussion Paper was determined as bringing effects-based approach. After the analysis of the Discussion Paper, the Commission's Guidance Paper is examined to see if it improved the proposed analysis in the Discussion Paper. While the Guidance Paper is the most recent document from the Commission to analyze the attitude towards the Article 82, the focus is on the Discussion Paper in this thesis as the Guidance Paper is mostly in line with the Discussion Paper and there is not enough literature about it.

In the last chapter of the thesis, I will provide some suggestions for the Commission to further modernize the application of Article 82 to exclusionary abuses of the dominant firms. For that aim, the theory of market leaders which is a viable alternative to old competition theories for the EU will be presented. I will analyze the theory of market leaders and provide suggestions for the Commission to improve the European Approach to Article 82 based on the propositions of this theory.

2. Competition Theory and The European Approach to Competition Law

2.1. Harvard School

One of the most important economic theories which have also significant effect in the formation of EC competition law is the Harvard School which is also called structure-conduct-performance theory. The Harvard School analyzes the interaction between the structure of an industry, the performance and the conduct of the firm. The structure of the industry such as the technological development or the concentration level determines the conduct of the firms such as the advertisement and R&D expenditures. The conduct of the firms at the end affects the performance of the industry in terms of the profits of the firms, the consumer welfare or technological development. Therefore the government intervention to the structure of the industry through tax legislation or competition law affects the performance of the industry and the firm directly.³

Mason who is the leading economist of Harvard School defines the structure as all the considerations in the market which affect the strategy and policies of the firm including all the buyers and sellers in the industry. He identifies types of structures which have effect on the conduct of the firm and its performance. For instance, if the structure of the market is close to pure competition conditions, the firm can only decide how much it wishes to sell at the price set by the market equilibrium. If the market structure is monopolistic or oligopolistic, the firms can be able to set the price without considering the market forces. And if the entry barriers are low and the number of possible conspirators is high, the structure of the market is very suitable for collusion. Based on these assumptions, *Mason* suggests that the pure competition rules are in the public interest as the price is at the competitive level while the monopolistic structure is something that should be suppressed by the competition law.

As a part of the Harvard School, the concentration doctrine explains the relationship between the number of firms operating in the industry and the performance of the firm. According to this doctrine, the high concentration in the market should be considered as high market power by the competition law. In market structures with small number of firms, the firms are able to affect the level of price with their individual business decisions. This doctrine falsely assumes that the high concentration cannot be the result of

³ Glader, Marcus, "The Innovation Markets and Competition Analysis: EU Competition Law and US Antitrust Law", Lund University, Malmö, 2004

economies of scale or the innovative performance of the firms in one industry. Therefore, this doctrine is criticized because it suggests that the competition law should consider the high concentration in the market evidence to strong market power. Therefore, the high level of concentration is a market failure and should be justified by the government intervention. The competition authorities thus should follow an active policy against the mergers and concentration.⁴ The strong effect of Harvard School can be observed in EU Competition Law as the competition authorities still focus on the market share rather than entry barriers and support the small and medium sized companies.⁵ Although, these theories have still significant effect on EU competition law, the next generation of economists which represent the Chicago School criticized these theories harshly and argued that the high concentration can be simply the result of high efficiency and innovative efforts of the firms operating in that market.

2.2. Chicago School

Major attack to the Harvard School and the concentration doctrine came from the Chicago School which mainly argues for a free market system and avoids the necessity of government intervention through competition law. They think that the high concentration ratios do not necessarily result in monopoly profits or collusion. Instead, the high concentration ratios are result of different cost structures more specifically the economies of scale. The high concentration is observed in markets where the large scale production is economically more advantages.⁶ In other words, the firms operating at the maximum efficiency level gets larger quickly and their market share and sales increase accordingly which result in high concentration rates in this market. Therefore, the high concentration is something desirable whereas the real problem is the collusion which results in artificially high prices and restricted output level.⁷

The attitudes of Harvard and Chicago scholars are the same regarding the perfect competition condition which results in maximum efficiency level and consumer welfare. However, while the Harvard School argues for government intervention to make the market structure closer to the perfect competition conditions, the Chicago School considers these conditions a guiding star which should be achieved through free market forces. Therefore despite the concentration doctrine which considers the high concentration a market failure that should be remedied by competition law, according to Chicago scholars the high concentration is the result of superior performance of some firms with high efficiency level in time. Moreover, high concentration is absolutely necessary for greater efficiency levels in an industry. Therefore, the government intervention just creates a market

⁴ Hildebrand, Doris, "The Role of Economic Analysis in the EC Competition Rules", Kluwer Law International, Second Edition, The Hague/London/New York, 2002

⁵ Glader (2004)

⁶ HildeBrand (2002)

⁷ Glader (2004)

failure except for some horizontal mergers and disturbs the most efficient firms in one industry.

Based on these arguments, it is suggested that for the competition laws the consumer welfare should be the most important value that guide all the decisions given by the courts and the aim should be increasing the economic efficiency. The courts should use detailed economic analysis of the facts of the case and empirical data to decide the conduct's actual effect on consumer welfare and overall efficiency. According to the Chicago School the high concentration other than pure monopoly power should be considered as effective as perfect competition and the main job of the competition authorities should just control and eliminate the overtly collusive behaviors of the firms.⁸ The policies of the firms for profit maximization should not be hampered by the competition authorities and the aim should be remedying any inefficient actions of the firms that at the end affect the consumer welfare. Therefore, Chicago scholars argue that the area that the competition law should intervene should be narrowed with the assumption that the free market forces will find the best way without government intervention.⁹

The effect of both Chicago and Harvard School can be observed in EC competition law which sometimes resulted in conflicting decisions. It should be noted that the policy of integration is the most important objective that should be achieved by the EC competition law. Although, the efficiency concept is getting more and more important in EU competition law, it cannot be expected that the Commission accords the same level of importance to efficiency as the Chicago School does. The further market integration is clearly conflicting with the unrestricted free market concept of Chicago School.¹⁰ Therefore it is clear that for a proper functioning competition law, there is a need for convergence between the Harvard School and Chicago School. Apparently, the European Approach which is very much affected by the Harvard School is unsuccessful in utilization of economic theories in antitrust cases whereas the arguments of Chicago School are against the protectionist attitude and common objectives of the European Union. One of the attempts to bring an alternative approach to Harvard and Chicago School was Post-Chicago School which is more supportive for government intervention and has also significant effect on the EU competition law.¹¹

⁸ Hildebrand (2002)

⁹ Glader (2004)

¹⁰ Rodger, J. Barry, "The Oligopoly Problem and the Concept of Collective Dominance: EC Developments in the Light of US Trends in Antitrust Law and Policy", *Columbia Journal of European Law*, 25, Winter 1996

¹¹ Johansen, Erik, "I Say Antitrust; You Say Anticompetitive: Why bridging the Divide between US and EU Competition Policy Makes More Economic Sense", *Penn State International Law Review*, 331, Fall 2005

2.3. Post-Chicago School

While the Chicago School argues that the government intervention through competition law actually hampers the competition in the market and decreases the level of efficiency and consumer welfare, the Post-Chicago School is more supportive for the government intervention. The Post-Chicago Scholars think that especially the application of Article 82 is very important to restore competition and increase the consumer welfare in a concentrated market. It is argued that the free market forces cannot be able to remedy a market failure without government intervention in a monopolistic or in an oligopolistic market.¹² The focus of Post-Chicago School is mainly on monopolistic markets and market imperfections such as information gap and high switching costs. It is argued that such markets are not able to remedy these failures alone and government intervention is necessary. The market imperfections such as information gap, high switching costs and entry barriers give unfair monopoly power to some firms even in a market with considerable number of small firms. Therefore, the Post-Chicago Scholars think that the competition authorities have the responsibility to prevent this monopoly from taking advantage of these market imperfections. The Post-Chicago School requires very detailed and complex economic analysis with a special focus on market dynamics and efficiency. Mainly, they criticize the Chicago School by saying that some market structures are not self correcting and allocative efficiency is not wealth maximizing.¹³

The Post-Chicago School finds the definition of real market conditions in Chicago School and Harvard School as over simplified. The possible anti-competitive practices and their effect on efficiency and consumer welfare cannot be defined easily especially when the new industries such as software and internet markets are considered. Therefore each case requires a very complex economic analysis which is the most important drawback of Post-Chicago School. It ignored the judicial and administrative difficulties of this extremely complicated approach. It is argued that the government is responsible to remedy the market failure but the administration agencies and courts may not be able to give the best decision using this complex economic analysis in each and every case. Although the Post-Chicago Scholars came up with impressive definitions of many market structures and conditions that may result in anti-competitive conduct, the judicial and administrative authorities are not able to create a totally new competition rules which can deal with all these complex economic analysis. The judges do not have the necessary skills and knowledge in economics while the economists are still not able to differentiate the anti-competitive actions from competitive ones with clear lines. To sum up, far from being a well

¹² Hovenkamp, Herbert, "Post-Chicago Antitrust: A Review and Critique", *Columbia Business Law Review*, 257, 2001

¹³ Johansen (2005)

functioning alternative approach to Harvard and Chicago School, the Post-Chicago School created many problems.¹⁴

2.4. The European Competition Law Development

In January 1958, with the Articles 85 and 86 (currently Article 81 and 82) in Rome Treaty, the agreements and concerted practices which restrict competition and the abuse of dominant position became illegal in the Community. These Articles were designed for the most important objective of the Community which is the progressive integration and unification of the Member States. Therefore, the wording of the legislative material and cases from the European Court of Justice (ECJ) should be analyzed under the light of this fact. After including the competition law in Rome Treaty, the first influential effect came from Germany which was the first Member State having competition rules in EEC. The competition law of Germany was created by a panel of scholars which is called Freiburg School and they affected the competition rules in EEC in the first years. Freiburg scholars considered the competition law one of the most important elements of economic system in addition to freedom to conclude contract and guarantee for property rights. Until the 1990s, the main concern of European competition law was the market integration but not the practices of the firms which might distort competition and this attitude had been supported both by the Commission and the ECJ until the first modernization attempts.¹⁵

2.5. The European Approach

In 1960s, the European Union created a new approach to competition law combining Freiburg, Chicago, Post-Chicago and Harvard Schools which is called European School. The ambition of the Community is to integrate all the national markets and create one common market. The allocational efficiency should be promoted by further liberalization of the national markets. To maximize the efficiency and maintain a well functioning economic market, the main instrument used by the Commission is the competition law. Therefore, the effect of this objective can be observed in the European Approach to competition law. Although, at the beginning Freiburg School had significant effects, it was just thought and was lack of analytical models. There were three main theories, Chicago, Harvard and Post-Chicago Schools which were suggesting different applied models of thought. The Commission created a conceptual framework considering the European social market models and the objectives of the Treaty. The Chicago was definitely conflicting with the common objectives and their arguments are mainly ignored by the Commission while the effect of

¹⁴ Hovenkamp (2001)

¹⁵ Weitbrecht, Andreas, "From Freiburg to Chicago and Beyond: the First 50 Years of European Competition Law", *European Competition Law Review*, Vol. 29, No.2, 2008, pp 81-88

Harvard School is significant on European competition law. Therefore, the Commission created a system which combines the structure-conduct-performance theory with Post-Chicago School which is called extended -conduct-performance framework. Instead of assuming that the structure affects the conduct and at the end the performance of the market, the Commission considered that these three elements are in interaction and performance also affects the structure of the market. Although this attitude has many problems, it is still considered that some market conditions are prerequisite for anti competitive conducts. Therefore, in the market conditions defined by Harvard School as unsuitable for anti-competitive conducts, it is unlikely that the Commission finds the conduct in question as anti-competitive.

However, it is obvious that the attitude of Commission especially in the application of Article 82 requires a deeper economic analysis. This is mainly because the suggestions of the Harvard School regarding the dominant firms got obsolete. The tendency in the new economic theories which suggest that the monopolistic or oligopolistic markets structures may be the result of increased efficiency and consumer welfare outdated the old suggestions of structure-conduct-performance theory. Especially in innovative markets a proper welfare analysis, which does not just consider the high prices but also the other elements affecting the consumer welfare such as the introduction of new and high quality products or the amount of R&D expenditures, is required. This created a need for deep economic analysis and giving priority to the effect on consumer welfare and efficiency in addition to the objectives of the common market in Article 82 cases.¹⁶ In 1990s, the competition law in EU has started to be Americanized and the consumer welfare and efficiency considerations got greater emphasis from the Commission.¹⁷ Currently, it is still evolving and a new approach is followed by the Commission.

2.6. Conclusion

Three main competition theories which are Harvard School, Chicago School and Post-Chicago School are analyzed in this section. The Harvard School is the oldest one among them and bases its arguments on the old economic theories and traditional market structures. While it is highly formalistic and has been criticized harshly by the next generation economic theories, the Harvard School is the competition theory having the most significant effect on EU competition law. The Chicago School which outdated the many presumptions of Harvard School is considered as too liberal and conflicting with the objectives of the common market by the Commission. The Chicago School rightly recognized the importance of economics-based analysis in competition law and criticized the formalistic approach in abuse of dominant position cases. The effect of Chicago School is very limited in EU

¹⁶ HildeBrand (2002), pp158-169

¹⁷ Andreas (2008)

competition policy while it is highly appreciated in US Antitrust. The Post-Chicago aimed to provide an alternative approach especially for EU competition law but the suggested way of analysis and methodology is found as extremely complicated and complex which may result in serious administrative and judicial difficulties. Since the Post-Chicago School is more formalistic than the Chicago School and gives higher support for government intervention, its effect is stronger in EU competition law. In 1960s, the EU created its own approach, EU Approach, which is affected by all these theories. The EU Approach puts the objectives of the common market especially the further integration between the Member States over the interest of consumers and efficiency considerations. This attitude has been criticized because of its very formalistic approach and lack of deep economic analysis.

3. The European Approach to Abuse of Dominant Position

Article 82 of the Treaty Establishing the European Community mainly prohibits any abuse of dominant position by stating that "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 in so far as it may affect trade between Member States". In Article 82, four possible abusive practices are provided which are very broad and non-specific in language.¹⁸ However before the analysis of whether the dominant firm abused its market power or not, the relevant market should be defined and whether or not the firm is dominant in the relevant market should be decided.

3.1. Defining the Relevant Market

While defining the market, firstly, the Commission analyzes the product market. A firm can only have dominant position for specific type of products or services. If the definition of product market is narrow, it is easier to establish the dominance in the defined product market. Secondly, the Commission defines the geographic market which is the territory where all the traders compete in the same or sufficiently homogenous conditions of competition in terms of the defined products and services. In the third step of the analysis, the Commission checks if the market has temporal factor or not. A firm may have market power in a product market just in a specific time of the year because the competitor products may be available seasonally.¹⁹ For the definition of relevant market, the Commission published a Notice on the Definition of Relevant Market for the Purposes of Community Competition Law.²⁰ The aim of the Commission's Notice is to bring a more economics-based analysis and predictability to the Commission's approach.²¹ The Discussion Paper also refers to the Commission's Notice for a deeper understanding of the methodology in the definition of relevant market.

¹⁸ Dibadj, Reza, "Article 82: Gestalt, Myths, Questions", Santa Clara Computer and High Technology Law Journal, 615, May 2007

¹⁹ Craig, Paul; de Búrca, Gráinne, "EU Law, Text, Cases and Materials" Fourth Edition, Oxford, New York: Oxford University Press, 2008

²⁰ Commission Notice on the Definition of Relevant market for the Purposes of Community Competition Law, 1997, OJ C 372, ,p. 5–13

²¹ Hildebrand (2002)

3.2. Dominance

After defining the relevant product, geographical and temporal elements of the market, the Commission investigates if the firm has dominant position in the defined market. In *United Brands*²², the Court states that the dominant firm has the strength of preventing the effective competition in the relevant market and can behave independently of its competitors, customers and consumers. To establish the dominance of the firm, the Commission utilizes two elements: the market share of the firm and other factors serving to reinforce its dominance. The market share analysis is the central of determination of market power according to the Commission and the Community Courts. In *United Brands*, the Court held that possession of 40-45 percent of the relevant market is an indication of freedom of action which has central importance in determination of dominance. Even if the firm has significant amount of market share, the other factors such as entry barriers, economies of scale and vertical integration are also analyzed. However, despite the suggestions of new economic theories, the existence of high market share is the most important factor in the analysis of dominance in EU competition law.²³

3.3. Abusive Practices

The Article 82 provides a list of possible abusive actions but this list is non-exhaustive and any other actions of the firms that are proved to be anti-competitive can be liable under Article 82. The aim of the Article is not to regulate the monopolistic market but the abusive behaviors of the monopoly. Therefore, the acquisition of monopoly power is not illegal but abusing this power is forbidden under Article 82. The abusive activities defined by EU competition law can be categorized under two main groups: the exploitative actions which are relevant for monopolistic markets and anti-competitive actions of dominant firms. The monopolist exploits its market power through abusive actions against the market players in different levels by excessive pricing, tie-in sales or discriminatory pricing. These abusive actions cannot be observed in a competitive market so government intervention is necessary to remedy such a market failure through competition rules.

In abusive actions, the dominant firm takes advantage of its dominant position through for instance vertical and horizontal mergers, refusal to supply, fidelity rebates, and exclusive or selective distribution systems. Such activities can be observed in highly competitive markets but they weaken the competition in the context of dominant position. In other words, the dominant firm has special responsibility to refrain from actions which may have anti-competitive effect while such actions can be encouraged for

²² Case C-27/76, *United Brands Company and United Brands Continentaal BV v Commission of the European Communities*, 1978, ECR 207, 274, 276

²³ *de Búrca, Gráinne*, 2008

the small firms. This concept was clarified in *AKZO*²⁴ Case in which the Commission provided that the dominant firm has the right to compete with the other small firms in the market and may exclude because of greater efficiency level but not by way of anti-competitive actions. That is to say, the dominant firm has a special responsibility and is not totally free in its strategic decisions against the other small firms operating in the market.²⁵ The Commission did not utilize deep economic analysis and the ruling was definitely under the influence of Harvard School. The same type of non-economic type of analysis can be observed in different types of abuses especially in the exclusionary abuses.

3.3.1. Predatory and Excessive Pricing

The Commission's formalistic approach in case of predatory pricing has been harshly criticized. In *Tetra Pak II*²⁶, the Court ruled that if the dominant firm keeps the prices below certain cost thresholds, this pricing strategy should be considered predatory and anti-competitive which is liable under Article 82. Although Tetra Pak argued that the recoupment is necessary to find such an action as abusive, the Court rejected that argument and added that the risk of eliminating the competition is enough to find the predatory pricing strategy liable under Article 82.²⁷ This attitude is definitely conflicting with the Chicago School and the recent economic theories which suggest that keeping the prices below a certain threshold is anti-competitive as long as the market is eliminated from competition. Actually such a pricing strategy improves the consumer welfare by offering low prices for a long time and the empirical data show that it is very unlikely that the dominant firm can really eliminate competition in such a market and recoup its losses in the future.²⁸

United Brands is the leading judgment regarding another abusive action which is excessive pricing. The Court ruled that the excessiveness of the prices can be determined based on the production costs and the price set by the dominant firm can be found abusive based on this production costs or compared to the prices of competing products. However, the Commission was aware that the determination of production costs is a very difficult task especially in such big and complex corporations. The judgment was criticized a lot because it was obvious that the Court was lack of economic understanding and ignored the fact that the actual cost structure of dominant firm cannot be determined in this way. It can be again referred to Chicago School and new economic theories which suggest that using the production cost of a dominant firm and comparing the prices with the competing products to determine if the prices are excessive or not is an over simplified

²⁴ Case C-62/82, *AKZO v. Commission*, 1991, ECR 3359

²⁵ Frazer, Tim, "Monopoly, Competition, and the Law", Harvester Wheatsheaf, New York, London, Toronto, Sydney, Tokyo, Singapore, Second Edition, 1992

²⁶ Case T-83/91, *Tetra Pak International SA v. Commission*, 1994, ECR 762

²⁷ *Hildebrand* (2002)

²⁸ *Glader* (2004)

and wrong analysis because the production cost of the dominant firm can be very low due to the efficiency gains and economies of scale.²⁹

3.3.2. Tying and Bundling

Bundling means selling two products together while tying is a more legal concept which occurs when the purchase of tying product is made conditional on the purchase of another good. According to EU competition law, these two products should be “separate products” while this definition is not meaningful in economic theories. It is economically not possible to really decide if the tying and tied products are separate or not. Although tying arrangements are listed among the possible abusive practices of dominant firm, tying is a very common commercial practice of the firms. Every seller would refuse to break down its product into smaller components while it is true that there will be demand for these small components by the consumers. There are two main theories regarding the tying arrangements. The classical approach provides that tying is generally an anti-competitive action and the business purpose achieved by tying arrangements can be also achieved through less restrictive ways. The more economics-based approach in Chicago School states that tying is generally efficiency enhancing and pro-competitive. The EU approach has been closer to the classical approach in which the per se prohibition is applied in tying cases without considering the real effect on consumers. The tying practice of the dominant firm is analyzed with reference to its form but not to its actual effect. Although, in *Microsoft*³⁰ Decision, the Commission recognized the possible efficiency gains of tying arrangements, the starting assumption is still in conflict with the new economic theories and suggests that tying is generally anti-competitive.³¹

3.3.3. Rebates

The ECJ and the Commission has considered the fidelity discounts and rebates abuse of dominant position under Article 82. In fidelity discounts, the dominant supplier of a product requires the customers to make exclusive purchasing agreement for a substantial discount. By way of doing this, the dominant firm creates entry barriers and prevents the competing firms from entering the market. While the quantity discounts are acceptable under Article 82, the fidelity rebates are fined heavily by the Commission. ECJ provided in *Hoffman-La Roche Case*³² that the fidelity rebates making discrimination against the customers purchasing the same amount of

²⁹ Frazer (1992)

³⁰ Commission Decision *Microsoft* 24 March 2004 COMP/C-3/37.792

³¹ “GCLC Research Papers on Article 82 EC”, Global Competition Center, College of Europe, Brugge, July 2005, <http://www.coleurop.be/content/gclc/documents/GCLC%20Research%20Papers%20on%20Article%2082%20EC.pdf>, (Accessed on April 28 2009)

³² Case 85/76, *Hoffmann-La Roche & Co. AG v EC Commission*, 1979, ECR 461

products from the dominant firm according to whether they make business with the competing firms is a serious abusive conduct and unjustifiable.³³ In *Michelin*³⁴ Case, the ECJ provided a similar conclusion in which it states that the type of fidelity discount system in question limits the customers' choice and makes the access of other dealers to the market more difficult. Therefore, the Court ruled that the fidelity discount in question cannot be economically justified. The Court in these two cases did not analyze the relationship between the discount system and the cost structures of Hoffman-LaRoche or Michelin. The attitude of the ECJ and the Commission has been criticized because of the lack of sufficient economic reasoning in the rulings and cost-based standard to analyze the fidelity discounts and rebates.³⁵

3.3.4. Refusal to Supply

Refusal to deal as an abusive conduct means that the dominant firm refuses to provide service or supply goods to an undertaking on reasonable terms. This conduct is abusive when the products or service provided by the dominant firm are key inputs for the other undertaking to be able to reach the end customers. Refusal to deal especially weakens the competition in the market when the depended undertaking is a competitor of the dominant firm.³⁶

The Commission has a strict approach and argues that the dominant firm has "special responsibility to supply" where an undertaking is depended to the dominant firm to be able conduct business. The leading case regarding the EU approach to refusal to deal cases is the *Commercial Solvents*³⁷ in which a dominant firm refused to supply a raw material which was key input for the depended undertaking. The dominant firm refused to supply because it intended to enter the market in the future and tried to eliminate competition before entering the market. ECJ emphasized the intention of the dominant firm to weaken the competition and declared that refusal to supply to exclude a competitor in one market before entering this market is abusing the dominant position. According to the Commission, the dominant firm has a duty to supply and such an action is abusive unless the dominant firm has reasonable justification for its action. This case has been criticized a lot because of the lack of sound economic analysis and qualitative analysis. Although, in the later judgments the Court used better analytical framework

³³ Frazer (1992)

³⁴ Case 322/81, N.V. Nederlandsche Banden-Industrie Michelin v. Commission, 1983, ECR 3461

³⁵ Duncan, A. Richard/ McCormac, S. Brian, "Loyalty and Fidelity Discounts and Rebates in the US and EU: Will Divergence Occur over Cost-Based Standards of Liability?", *Sedona Conference Journal*, J. 133, Fall 2008

³⁶ Nagy, Csongor Istvan "Refusal to Deal and The Doctrine of Essential Facilities in US and EC Competition Law: A Comparative Perspective and Proposal for a Workable Analytical Framework", *European Law Review*, Vol. 32, No.5, 2007, pp. 664-685

³⁷ Case 6-7/73, Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation v EC Commission, 1974, ECR 223

and economic analysis, the EU approach to refusal to deal cases is still found to be poor by the scholars.³⁸

The problem with the EU approach is that it forsakes the economic efficiency gain for the short-run interest of the consumers. The EU over-emphasizes on the “essential facilities doctrine” and does not use economic analysis in refusal to deal cases. However, the new economic theories suggest that EU’s Approach can actually hamper the competition in the long run and decrease the incentive of the dominant firm to invest in areas which will be opened to competitors by the Court orders. Therefore, the competitors may not want to invest in their own facilities because they consider that the Court will provide access to these facilities. Such a competition policy hampers the innovative activities, decreases the dynamism and efficiency level in the market.³⁹ After all the criticism it got in *Commercial Solvents Case*, the ECJ applied the essential facilities doctrine in a narrow sense and considered the significance of encouraging innovation and investment by the dominant firm in *Bronner*⁴⁰ Case. In *Bronner Case*, an Austrian newspaper group holding a dominant position refused to deliver newspapers of a small publisher through its national home-delivery service. The small firm brought action against this action and the national court referred to ECJ to determine if this action was abuse of dominant position within the meaning of Article 82. The Court brought three criteria for the conduct of refusal to deal to be abuse under Article 82.

Firstly, whether the refusal is likely to eliminate all the competition in the market by the dominant firm or not should be analyzed. This criterion is quite different from US approach which is very much affected by Chicago School. So the question is not really if the competition would be eliminated in that market or not but whether the undertaking in question could survive without the service or product provided by the dominant firm or not. The second criterion is if this conduct is objectively justified or not. And the third one is if the service or product refused to be supplied is indispensable to business in that downstream market. Apparently, in *Bronner Case* one of the most important reasons of the change in the Court’s attitude towards the essential facilities doctrine was the opinion of Advocate General Jacobs⁴¹ which was influenced by the recent economic theories. He suggests that the application of this doctrine decreases the incentive of the firms to make investment. Although the EU’s approach may have positive effects on static economy, it will have negative effects on the dynamic economy. Secondly,

³⁸ Stothers, Christopher, “Refusal To Supply as Abuse of a Dominant Position: Essential Facilities in the European Union”, *European Competition Law Review*, Vol. 22, No. 7, 2001, pp 256-262

³⁹ Nagy (2007)

⁴⁰ Case C-7/97, Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG, 1998, ECR 07791

⁴¹ Opinion of Mr Advocate General Jacobs delivered on 28 May 1998, Case C-7/97, Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG, ECR 07791

he referred to the US approach and suggested that the dominant firm should also have significant market power in the downstream market. Lastly, Jacobs emphasized the recent economic theories which suggest that the regulation of such markets is very costly and does not provide enough benefits which may outweigh the associated costs.⁴²

3.4. Conclusion

To sum up, although both the EU and US which is more influenced by Chicago School and recent economic theories acknowledged the importance of promoting innovation in refusal to deal cases, their attitudes are significantly different. EU considers the monopolists or dominant firms refusing to supply an obstacle to enhancement of innovation in one market, US argues that they improve the innovation. Actually, this divergence of attitude can be observed in all types of exclusionary abuses. As it can be observed in the European 2005 Discussion Paper, the EU is trying to solve this divergence problem and to utilize a more economics-based approach in these cases. However, the problem is that the EU competition law should be renewed and a more economics-based approach should be applied. While the US is using the economic analysis more and more in abuse of dominant position cases, EU has been still under the influence of Harvard School and is following a formalistic approach prohibiting the practices of dominant firms due to the legal form not on the grounds of economic analysis and effect on consumers.⁴³ The most important reason of this approach is that the EU Competition law is not just about economic analysis and microeconomics but also is a part of EU policy for further integration and harmonious functioning of the internal market. While the entry barriers are being dismantled in the Union through abolishing the tariff and non-tariff barriers between the Member States, the Commission cannot let the private entities to create barriers through concerted practices or abuse of dominant position. Therefore, the new approach should not jeopardize these common objectives of the Treaty by modernizing the EU competition law through the utilization of more and more economic analysis.⁴⁴

⁴² Stothers (2001)

⁴³ “Monopolists’ Refusal to Deal in IP:US Courts and EU Institutions line up along some Cultural and Jurisdictional Cleavages”, European Policy for Intellectual Property(EPIP), 3rd Annual Conference of the EPIP Association, http://www.epip.eu/conferences/epip03/papers/Maggiolino_Berna%20paper_final%20version_September%2011.pdf (Accessed on 8 April 2009)

⁴⁴ Dibadj (2007)

4. Modernization of Article 82 and the Commission's New "Effects-Based Approach"

4.1. The reasons for the Modernization of Article 82

For years, the EU competition law has been criticized for its formalistic approach but these criticisms did not gain much attention until mid-1990s. In 1980s, the Chicago School significantly affected the US competition law. The divergence between US antitrust and EU competition law became apparent in 1990s and the Commission recognized the significance of the criticisms. Therefore, the Commission started to work in collaboration with US officials to learn more about the US antitrust and the economic approach they are utilizing. After many meetings and joint projects, the number of the Commissioners looking for a modernized EU competition law which is more affected by the Chicago School increased. Another factor was the economic performance of US during the 1990s which was better than EU's performance. Many scholars blamed the Commission for its significant interventions in business activities and called for a more liberalized market for the European firms to be able to compete with the US firms.⁴⁵

After all the discussions and criticism against the formalistic approach of EU competition law, in December 2005 the Commission published a Discussion Paper regarding the exclusionary abuses of dominant firms under Article 82. The Discussion Paper provides for an effects-based approach in which increasing efficiency and consumer welfare will be the principles in the application of Article 82. The effect-based approach argues for utilization of more economic analysis and the general approach is closer to Chicago School liberalization.⁴⁶ The modernization process includes two components. First one is weakening the effect of common objectives of the EU such as further market integration on EU competition law. The new objectives are defined as increased consumer welfare and promotion of efficiency. The second component is to redefine the methods and standards of competition based on these new objectives. These two components together created the new approach of the EU competition law which is so called "economics-based approach" or "effects-based approach".⁴⁷

⁴⁵ Gerber, David J. "Two Forms of Modernization in European Competition Law", *Fordham International Law Journal*, 1235, May 2008

⁴⁶ Bishop, Simon / Marsden, Philip, "Editorial the Article 82 Discussion Paper: A Missed Opportunity", *European Competition Journal*, April 2006,

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=985509, (Accessed on 15 April 2009)

⁴⁷ Gerber (2008)

Economics-based approach argues that the ultimate goal of the competition law is to protect the rights of the consumers but not the competitors. Competition is necessary for the firms to respond to the needs and wants of the consumers and offer high quality products with lower prices and higher variety. However, competition is a natural process in which the more efficient firms replace the less efficient firms. Therefore, economics-based approach aims to create a more competitive European economy by increasing the total efficiency and consumer welfare in the EU.

Economics-based approach provides mainly two benefits. The effects-based analysis requires a deep economic investigation in each case to evaluate the effect of the dominant firm's conduct on the specific market. By focusing on the effect of the conduct rather than the form of the conduct, the possibility of the firm to circumvent the competition rules by adopting different business practices to achieve the same anti-competitive effect is decreased. Therefore two different practices which result in same anti-competitive effect on the market are treated in the same way. Secondly, effects-based approach guarantees that some pro-competitive conducts which could be considered as abusive practices under the formalistic approach will be evaluated objectively. It is true that some business practices can have different effects in different circumstances: they can promote innovation in some cases while they can distort competition in other cases. Therefore, the effects-based approach can analyze these cases with a focus on their real effect on consumer welfare and total efficiency gain and can provide the most objective and correct analysis.⁴⁸

4.2. The Discussion Paper and the New Effects-Based Approach: Is the Commission's New Approach Really "Economics-Friendly"?

As it is mentioned before, the analysis of Article 82 constitutes two-step test. Firstly, it should be established that the firm which is investigated is enjoying a dominant position with significant market power on the relevant market. When this is established, whether the conduct of the firm is abuse or not should be analyzed. During this analysis, the focus of the Commission which is also supported by the Courts is on the legal form of the conduct rather than the actual effect of this conduct on competition. The effects-based approach suggests that the conduct of dominant firm can be pro-competitive and consumer welfare enhancing although it can be defined as a

⁴⁸ Report by Economic Advisory Group for Competition Policy(EAGCP), Gual, Jordi/ Hellwig, Martin/Perrot, Anne/ Polo, Michele/ Rey, Patrick/ Schmidt, Klaus/ Stenbacka, Rune, "An Economic Approach to Article 82 Report by the European Advisory Group on Competition Policy", July 2005, <http://www.sfbtr15.de/dipa/82.pdf>, (Accessed on 10 April 2009)

clear abuse according to the wording of Article 82. Some conducts of the dominant firm such as fidelity rebates or tying can be harmful for the other small firms in the market while it is very beneficial for the consumers as these practices may deliver immediate benefits to the consumers in the form of low prices or unique product offering. Therefore, the Discussion Paper points out that the real effect on consumers and efficiency should be analyzed in the second step instead of directly calling the conduct as an abuse based on the definitions of old economic theories. This attitude has also implication on the definition of dominant firm. Considering the fact that these conducts are adopted by the non-dominant firms frequently and they are not considered as abuse, the investigation of the conduct should not be based on the fact that the firm is dominant but be based on the effect of the conduct on consumer welfare and efficiency.⁴⁹ In this section, the new attitude brought by the Discussion Paper and whether the Paper provides a real economics-based approach to Article 82 or not is analyzed in detail.

4.2.1. Market Definition and Dominance

The first phase of Article 82 analysis is defining the market and verifying the existence of a dominant position. The Discussion Paper mainly refers to the Commission's Notice regarding the definition of a relevant market. However, it adds to the Commission's current attitude in one issue which is "cellophane fallacy". It is provided that the inability to increase the prices without significant substitution does not necessarily show wider markets. Instead, it could reveal that the prices are set at supra-competitive level. Therefore, "cellophane fallacy" is an easy to apply tool to avoid this problem.⁵⁰

Regarding finding the dominance, the Discussion Paper defined the dominant position as a position having significant amount of market power which enables the dominant firm on the relevant market to behave independently from its competitors, customers and consumers. From this definition, a firm to be considered as dominant should have a leading position on the market without effective competitive constraints while the dominant firm and other players acting on the market. Based on this definition, there can be two types of markets which should be analyzed under Article 82: one is the pure monopoly situation in which the dominant firm is the only player on the market and second is the market leadership in which the dominant firm has other competitors on the market. Second scenario which is the most controversial and problematic situation can be analyzed under two groups. In the first one, there are entry barriers; the number of competitors is set exogenously so the dominant firm can really act independently. In the second scenario which is more frequently

⁴⁹ Bishop & Marsden (2006)

⁵⁰ Hildebrand, Doris, "EE&MC Comments on DG Competition's Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses", European Economic & Marketing Consultants, April 2006, <http://ec.europa.eu/competition/antitrust/art82/113.pdf>, (Accessed on 15 April 2009)

observed, there are not significant entry barriers and the competition in the market is effective. In this case, aggressive strategies can be applied by the dominant firm to maintain its market position in the market. However, the economic realities are conflicting with the Discussion Paper's definition as these aggressive strategies are usually beneficial for the consumers and are routinely applied strategies by all the firms on the market.⁵¹

Therefore, at this point the Discussion Paper creates ambiguity by saying that when the entry is easy by the competitors, a high market share is not really an indication for dominance. Therefore, the Commission should assess whether the entry would have been easy and immediate enough to prevent the dominant firm from charging price above competitive level.⁵² Moreover, it is stated that when the firm with substantial market share is compelled by the other players on the market for a price reduction, it is unlikely to find dominance on this market. Although, these two suggestions look like reasonable, the new economic theories go further by saying that in these circumstances dominance can never be found out. Because when the entry barriers are significantly low and the competitors are strong enough to force for a price reduction, the firm with high market share cannot act independently which shows the non-existence of substantial market power.⁵³

The Discussion Paper stresses upon the market share which is still considered as the decisive factor for recognition of market power. Although, the product differentiation is also mentioned as a proxy to assess the market power of a firm, the fact that the structural indications do not always provide the correct tools to measure the market power is not stressed enough.⁵⁴ The Commission's emphasis on the market share is conflicting with the modern economic theory. The market leaders have higher market shares when there is effective competition in the market and the potential entrants stand as a threat for the dominant firm. If the dominant firm is constrained with effective competition, it adopts aggressive pricing and investment strategies and tries to be more efficient. Thus the dominant firm gets larger and expands its market share. This means that there is no certain positive correlation between the market power and market share.⁵⁵ In the EAGCP's report, this fact is rightly recognized and it is provided that the structural indicators which are proxies for dominance can be the right tool in some cases but not all the cases especially in high-tech sectors and New Economy industries such as computer hardware and software, online businesses and biotechnology.⁵⁶

⁵¹ Etro, Federico, "The EU Approach to Abuse of Dominance", International Think-tank on Innovation and Competition, U.C.S.C., Department of Economics and ECG, Milan, February 2006, <http://www.intertic.org/Policy%20Papers/EU%20Antitrust.pdf>, (Accessed on 12 April 2009)

⁵² Akman, Pinar, "The EC Discussion Paper on the Application of Article 82", Norwich Law School, Centre for Competition Policy, March 2006, <http://ec.europa.eu/competition/antitrust/art82/004.pdf>, (Accessed on 15 April 2009)

⁵³ Etro (2006)

⁵⁴ Akman (2006)

⁵⁵ Etro (2006)

⁵⁶ Report by EAGCP (2005)

The Discussion Paper also fails to bring a new approach to the problem of dynamic versus static analysis of the market. In high-tech and New Economy industries, the competition is dynamic and any static analysis of the market which reveals a large market share of a firm does not mean that this firm has market power. In a static analysis, the potential competition and the R&D investments made by the future competitors (and this situation is frequently observed in New Economy industries) are ignored. Therefore, the static and market-share-based analysis of the Discussion Paper may come to the conclusion that the firm with large market share has significant market power in a specific market while this market is highly competitive in dynamic sense. The static analysis of the dominance, which suggests that large market share which has been held for some time is an indication for dominance, is misleading in high-tech industries. The firm with high market share should invest in R&D and innovate to preserve its market share in high-tech industries when they are confronted with effective competition. Therefore this firm stays as a market leader for some time because of its aggressive investment policies while there is effective competition in the market.⁵⁷

Although the promise of the Discussion Paper is being effects-based and more economics friendly in the assessment of the market definition and dominance, the message is not clear and the new approach fails to be economics-based in some cases. It should be stated that the establishment of dominance should be based on careful and detailed economic analysis of the real conditions of the market instead of stressing the significance of the market share in the analysis. It should be clarified that the substantial market share is not synonym of market power and dominance. Even a company with 100 percent market share can be non-dominant if there is effective competition in the market as it is in high-tech industries. In high-tech industries where high fixed costs of production and R&D can be observed as entry barriers, the market leader usually does not adopt anti-competitive practices mainly because of the threat of potential entrants. These entry barriers do not make the entry impossible and the firm with high market share is still confronted with effective competition. Therefore, this issue should be elaborated by the Commission in the future to provide an unambiguous guideline for the firms especially for the ones in New Economy industries.⁵⁸

⁵⁷ Etro (2006)

⁵⁸ Hildebrand (2009)

4.2.2. Exclusionary Conducts

4.2.2.1. Predatory Pricing

Regarding the predatory pricing, Discussion Paper suggests that it is an illegal conduct under Article 82 if the dominant firm utilizes this pricing strategy to protect or strengthen its position in the market. Moreover, predatory pricing is a relevant abuse as long as the firm practicing this strategy is a dominant firm. In predatory pricing, the Discussion Paper rightly recognized that this strategy only makes sense when the dominant firm is able to recoup its short-term losses in the future. Although this approach to predatory pricing is economics-based and was not used in old approach, the Commission does not consider the proof of future recoupment necessary to find the conduct as abuse of dominant position.⁵⁹

The Discussion Paper analyzes the predatory pricing strategies under two groups: when the price is below average avoidable cost which is the average marginal cost of the extra output and when the price is above the average avoidable cost but below average total cost. When the price of the dominant firm is below the average total cost, it is considered as a certain abuse because the firm could have avoided this cost when it had not produced a discrete amount of extra output which is subject to abuse. This theory is in line with the old economic theory which suggests that the price which is below the marginal cost always has predatory purpose. The Discussion Paper replaces the average variable cost with average avoidable cost. However, this new approach is also criticized because the average avoidable cost can be higher than the right theoretical concept when it also includes the fixed costs. Moreover, measuring the average avoidable cost rightly is very difficult because it is almost impossible to isolate the cost of extra output from the total output. In addition, the pricing strategy of keeping the prices below marginal cost is an ordinary pricing strategy in some cases such as in presence of network externalities. Therefore, the usage of average avoidable cost instead of average variable cost does not provide the best results for the analysis of predatory pricing.⁶⁰

In this case, according to the Discussion Paper, the dominant firm can justify this conduct by saying that it is just minimizing its losses for instance in case of strong learning effect and start up costs. However, this approach is conflicting with the general EU competition rules as the predatory pricing cannot be justified based on efficiency defense when the price of the dominant firm is below the average avoidable cost in predatory pricing cases.⁶¹ Moreover, the list of possible justifications is missing a very important component which is the network effects whose effect is very similar to learning effect.⁶²

⁵⁹ Akman (2006)

⁶⁰ Etro (2006)

⁶¹ Akman (2006)

⁶² Etro (2006)

The second case in which the dominant firm charges prices above the average avoidable cost but below average total cost is more controversial. The Discussion Paper suggests that such a pricing strategy is abuse of dominant position when the firm has a predatory intent. This approach can be very misleading firstly in cases where the competitors are also operating at the same efficiency level with the dominant firm. In this case, the competitors will not want to leave the market when the price is set below the average total cost by the dominant firm because it will be profitable for them to stay in the business as long as the price is above the average avoidable cost. The Discussion Paper suggests analyzing the financial market if they are willing to finance the other small firms in the market. However, this attitude is also wrong because the capital market will definitely want to finance the firms operating at the same efficiency level with the dominant firm. Even if the capital markets do not want to finance, these firms would prefer to stay in this business to make some money instead of making no money. Finding the predatory intent is also a wrong approach because all the competitive firms want to eliminate or decrease the competition in a market. Any firm in a market will want to cut the prices if it makes commercial sense and this strategy is promising an increase in the sales of the firm. Therefore, whether it is dominant or not, this strategy will impair the competition in the market and the other firms never react as leaving the market.⁶³

Regarding the third scenario in which the dominant firm's price is above the average total cost, the Discussion Paper brings a very radical approach and considers it an abuse in some circumstances. According to Discussion Paper, the price above average total cost can be considered as abuse if the economies of scale are significant; the production of new entrants is below the minimum efficient scale; and the price set by the dominant firm is below the average total cost of the entrant. Therefore, the Discussion Paper is broadening this concept to all the pricing strategies of a dominant firm which is relatively lower. When the dominant firm engages in limit pricing, it can be liable under Article 82 because of the predatory nature of its pricing strategy but it can be again liable under Article 82 when it practices excessive pricing. Moreover, the new entrant although it has lower efficiency level, it will definitely increase its efficiency and will not leave the market because of the prices above average total costs. Therefore, the Discussion Paper in this issue does not bring any solution while it makes the economic analysis of predatory pricing very complex. Moreover, the main objective of the competition law is determined as increasing the consumer welfare by the Discussion paper, while this new attitude encourages the dominant firm to increase the prices which harms the consumers and does not provide any real benefits for encouraging entry and long-term competition.⁶⁴

⁶³ Elhauge, Einer, "Comments of Professor Elhauge on DG Competition Discussion Paper on Exclusionary Abuses", Harvard School, March 2006, <http://ec.europa.eu/competition/antitrust/art82/072.pdf>, (Accessed on 17 April 2009)

⁶⁴ Elhauge (2006)

4.2.2.2. Tying and Bundling

For many years, tying cases are analyzed under formalistic approach and considered as abuse of dominant position in EU competition law without considering the actual effect on competition and consumers. The Discussion Paper aims to bring a more economics-based approach to tying cases with a focus on their effect on competition. However, the suggested framework to analyze these cases is still very much affected by the formalistic approach and does not utilize the economic analysis. The paper rightly provides that the tying practice is generally efficiency enhancing with the aim of providing better quality products in cost effective ways. However, the focus on the paper is controversially on the anti-competitive effects of tying. The economic theories suggest that tying is very often pro-competitive and increases the efficiency while lowering the production, distribution and transaction costs especially in “*technical tying*”.⁶⁵ (“*Technical Tying*” means that the tied product is physically integrated in the tying product and it is analyzed in *Microsoft* case where the Windows Media Player was tied to the Windows Operating System.)⁶⁶ Although the economic theories proved that “*technical tying*” improves the performance, functionality, quality of the products, the Discussion Paper shows that the Commission is still loyal to the formalistic approach towards tying cases and fails to recognize the new economic theories. The new approach should have considered the tying and bundling efficiency enhancing and non-abusive unless proven otherwise.⁶⁷

The Discussion Paper identifies four conditions for the tying conduct to be liable under Article 82. Firstly, the firm in question should be dominant in the tying market. The second condition which provides that the tying and tied products should be two distinct products is a more controversial condition. According to the Discussion Paper the products that would be purchased separately in consumers’ perspective are distinct products. The broad application of this approach can be very misleading as any product can be considered as bundle because the consumers are very often willing to buy the products separately. The Paper should have been more focused on the effect on competition and consumer welfare instead of depending on the formalistic definitions.⁶⁸ Actually, the right question for identifying the distinct products should be if the consumers would be really willing to buy the tying product without the tied product or not. Moreover, using this test for the technically integrated products which were sold distinctively previously can be also misleading. The right question should be whether the

⁶⁵ Report by American Chamber of Commerce to the European Union, “Comments on the DG competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses”, April 4 2006, <http://ec.europa.eu/competition/antitrust/art82/037.pdf>, (Accessed on 18 April 2009)

⁶⁶ Akman (2006)

⁶⁷ Report by American Chamber of Commerce to the European Union (2006)

⁶⁸ Report by RBB Economics, “The Response of RBB Economics to the DG Competition Discussion Paper on the Application of Article 82 of the Treaty to the Exclusionary Abuses”, March 2006, <http://ec.europa.eu/competition/antitrust/art82/068.pdf>, (Accessed on 19 April 2009)

company has any efficiency gains as a result of tying these products or not as the technical tying should be efficiency enhancing according to the new economic theories.⁶⁹

The third criterion is that the tying or bundling should result in foreclosure of competitors in the tied market. The Discussion Paper suggest that when the dominant firm ties a sufficient part of the market, the Commission will likely come to the conclusion that the conduct has a foreclosure effect on the competitors.⁷⁰ This attitude definitely does not reflect the fact that tying arrangements are efficiency enhancing. The standard to prove its abusive nature is very low. The foreclosure effect on competitors is usually low when there is still demand for unbundled products because the other companies will find a way to make profit in such a case. Moreover, according to the Discussion Paper's standard, it is very easy to establish the foreclosure effect of tying arrangement. Showing the real anti-competitive effect of the tying arrangement on the market and consumer welfare is not necessary as long as the Commission proves that the conduct has potential foreclosure effect on competition. This attitude will have deterring effect on the dominant firm to introduce bundled products although the dominant firm is certain that there will not be actual effect on competition.⁷¹

Finally, the last criterion provides that it is the defendant firm to prove that its tying conduct has efficiency gains which outweigh the negative impact on competition. However, the new economic theory suggests that this attitude of the Commission discourages the tying arrangements which are efficiency enhancing. It should be the Commission or the national competition authorities to prove the negative effect on the competition and consumers once the dominant firm shows the efficiencies. The Discussion Paper should have suggested this system because it is also more appropriate that the competition authorities or the Commission makes the efficiency analysis as they have better resources and analytical tools for such an analysis.⁷²

4.2.2.3. Rebates and Single Branding

The new economic theories support that the discounts and rebates should be encouraged even for the dominant firms as they are consumer welfare enhancing and pro-competitive while they are harmful for the competition in exceptional circumstances. The dominant firm should not be compelled to justify its conduct as the exclusive dealing arrangements are very often found as pro-competitive by the economic theories. Although the pro-competitive effect of single branding and rebates is emphasized at the beginning by the Discussion Paper, it later provides that they can be loyalty enhancing in some cases. Making an assumption that the single branding is

⁶⁹ Etro (2006)

⁷⁰ Report by RBB Economics (2006)

⁷¹ Etro (2006)

⁷² Report by American Chamber of Commerce to the European Union (2006)

anti-competitive can be very misleading and harmful for competition. For instance in some markets, it is an ordinary commercial practice that the buyer demands for an exclusive purchasing agreement in return of low prices. And when the dominant firm makes this exclusive dealing, it affects the substantial amount of the market. However, this practice is just an ordinary commercial practice and there is no proved harm on competition. Therefore, the Discussion Paper should have started the analysis with the presumption that the single branding and rebates are usually consumer welfare and efficiency enhancing.⁷³ Moreover, it is stated that when the dominant firm uses rebates to maintain or strengthen its position in the market, it is abuse of dominant position as the growth of competition is hindered. However, such aggressive strategies exist when there is effective competition in the market. It is very normal for the dominant firm to adopt such strategies to increase or maintain its market share and the Discussion Paper also allows the dominant firm to compete effectively. Therefore, it is hard to understand why the dominant firm is forbidden from adopting rebates which would result in long-term aggressive price competition.⁷⁴ According to the general attitude of the Discussion Paper, when the existence of dominance is established, applying rebate by the dominant firm is almost always abuse of dominance under Article 82 as it will somehow distort competition.

The Discussion Paper provides five conditions which must be met for a rebate system to be abuse under Article 82. These four conditions include complex calculations and formulas to make an economic analysis. Firstly the method provided has many artificial assumptions and is not consistent with the recent economic theories. Moreover, the calculation method is too complex to be applied by the firms in their daily business activities.⁷⁵ The conditional rebate system discussed in the Paper is actually a simple quantity discount system which is proved to be welfare enhancing. When the percentage rebate is small enough, the rebates should never be considered as abuse. Regarding the fidelity rebates which is a sign of aggressive pricing strategy and effective competition in the market should be abuse just in case of the inability of competitors to offer the same kind of rebates or different ones. Moreover, the theoretical formulation provided is very inconsistent with the new economic theories. Therefore all the complexity, inconsistency and ambiguity in the Discussion Paper results in legal uncertainty. The system is especially harmful in innovative markets where the dominant firm engages in R&D and does not manufacture the products. In this case, the dominant firm should give incentive to manufacturers in the downstream market to expand sales and to make further investment. The fidelity rebates decrease the cost of the manufacturer and helps it to recover the huge fixed costs. Since the discount

⁷³ Report by American Chamber of Commerce to the European Union, (2006)

⁷⁴ Report by International Chamber of Commerce, the World Business Organization, "ICC Comments on the European Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses", 2006,

<http://ec.europa.eu/competition/antitrust/art82/106.pdf>, (Accessed on 22 April 2009)

⁷⁵ Etro (2006)

it got from the dominant firm is reflected to the end customers, the incentive for manufacturer to expand its sales is created. Where the innovator is allowed to provide fidelity rebates to the contestable markets and to charge higher prices to the markets with inelastic demand, the innovator can recover its R&D costs and an incentive for further investment is created.⁷⁶ Therefore, the Commission should adopt a more economics-based approach towards the rebates in especially high-tech markets to further encourage innovation in the EU in the long-run.

The attitude of the Discussion Paper against the unconditional rebate schemes in which the dominant firm provides rebates independent of their purchasing habits is also not economics-based. According to the Discussion Paper, such rebate schemes are usually adopted to force the customers to switch to the dominant firm by charging lower prices. Therefore, the dominant firm is forbidden from making price discrimination and competing on price. However, the economic theories tell us that the rebates are the result of ordinary competition as the oligopoly just charges lower prices than the monopoly in the existence of substitutes. Therefore, by preventing the dominant firm to offer lower prices to increase its market share, the Discussion Paper is actually harming the consumers while it is protecting the competitors. This is in conflict with the main objectives mentioned by the Paper itself. Moreover, the Discussion Paper mentions that the unconditional rebates which are exclusionary in nature are abuse within the meaning of Article 82. However, this statement results in duplication as offering prices below average avoidable cost is analyzed under the predatory pricing. Stressing this issue under the rebate schemes just creates a disincentive for the dominant firm to engage in aggressive competition while it does not provide any benefit in terms of promoting effective competition.⁷⁷

4.2.2.4. Refusal to Supply

Regarding the refusal to supply, the Discussion Paper recognizes that it may have negative effect on the short-run competition while a strict policy against refusal to supply can also hamper the long-run investment incentives. However, the suggested approach and the method of analysis are still very close to the old approach and are not economics-based. Every year, the national competition authorities and the Commission get many cases regarding the refusal to supply but almost all of them are raised by the firms which are complaining about not getting supply from the dominant firm while there is no effect on competition. In these cases, there is usually very little or no effect on competition or the effect is pro-competitive and consumer welfare enhancing. Therefore, a new type of analysis in refusal to supply was very significant to avoid compelling the dominant firm to supply while there is no substantial anti-competitive effect. However, it is clear that

⁷⁶ Report by International Chamber of Commerce (2006)

⁷⁷ Report by RBB Economics (2006)

the new approach suggested by the Discussion Paper failed to bring a new economic-based approach to refusal to supply cases. The Paper categorizes the refusal to supply cases in two groups: where the dominant firm is operating in the downstream market and where it is not operating in the downstream market. The Discussion Paper provides that refusal to deal can be abuse even if the dominant firm is not active in the downstream market. If the dominant firm is active in the downstream market, it can be abuse only if there few competitors in that market, this creates too much uncertainty. To consider a refusal to deal conduct abuse under Article 82, the actual effect on the competition should be analyzed instead of depending on formalistic definitions.⁷⁸ The Paper identifies three different situations where the refusal to supply can be abusive: when there is an existing supply relationship, where the dominant firm refuses to start supply relationship (including the IPRs cases) and when the input is information which is necessary for interoperability.

For the first case, the Discussion Paper provides four conditions to consider it abusive: the conduct should be characterized as termination of the supply arrangement; the firm refusing to supply should have dominant position; the conduct should have negative effect on competition; and the conduct should not be justified objectively or by efficiencies.⁷⁹ The Discussion Paper suggests that if a dominant firm ceases to supply a firm which made investment depending on the existence of the supply, it is definitely abusive. Moreover, in case of terminating a supply relationship, there is no requirement to show the indispensability. However, the economic theories provide that continuing a supply relationship is not necessarily pro-competitive. It should be the firms to freely decide whom it makes business except for the cases where the firm in the downstream market is very much depended on the supplier. Otherwise, compelling the dominant firm for the continuation of its existing supply relationships creates a disincentive to start supply arrangements in the first place.⁸⁰

Regarding the cases where the dominant firm refuses to commence to supply, the indispensability criterion is added to the list provided above. The Discussion Paper provides that the incentive to invest and innovate should be protected and the dominant firm has the right to get compensation for supplying a certain service or products. Therefore, the dominant firm may also exclude some firms from accessing to its facilities for a certain period of time. This should be allowed to create incentive to invest and innovate although it can eliminate or hamper the effective competition in this period of time. The analysis of such cases is especially complicated when the supplied product or service has IPR.⁸¹ The Discussion Paper maintains the position taken by the ECJ in *IMS Health*⁸² Case. The Court ruled in *IMS*

⁷⁸ Report by RBB Economics (2006)

⁷⁹ Etro (2006)

⁸⁰ Report by American Chamber of Commerce to the European Union, (2006)

⁸¹ Etro (2006)

⁸² Case C-418/01, *IMS Health GmbH & Co OHG v NDC Health GmbH & Co KG*, 2004, ECR 05039

Health Case that the dominant firm has to provide license when the license is essential for the firm requesting the supply to produce new goods and services for which there is potential customer demand. The dominant firm cannot be compelled to license when the firm is just duplicating the goods and services already offered by the dominant firm. Although this attitude is more economics-friendly, the Discussion Paper later broadens this interpretation and provides that the dominant firm must also supply when its IPR-protected technology is indispensable for the competitors to further develop technology in this area even if the competitors are not certainly able to produce a new product or service.⁸³ Although the Paper suggests that the IPR holder should be compelled to license in very exceptional circumstances, it broadens the interpretation of the Court and forces the IPR holder to supply license when the technology in question is indispensable for “follow-on innovation”.⁸⁴ It is stated that the refusal to supply the IPR-protected technology should not hamper the innovative capacity of the competitors and at the end the consumer welfare. However, the new economic theories are not really supporting this approach which argues for weakening the IPR to enhance the innovation in the long-run. This approach definitely discourages the dominant firm to invest and innovate and this attitude of the Commission will seriously harm the innovation in EU in the long-run.⁸⁵

Regarding the last type of refusal to supply, the Discussion Paper supports position taken in *Microsoft* Decision and states that the “high standards” applied in ordinary refusal to supply IPR cases cannot be applied in refusal to supply the interoperability information. Therefore, it is more likely to find abuse when the dominant firm refuses to supply the interoperability information. This approach is also harmful for innovation as the competitors of dominant firm which are not able to directly convert the IPR-protected technology into a new product can easily exploit this attitude to access the IPR of the dominant firm.⁸⁶ Moreover, in this case the Discussion Paper tells about the concept of “leveraging market power” from one market to another by refusing to supply interoperability information. However, the Paper fails to identify in which circumstances “leveraging market power” can be abusive. Therefore, it creates a situation where the intervention can be very easy and unexpected. Moreover, the Discussion Paper does not give any reason why there is less protection against the trade secrets while the trade secrets are accepted as equally important as the other types of IPRs to promote innovation.⁸⁷ This uncertainty and ambiguity will hamper the incentive of the IPR holders to further invest in R&D and innovate and will dramatically affect the consumer welfare in EU in a very negative way. And this result is definitely conflicting with the objectives mentioned at the beginning of the Discussion Paper.⁸⁸

⁸³ Akman (2006)

⁸⁴ Report by American Chamber of Commerce to the European Union, (2006)

⁸⁵ Etro (2006)

⁸⁶ Akman (2006)

⁸⁷ Report by American Chamber of Commerce to the European Union, (2006)

⁸⁸ Etro (2006)

4.2.3. Aftermarkets

At the end of the analysis of the exclusionary conducts, the Discussion Paper tells about the aftermarkets. The new position of the Discussion Paper against the aftermarkets is supported because of its effects-based approach. The economic theories suggest that the firms having smaller market shares in the primary market usually have dominant positions in the aftermarket. The firm having dominant position in the primary market should not be considered to maintain the same position in the aftermarket and when there is a separate aftermarket, the dominance analysis should be held both in the primary market and the aftermarket.⁸⁹

4.2.4. Objective Justification and Efficiency Defense

When it is established that the firm has dominant position in the relevant market and the conduct of the firm is abuse within the meaning of Article 82, the firm can escape the prohibition if it can provide an objective justification for its behavior or if its conduct produces efficiency which outweigh the negative effect on competition. There are two types of objective justification. Firstly, the firm may prove that its conduct is necessary because of the factors external to it. The dominant firm should show that its conduct is necessary for all the firms in the market to be able to produce or distribute a product. Secondly, dominant firm may show that its conduct is necessary to meet the competition in the market and to be able to compete effectively. This defense can only be used when the firm is able to prove that its low prices are the result of competitors' low prices. When it is found to be a reasonable justification, the dominant firm should show that its conduct is suitable to achieve the legitimate aim, necessary and proportionate considering the aim of Article 82.

The Discussion Paper states that the proportionality test requires a detailed analysis to protect the interest of the dominant firm to minimize its losses and also the interest of the competitors to enter and expand. This statement is very conflicting as the main aim of the Discussion Paper is to protect the consumers but the test itself does not really consider the consumer welfare. It is not definitely in the consumers' interest to prevent the dominant firm to charge lower prices to save the interests of the competitors. The Paper makes a misleading presumption that the protection of the interests of the competitors amounts to protecting the interests of the consumers. However, the economic theories suggest that this assumption is only acceptable in exceptional circumstances.⁹⁰

⁸⁹ Report by American Chamber of Commerce to the European Union, (2006)

⁹⁰ Akman (2006)

Regarding the efficiency defense, the Discussion Paper is following the two stage test of Article 81 and provides four conditions that should be met. Firstly, the conduct of the firm should produce efficiency. Secondly, the conduct in question should be necessary to gain these efficiencies. Moreover, the efficiencies produced should benefit the consumers and competition should not be eliminated as a result of the conduct in question.⁹¹ Firstly, the Commission should not follow the two stage analysis made under Article 81 in which the defendant firm has the burden of proof to show the efficiency gains. Instead, the efficiency analysis should be an integral part of the Article 82 analysis in which the plaintiff is having the burden of proof to show that the abusive conduct cannot be justified under Article 82. If the conduct is producing efficiencies which outweigh the ant-competitive effects, the conduct should not be considered as abuse within the meaning of Article 82.⁹² In addition to that, the competition authorities and the Commission have better resources to get the relevant data and make the efficiency analysis.⁹³

Moreover, these conditions are very hard to meet especially when the foreclosure effect of the conduct is proved. The Discussion Paper states that it is enough to show the “likely foreclosure effect” whereas the dominant firm should prove that certainly the competition will not be eliminated. Moreover, the dominant firm should make a complex and deep analysis of the conduct’s effect on the consumer welfare while the Commission can find the conduct as abusive based on the effect on the market.⁹⁴ Regarding the ‘indispensability’ requirement for the conduct, the Discussion Paper is ignoring the business and economic realities. The firms during their daily business practices do not make an analysis of alternative conducts having less impact on the competitors. Forcing the dominant firm to search for the less harmful conducts for the competitors would decrease the net efficiency level in the market because the dominant firm would go for the most efficient alternative without the fear of being liable under Article 82.⁹⁵

The last condition is also conflicting with the general attitude of the Paper as even if the dominant firm proves the efficiency gain which will enhance the consumer welfare, it can still be liable because of the harmful effect on the competitors. The Paper is placing the interests of the competitors over the goal of improving consumer welfare and efficiency in the EU.⁹⁶ According to the Discussion Paper, if the firm has a market share of more than 75 percent, the efficiency gain is not the most important goal to be achieved. This attitude is conflicting with the Treaty and Article 82 as the conducts of the dominant firm producing efficiency gains outweighing the negative impacts on competition should not be liable just because of the dominant firm’s high market share or less efficient firms in the market. The economic

⁹¹ Report by RBB Economics (2006)

⁹² Report by American Chamber of Commerce to the European Union (2006)

⁹³ Etro (2006)

⁹⁴ Report by RBB Economics (2006)

⁹⁵ Report by American Chamber of Commerce to the European Union (2006)

⁹⁶ Report by RBB Economics (2006)

theories do not suggest any discriminatory treatment against the firms having market share more than 75 percent whereas it is suggested that such a high market share is usually the result of effective competition which forces the dominant firm to adopt aggressive pricing and investment strategies.⁹⁷

To sum up, the attitude and proposed analysis of the Discussion Paper for efficiency defense far from being economics-friendly and the conditions mentioned are very hard to be met by the dominant firm. These high standards to prove the efficiency gain would not be a problem but the initial stage of analysis of the exclusionary conduct is very inclusive. Therefore, in almost every case the dominant firm should use the efficiency defense to escape from the prohibition of Article 82 while it is made extremely difficult.⁹⁸

4.3. The Commission's Article 82 Guidance

Three years after the publication of the Discussion Paper, the Commission published its Guidance Paper on the application of Article 82 of the EC Treaty to exclusionary abuses in December 3, 2008⁹⁹. The Commission prioritizes the cases in which exclusionary conduct of the dominant firm has harmful effect on consumers. The aim is to clarify the scope of the Commission's intervention in the conducts of the dominant firm considering the current controversial economic and legal discussions. The Guidance Paper is important as it proves the intent of the Commission to bring a more-economics approach.¹⁰⁰ It is interesting that on the day of the publication of the Guidelines, an economist was appointed to the top position of DG Competition that is the Directorate-General Dealing with the competition law enforcement.¹⁰¹ Although the Guidelines is a good step towards a more economics friendly approach in Article 82 and provides a more flexible approach towards dominant firms, the Guidance is mostly in line with the analytical framework proposed by the Discussion Paper. For instance, despite all criticism about the method of analysis in Article 82, the Commission followed the same way of analysis used in Article 81(3). Moreover, as it is analyzed in the previous section, the attitude towards the

⁹⁷ Etro (2006)

⁹⁸ Report by RBB Economics (2006)

⁹⁹ Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, ec.europa.eu/competition/antitrust/art82/guidance.pdf, (Accessed on 5 May 2009)

¹⁰⁰ EU and Competition briefing, "European Commission Publishes Article 82 Enforcement Guidelines", Ashurst Brussels, December 2008, www.ashurst.com/doc.aspx?id_Content=4120, (Accessed on 5 May 2009)

¹⁰¹ A Legal Update from Dechert's Antitrust/Competition Group, "EU Commission's Article 82 Guidelines Adopt Effects-Based Approach", Dechert on Point, December 2008, Issue 30, http://www.dechert.com/library/Antitrust_30_12-08_European_Commissions_Effects-Based_Enforcement.pdf, (Accessed on 5 May 2009)

dominant firms having more than 75 percent market share has not been changed. Despite the suggestions of new economic theories, according to the Guidelines, it is not possible to justify the exclusionary conduct of these firms when they intend to strengthen or maintain its position in the market. The Commission also maintains the same approach of the Discussion Paper to a large extent regarding the exclusionary conducts.¹⁰²

Regarding the predatory pricing, the Commission maintained its strict approach while stressed that it is very likely to establish the abusive nature of the conduct if the price of the dominant firm is below the average avoidable cost. Although the Discussion was criticized a lot regarding the attitude towards the question of recoupment, it appears from the Guidelines that it is still very difficult to escape from the prohibition under Article 82 even if the dominant firm shows that it did not recoup its losses. Moreover, the Commission does not really bring a new approach regarding the tying cases while adding that they can be efficiency enhancing in some cases. In Guidelines, it is stated that the permanent ties such as technical ties are more problematic than the temporary one while the larger number of products in bundle is also considered as a disadvantage in the tying case analysis.¹⁰³ The Guidance Paper conflicted with new economic theories by stressing the anticompetitive harm of technological tying while ignoring the possible benefits it may bring.¹⁰⁴

While mostly maintaining the same type of attitude with the Discussion Paper in case of single branding and rebates, the Commission brought a new approach in the application of “as-efficient competitor” test.¹⁰⁵ The Commission will investigate the cost structure and the price of the dominant firm and if not available, the competitors’ cost and price will be determined. If the data shows that the efficient competitor of the dominant firm is able to effectively compete with the dominant firm, it is unlikely that the Commission will intervene. The Commission uses the long-run average incremental cost and average avoidable cost as the benchmark to analyze the rebate system in question.¹⁰⁶ Although the test aims to bring a more economics-based approach in case of rebates, it should be noted that the determination of long-run average incremental cost and relevant range of demand will not be an easy task.

The attitude of the Guidance Paper against the refusal to supply is maybe the only area that the Commission really has departed from the Discussion Paper. The Commission brought a common approach against the three types of refusal to supply cases and proposed one test for the discontinuation of

¹⁰² EU and Competition briefing (2008)

¹⁰³ EU and Competition briefing (2008)

¹⁰⁴ Alese, Femi, “The EC Commission Article 82 Guidance”, Institute for Consumer Antitrust Studies, Loyola University Chicago Law School. 2008, www.luc.edu/law/academics/special/center/antitrust/pdfs/alese_ec_comm.pdf, (Accessed on 5 May 2009)

¹⁰⁵ EU and Competition briefing (2008)

¹⁰⁶ A Legal Update from Dechert’s Antitrust/Competition Group (2008)

the supply relationship, refusing to supply a new customer and refusing to supply an IPR.¹⁰⁷

To sum up, the Commission showed its intention to move away from its formalistic approach and to apply an effects-based approach. However, Guidance Paper is very much in line with the Discussion Paper while it is maybe shorter, general and clearer compared to the Discussion Paper.¹⁰⁸ While Guidance aims to focus on the effect on consumers rather than the formalistic definitions of the abusive conduct, the proposed analysis of consumer harm is not clear and well-defined.¹⁰⁹ Therefore, it can be noted that the Guidance Paper did not gain as much attention as the Discussion Paper because it did not provide a real improvement to the Discussion Paper.

4.4. Conclusion

In this section, the new approach to the Article 82 on the exclusionary conducts of the dominant firm brought by the Commission's Discussion Paper in 2005 is analyzed. The aim of the Discussion Paper was to bring a more economics-based approach which is closer to Chicago School and US antitrust. Therefore, the objectives mentioned by the Commission are determined as increased efficiency and consumer welfare. Although it is a very significant step which proves the intent of the Commission for an economics-based analysis in Article 82, the Commission failed to do so in practice while being loyal to the old approach in the method of analyzing the exclusionary abuses in many points. Although the Commission stresses the possible efficiency and consumer welfare enhancing role of the exclusionary abuses many times, the focus in the detailed analysis is on the anti-competitive effect of the conduct. Moreover, while finding the dominance, the Commission ignored the new economic theories which suggest focusing on entry barriers in the determination of dominance instead of the market share. The static analysis of market in the old approach is maintained while the market share of the dominant firm is maintained as the decisive factor in the dominance analysis. The Commission also tells about escaping the prohibition of Article 82 through objective justification and efficiency defense. However, the approach suggested for this part is also not economics-friendly and did not change the old approach significantly. Finally, last year the Commission published the Guidance Paper on Article 82. However, as it is analyzed in the previous section, the Guidance Paper did not propose a dramatic change to the old approach while generally being in line with the Discussion Paper.

¹⁰⁷ EU and Competition briefing (2008)

¹⁰⁸ Alesse (2008)

¹⁰⁹ Petit, Nicolas, "From Formalism to Effects? – The Commission's Guidance on Article 82 EC", 11 April 2009, http://lawprofessors.typepad.com/antitrustprof_blog/2009/04/from-formalism-to-effects-the-commissions-guidance-on-article-82-ec.html, (Accessed on 20 April 2009)

5. The Future of Article 82: The Theory of Market Leaders and Suggestions for The Commission

The new economic theories after Chicago and Post-Chicago era stress the necessity of a new approach for the abuse of dominant position. The old approach against the dominant position protects the competitors of the dominant firm rather than giving the priority to enhancing consumer welfare and increasing the efficiency. The reason of such a change in the attitude of the economic theories is that the structure of the markets has changed and the development of New Economy which is characterized by very dynamic and innovative markets. With the Discussion Paper, the EU started to develop in favor of more economics-based approach and recognized the importance of economic analysis in Article 82 cases. However, as it is analyzed in the previous section it failed in many parts of the proposed analysis. Therefore, the EU competition law needs a new approach in the future which can be applied both in the old market structures and New Economy.

The old suggestions of Harvard School which base its arguments in traditional market structures have lost all its viability in the recent years. While the US has recognized this fact many years ago and updated the antitrust rules based on the Chicago and Post-Chicago School, the EU is still under the influence of Harvard School and maybe Post-Chicago School which is not as liberalist as Chicago School. The EU was reluctant for the application of new economic theories to the competition policy because of the reasons mentioned in the first section.

The theory of market leaders which gives full effect to the effects-based analysis stands as a viable approach which can be utilized by the EU competition law. In a very simple way, the theory suggests that the dominant firm behaves in an anti-competitive way when the number of firms in the market is determined exogenously. However, it only behaves in aggressive way when the entry into the market is endogenous and this situation is the most commonly observed one. In this case, the dominant firm follows very aggressive strategies in which it invests a lot in R&D, advertising and further innovation and produces more to reduce costs and improve quality. Therefore, it decreases its costs and keeps prices very low which results in higher market share. Such an aggressive strategy can be harmful for competitors but the benefits to consumers are undeniable. Opposite to the belief of old theories, the markets with high concentration are usually very efficient and the competition is very effective. The dominant firm especially follows this aggressive strategy in New

Economy.¹¹⁰ The traditional Post-Chicago School which has relatively more effect on EU competition policy suggests that in such a market the aggressive pricing strategies with predatory purpose are anti-competitive while the new theory of market leaders defines such strategies as pro-competitive and consumer welfare and efficiency enhancing. The same conclusion can be drawn for the other aggressive strategies like bundling and rebates. Therefore, the EU competition Policy should change its attitude towards aggressive strategies and should accept that these strategies do not have exclusionary effect in real life and improve the allocative efficiency and consumer welfare.

The EU competition authorities should intervene only when the entry barriers are very high and the dominant firm is not threatened by the new entrants. The Post-Chicago School rightly recognizes that the dominant firm's behaviors are anti-competitive in this market structure. Even in case of excessive monopoly pricing, the competition authorities in EU should hesitate to intervene as long as the entry is endogenous especially in high-tech markets. In this case, the market leader will aggressively invest in R&D to further innovate with the profits it earned from excessive pricing with the fear of effective future competition. And increased investment in innovation will increase the consumer welfare in the long-run.

Although, the Discussion Paper starts a good initiative to discuss further on new approaches, it ignored all these economic theories and maintained the old strict competition policy against dominant firms. The Paper starts with the assumption that the conducts of the dominant firm which are defined as exclusionary are abuse within the meaning of Article 82 and if the market share of the dominant firm is high in the relevant market, it is a great disadvantage during the analysis despite the suggestions of the new economic theories. However, the Paper brings a novelty to the old approach and recognized the efficiency gains of aggressive strategies of dominant firm in the defense part. However, this novelty has no practical implication on the dominant firms having market share of above 75 percent. However, the EU competition policy should recognize that the analysis of Article 82 cases has nothing to do with the market share in the new economic theories, the theory of market leaders. In a static dominance analysis, the firm may have huge market share but the thing which matters is whether the entry to the market is endogenous or not.

A similar conclusion can be derived even when there are high entry barriers and fixed costs. In this case, the dominant firm produces more in a more efficient way and keeps the prices low despite the belief of EU approach. For instance in a market where the product differentiation is not significant and the fixed costs are very high to start business¹¹¹, many small firms can

¹¹⁰ The strategy of the dominant firm is even more aggressive in New Economy whose characteristics are fast technological development, product homogeneity, learning by doing, scale economies, network effects.

¹¹¹ This market structure typically defines the telecommunication and energy industries and high-tech sectors.

share the total production and set the price equal to average cost. In such a market, the dominant firm or a monopoly may start producing high quantities and keep the prices very low to deter entry. To prevent the entry in the market, the market leader operates in full efficiency; benefits from economies of scale; makes the production process very cheap; and at the end keeps the prices very low. This increased efficiency and consumer welfare arguments are also true when the product differentiation is important. In this case, the consumers will have lower variety of products because of the high entry barriers but are able to get some products at very low prices. This type of conclusion is very similar to Chicago Approach which has almost no effect on EU competition law but with a more generalized framework. Therefore, the competition authorities in EU should not intervene because the consumers benefit from very low prices and great cost efficiency in such markets. Therefore, the EU competition rules stop preventing the market leader from creating entry barriers as it is the most beneficial way for the society.

Regarding the analysis of dominance, the EU approach in which the dominance is considered as the synonym of high market share should be changed. The theory of market leaders suggests that the correlation between market share and effective competition can be positive. The threat of effective competition forces the dominant firm to adopt aggressive strategies which results in rising market share. Therefore, the EU competition law should make a deep and dynamic economic analysis to decide if the firm is dominant or not instead of basing the whole argument on the market share.

As it is analyzed in the previous section, the EU approach to bundling is also very obsolete and needs be updated. The Chicago School first stressed the efficiency enhancing effect of bundling and the positive effect on consumer welfare. The new economic theories suggest that the EU law should not start the analysis of bundling cases with the presumption which tells that they are abusive. The theory of market leaders suggest that bundling is an aggressive and pro-competitive strategy usually without any entry deterrence purpose and may increase consumer welfare even without taking into account the efficiency reasons. With bundling, the consumers benefit from low prices because of the larger scale economies and as a result the consumer welfare increases. If the entry is endogenous in the secondary market, punishing the dominant firm for its bundling conduct would actually harm the consumers. If the bundling creates technological efficiencies and the bundled products are complementary, there will be very great efficiency gains. All these new economic analysis strengthens the conclusion that the bundling is pro-competitive and the EU's attitude against them should be changed. In the Discussion Paper, there is no need to prove the actual foreclosure effect on competition while it is enough to show the likely effect based on the formalistic assumptions. Such a policy prevents the dominant firm to bring new bundled products to market and harm the consumer welfare in the long-run.

The issue of economics-based approach in analysis of Article 82 cases is especially important to further increase the innovation activities of the EU in the future. As it is stressed in Economic Focus of the Economist¹¹², in modern economy, it is very often the dominant firms making huge investment in R&D and bringing innovative products to the market. The theory of market leaders proves that the dominant firm has more incentive to invest in R&D and innovate than the outsiders when the entry to the market is endogenous. Because of its huge investment in innovations, it has higher market share and remain dominant for a long time. Therefore, there is no point of the EU competition policy to encourage further entry into such markets by harming the power of dominant firm. The dominant firm already operates in the most efficient way and engages in innovation. The high market share and market power of the dominant firm in high-tech markets is the sign of effective competition. The *Microsoft* decision is the proof of the Commission's strict competition policy against the dominant firms operating in high-tech market. This attitude should be changed and the Commission should be more careful against these cases as the dominant firm in high-tech markets usually applies these strategies just to survive from effective competition.

Another harmful attitude for the innovative activities of the dominant firm can be observed in the refusal to supply cases. As it is analyzed in the previous section, the proposed analysis in the Discussion Paper and the *Microsoft* decision creates too much uncertainty regarding the refusal to supply. The Commission makes a broad interpretation of the dominant firm's obligation to supply the IPR protected technology while the dominant firm should be forced to do so in very exceptional cases. Especially this attitude will have serious consequences for the consumer welfare in EU as it will harm the incentive of the dominant firm to invest in innovation by limiting its intellectual property rights. The theory of market leaders suggest for a careful economic analysis and economic-based approach in refusal to supply cases. The Commission should review its policy against these cases and give higher protection to the IPRs of the dominant firm if it wants to improve the innovative capacity of EU in the future.¹¹³

¹¹² Economist, "Slackers or Pace-setters? Monopolies may have more incentives to innovate than economists have thought", Economic Focus, 20 May 2004, p. 84.

<http://www.intertic.org/BookPapers/Economist2004.pdf>, (Accessed on 24 April 2009)

¹¹³ Etro, Federico, "Competition Policy: Towards a New Approach", European Competition Journal, Vol. 2, April 2006, pp 29-55, <http://www.intertic.org/Policy%20Papers/ECJ.pdf>, (Accessed on 7 April 2009)

6. Conclusion

The attitude of the Commission and the Community Courts towards the application of Article 82 to the exclusionary conducts of the dominant firms has significant effect on the consumer welfare, total efficiency, innovative activities and the overall economic development in the European Union. The Article 82 was designed to serve to the common objectives of the Community in which the further integration and unification are the priorities. Under the effect of these objectives, the Commission and the Community Courts have followed a very strict policy against dominant firms with significant amount of intervention by the Commission. However, the market structures have changed and accordingly the economic theories trying to bring explanation for the markets and the firms have changed. The formalistic approach which provides definitions for the exclusionary conducts of the dominant firms which are abuse within the meaning of Article 82 have been outdated by the recent economic theories. The old definitions which consider the refusal to supply, rebates or bundling anti-competitive lost their viability. The American authorities have realized this fact and updated the competition policy against the dominant firms. The EU started a great initiative with the Discussion Paper to discuss and update the application of Article 82 but the steps taken are not enough and further improvement is inevitable.

Firstly, the analysis of dominance should be changed. The high market share or high concentration should not be considered as evidence to market power. The determination of market share should not have the central importance in the dominance analysis. Based on the new economic theories, whether the entry is endogenous or not should be determinant for the Commission. The static dominance analysis should be changed to dynamic analysis in which the entry barriers and other structural elements in the market are significant. Especially the attitude towards the firms with more than 75 percent of the market should be relieved as the theory market leaders suggest that this high market share is usually (when the entry barriers are low) evidence to high efficiency, low cost production and prices, significant investment in R&D and high innovation. The Commission should recognize that there is no certain positive correlation between market power and market share.

Regarding the exclusionary conducts, the Commission should start the analysis with the presumption that these conducts are pro-competitive and enhancing the consumer welfare and efficiency. The new economic theories provide that the formalistic approach is wrong while assuming these conducts as anti-competitive but they can be justified based on objective justification or efficiency defence. This method of analysis which is also used in Article 81 cases should be changed. The Commission should start the analysis with the fact that these exclusionary conducts of the dominant firms are pro-competitive and the burden of proof to prove the opposite should be on the Commission. This is very important as the Commission,

the Community Courts and the Competition Authorities in the EU have better resources and tools to make such a complex analysis.

During that analysis, the focus of the Commission should not be on the definitions of the conducts but should be on the real effect of these conducts on the market. Instead of assuming the anti-competitive effects of the exclusionary conducts of the dominant firms, the Commission should examine the real effect on the consumer welfare and efficiency. It should be noted that significant intervention to the activities of the dominant firms hampers the innovation and economic development in the long-run. The common objectives of the Community are important but the economic performance of the EU is also very important. Therefore, during the analysis, the Commission should be thorough to respect the freedom of the dominant firm in conducting business especially in case of IPRs. It is true that the analysis of the Commission for the application of Article 82 to exclusionary conducts of the dominant firms is very inclusive while it is made extremely difficult for the dominant firm (it is even impossible when the market share is more than 75 percent) to benefit from objective justification and efficiency defence. This attitude will have serious consequences on the innovation, economic development and total efficiency in EU if the Commission insists on its formalistic approach in near future. The new economic theories proved that it is the dominant firm making innovation and making huge investments in R&D. The Commission should publish new Guidelines which is in harmony with the new economic theories and case law especially the recent ones.

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