

A BUNDESKARTELLAMT/COMPETITION LAW FORUM DEBATE ON REFORM OF ARTICLE 82: A “DIALECTIC” ON COMPETING APPROACHES

SUMMARY

This paper seeks to contribute to a more refined debate about the reform of Article 82 EC by describing two different approaches to the application of Article 82: the consumer welfare approach and ordoliberal economic freedom approach. The paper is based on discussions held between representatives of the Competition Law Forum and the Bundeskartellamt.¹ Despite representing different approaches, there was broad agreement on some issues. For example, both sides agreed that a per se approach to Article 82 was inappropriate and endorsed the use of economic evidence and analysis. Both also agreed that in applying Article 82, actual harm did not need to be proven: both are satisfied with evidence of likely harm. The remaining, and fundamental, difference concerns the type of harm that should be prevented. The consumer welfare approach focuses on likely harm to consumers; the economic freedom approach focuses on likely harm to the structure of the market. This paper examines the differences between these approaches, provides examples from case law and discusses some ramifications for enforcement.

¹ The paper reports on and develops a debate held at the Bundeskartellamt in Bonn on 19 May, 2005, between members of the Bundeskartellamt and the Competition Law Forum. Participants from the BKartA included: Dr Ulf Böge, Andreas Mundt, Dr Felix Engelsing, Dr Dirk Möller, Sandro Gleave, Dr Andreas Polk, Jörg Nothdurft, Juliane Lagemann and Silke Hossenfelder. Participants from the CLF included Dr Philip Marsden, Dr Mike Walker, Christian Alhorn, Liza Lovdahl Gormsen, Thomas Hoehn, Dr Helen Jenkins, Tim Cowen and Prof. John Kallaugher. Other members of the CLF Article 82 Review Group who contributed to this paper include: Margaret Bloom, Oliver Bretz, Dr Gunnar Niels, Mark Clough QC, Liam Colley, Margaret Moore and Frances Murphy. Members of the Bundeskartellamt who contributed to this paper include: Dr Felix Engelsing, Dr Dirk Möller and Dr Konrad Ost. Primary authors are Engelsing, Marsden and Möller. Nothing in this paper should be attributed to the BKartA or to the other contributors' organisations. For further information about the Competition Law Forum, please see www.competitionlawforum.org or contact its Director, Dr Philip Marsden, at p.marsden@biicl.org or (tel) +44-207-862-5151. For further information about the Bundeskartellamt see www.bundeskartellamt.de or contact +49-9499-0.

A. INTRODUCTION

To attain a deeper understanding of various perspectives with respect to the enforcement and reform of Article 82 EC, Dr Ulf Böge and Dr Philip Marsden convened a meeting between senior officials of the Bundeskartellamt (BKartA) and members of the Competition Law Forum's Article 82 Review Group (CLF). At this meeting, the participants identified areas where they believe that understanding can be improved with respect to this aspect of European competition law and policy. These areas are set out in this paper, identifying areas of consensus and remaining differences of opinion which came to light during the discussions. Our findings lead us to argue against formalistic appraisals of dominant firm conduct, and instead for the use of rebuttable presumptions and safe harbours, more economic analysis, a likely-effects-based approach² and a focus on fostering improvements in competitive performance as the primary mode of competition in Europe.

B. BACKGROUND

1. Irreconcilable Differences?

The substantive debate about the appropriate enforcement approach to Article 82 and its possible reform often founders on what appear to be fundamental policy differences and philosophical approaches to dominant firm conduct. In particular, this divide appears when discussion involves a comparison of the two main underlying approaches to analysing abuse of market power, namely, the supposed “Anglo-American” focus on “consumer welfare” and the supposed German “Ordoliberal”³ focus on “freedom in economic order” (“economic freedom approach”). The latter inspired the BKartA's practical case work. Therefore it is used—even if not followed by the BKartA in the strict sense—to label the BKartA's approach. In the discussions, the participants found some

² To the CLF, a consideration of likely effects can include analysis of any actual effects that might be identifiable. However, a consideration of likely effects does not require proof of actual effects before an authority can intervene. The standard is likely harm: the main difference of approach discussed in this paper, therefore, is not with respect to whether effects are likely or actual, but about the form of the harm itself, ie harm to consumer welfare or to economic freedom.

³ Ordoliberalism is attributed to authors such as Walter Eucken, Franz Böhm, Wilhelm Röpke, Alexander Rüstow and Ludwig Ehrhard. They emphasise the necessity of basic principles to implement freedom in economic order while counteracting tendencies which neutralize competition, thus accepting certain regulating interventions legitimised “in order to prevent this freedom from destroying its own prerequisites”. See A Peacock, H Willgerodt (eds), *German neo-Liberals and the Social Market Economy* (London, Macmillan, 1989), 149. A general overview is provided by D Gerber, *Law and Competition in Twentieth-Century Europe* (Oxford University Press, 2001), ch VII.

important similarities, and that some of the differences between these two focuses are less stark—and more nuanced—than is often thought. In such areas, we hope that our meeting and this paper will help to move the current debate in our and other fora on from areas where discussants simply “agree to disagree”.

2. Calls for Change

The CLF notes some dissatisfaction among academics (economists and lawyers), counsel, economic consultants, industry leaders and some officials with respect to the current approach of the European Commission and the European courts to Article 82. Calls for a “more economic” approach to Article 82 are common,⁴ and yet it seems impossible to agree on the appropriate “modernised” approach and how it should be implemented. The BKartA believes that the approach proposed in DG COMP’s discussion paper of December 2005 to the application of Article 82 is a predominantly correct and efficient approach.

3. Differences in Implementation

With respect to implementation alone, very serious concerns have been raised. There is much disagreement about whether the “consumer welfare” approach, for example, involves such a comprehensive effects-based analysis that it is often unwieldy and results in anti-competitive conduct being allowed, or enforcement action being inappropriately delayed. At the same time, the “economic freedom” approach can appear to be based on assumptions of harm which use per se rules that can be inappropriately prohibitive and rigid. At the meeting, it was found that in terms of *process* the approaches—as understood in the jurisdictions with which the participants are most familiar (the UK and Germany)—actually share some similarities: both involve structured analysis based on a set of rebuttable presumptions and both do consider at least likely market effects.⁵ However, the way of considering economic effects differs. To the CLF, economic analysis is used to identify and examine the likely harm to consumer welfare; to the BKartA, economic theory is used to get an *abstract* idea of likely harm to the structure of competition. One straight version of this type of structure-based analysis seems to be employed in many of the cases of the European Commission and the European courts in Article 82 cases, although likely economic effects are not considered (and particularly not in rebate cases).⁶

⁴ Cf Report of the Economic Advisory Group for Competition Policy, available at http://europa.eu.int/comm/competition/publications/studies/eagcp_july_21_05.pdf.

⁵ See discussion in section C.

⁶ Eg Case T-203/01 *Michelin v Commission*, judgment of 30 September 2003, and Case T-219/99 *British Airways v Commission*, judgment of 17 December 2003.

4. Differences on Substance

Identifying similarities of process, of course, does not mean to gloss over the important differences in *substantive* analysis which result from these different approaches. Clearly, the consumer welfare and economic freedom approaches each base their analysis on fundamentally different theories of harm. The consumer welfare approach favoured by the CLF, for example, would not prohibit conduct which merely (and only possibly) restricted rivals' "economic freedom", unless there was clear evidence that this risk also involved probable harm to competition itself as evidenced by likely price increases. The "economic freedom" approach favoured by the BKartA, on the other hand, would not require evidence of actual harm to competition, competitors or consumer welfare, but would take into account likely market effects on the structure of competition. The economic freedom approach would also consider the existence of competitors generally as useful, especially in markets with high barriers to entry. In such markets, under the straight economic freedom approach even inefficient competitors are good for competition in the market as a means of enhancing consumer welfare. The CLF queries whether a much smaller and inefficient rival would offer much (or any) competitive discipline on a dominant company, and whether it would have much incentive to become efficient if its existence is assured through government intervention.

The BKartA holds the view that the aim of Article 82 is the protection of competition as an institution and not of (inefficient) competitors. However, it states that it could be useful to protect competitors that are not (yet) as efficient as the dominant company. This may particularly be the case when there are large economies of scale and of scope, learning curve effects, first mover advantages or any kind of barriers to entry. Then protection of less efficient companies may limit the scope of actions of the dominant undertaking. As the OECD pointed out in the Executive Summary of the Roundtable Discussion on Competition on the Merits of 7 December 2005⁷:

"The ['as efficient' competitor] test may be too lenient, if it is interpreted as allowing the elimination of new firms that are currently less efficient but that would eventually become equally or more efficient than the incumbent if they are able to survive long enough."

5. The Subset of Concern

Nevertheless, despite even these substantive differences, it was recognised that the two different approaches will not always lead to different results in practice. Enforcement action against dominant firm conduct which may possibly limit a

⁷ Summary Record of 94th Meeting of the Competition Committee held on 1–2 June 2005: DAF/COMP/M(2005)2/ANN5 of 7 December 2005.

rival's economic freedom may also address conduct which likely harms competition and consumer welfare; similarly, enforcement action against conduct which likely harms competition and consumer welfare may also address conduct which involves a possible restriction of a rival's economic freedom. The subset of cases that the discussants are primarily concerned about, however, is where the economic freedom approach would prohibit conduct that the consumer welfare approach would allow. Here the question remains open whether—as the CLF fears—an inappropriately formalistic approach in some cases would cause greater harm to the economy as a whole or—as the BKartA fears—whether more serious damage to the economy would result from an (especially private) underenforcement if the analytical requirements were too high.

6. Primary Values and Remaining Questions

According to the EC Treaty, the primary aim of European competition policy is to ensure that competition in the internal market is not distorted.⁸ There is not much guidance on what this means, but one can be clear on what it does not mean. At the European level, it does not mean protecting European businesses from foreign competitors; so too at the national level it does not mean protecting national businesses from foreign competitors. To recite a commonplace—albeit an important one—competition policy protects competition, not competitors. Another increasingly common assertion is that competition authorities protect competition not because it is considered as a goal in itself. It ensures market entrance, innovation, price reductions and improvement of supply. So, competition is a means of both enhancing consumer welfare and ensuring an efficient allocation of resources which helps prevent other welfare-decreasing effects (such as a waste of resources or a rise in production input factor prices). Thus everybody (not only consumers) benefits from the protection of competition, at least in the medium or long term. Competition is viewed as a process that forces firms to respond to consumers' needs through lower prices, better quality and variety, and with more efficient firms replacing less efficient ones. In the discussions, it was felt that many authorities are clear enough about these concepts to state that consumer welfare is their primary aim, while others do not see it as being the “guiding star” of their policy. The BKartA, for example, seeks to protect competition as a means of enhancing consumer welfare and preserving the “economic freedom”, rights and opportunities of market operators. The authors welcome the clear statement in the DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses that the “objective of Article 82 is the protection of competition on the market *as a means* of enhancing consumer welfare and of ensuring an efficient allocation of resources”.⁹

⁸ Article 3(g) EC.

⁹ Paragraph 4 of DG Competition Discussion Paper (emphasis added).

To try to understand better what all of these various concepts mean, the next section reports on some specific findings arising from our meeting in Bonn. In doing so, we hope that this paper will help to clear up some misconceptions about how the two major approaches are implemented in practice and whether there is scope for consensus on a unified approach to the reform of Article 82 EC.

C. COMPARING THE TWO MAIN APPROACHES: MISPERCEPTIONS AND IRRECONCILABLE DIFFERENCES?

1. The “Consumer Welfare” Approach in Practice

To the CLF, under the “consumer welfare” model, one examines a practice’s effects on competition itself, primarily as evidenced by probable price increases or reductions in output. When used to apply Article 82, the consumer welfare model would focus on abuses of a dominant position, not the dominance itself, to identify whether consumers are likely to be harmed. To the CLF, the consumer welfare approach would only consider pure structural change, or a structure that contains a dominant position, insofar as it might be likely to lead to consumer harm.

2. The “Economic Freedom” Approach in Practice

When following the “economic freedom” model, one examines a practice’s possible effects on the competitive structure of the market, primarily as evidenced by possible harm to or limitation of the “freedom of manoeuvre” of the other market players. This model assumes that a dominant firm is able to alter the market structure from the competitive norm, and thus a dominant firm has a “special responsibility” not to harm the structure of the market any further. This approach thus requires less proven evidence in the market but considers the likely market effects. It is based on the belief that competition in dominated markets will only have optimal results if the competitors are protected from the constraints which follow from the dominance of one firm. As Advocate General Kokott emphasized in her opinion on the British Airways case of 23 February 2006¹⁰ (para 44, 68, 86):

¹⁰ <http://www.curia.eu.int/jurisp/cgi-bin/gettext.pl?lang=en&num=79939776C19040095&doc=T&ouvert=T&seance=CONCL>.

“Article 82 EC, like the other competition rules in the Treaty, is not designed only or primarily to protect the immediate interests of individual competitors or consumers, but to protect the *structure of the market* and thus *competition as such (as an institution)*”.¹¹

3. Disagreements about Practice

(a) *Over-formality?*

To those who follow the consumer welfare model, or who are more comfortable engaging in an analysis of likely economic effects of a practice, the economic freedom model represents a formalistic and often insufficiently economic regime—with a risk of excessive intervention which may chill pro-competitive business conduct. It appears to rely on some per se rules, the presumption of likely market effects and some assumptions that certain conducts in certain situations lead to an exclusionary effect.

(b) *Over-analysis?*

A principle objective of Article 82 EC must be the establishment of workable standards of both public and private enforcement of abuse control to guarantee companies the necessary legal certainty and ensure an effective protection of competition. Critics of the consumer welfare approach assume that it requires a comprehensive review of all possible and actual economic effects of a practice, and thus view it as not being conducive to relatively rapid or accurate decision-making. Competition authorities would not be able to handle as many cases, although some intervention of the authority would be necessary. And when they do act, the protection of competition would require that unjustified abusive practices be prohibited by the competition authority or the courts within a reasonable timeframe at the earliest possible stage so that efficient competitors could survive in the market. Apart from empirical, methodical and theoretical problems in proving evidence, if in any case actual market evidence needed to be assessed, the implementation cost (complexity and the time required to conduct such an examination) would rise materially. As a result, authorities (or private enforcers) may act—if at all—too late to prevent harm to the competitive structure of the market. Thus the amount of Type II errors (no prohibition of abusive behaviour) is supposed to increase. The economic freedom approach would permit intervention in those cases in which economic theory or experience in the past suggest an elevated likelihood of harm of competition. Even then, however, a decision is to be taken considering the whole circumstances of every case.

¹¹ Court of Justice, [1973] ECR 215, para 26, *Continental Can* (emphasis in original); Case 85/76 *Hoffman-La Roche* [1979] ECR 461, paras 91, 123, 125; *Michelin I* [1983] ECR 3461, para 70; Case 31/80 *L'Oréal* [1980] ECR 3775, para 27.

(c) Legal Certainty

To the BKartA, its approach provides greater legal certainty to business and to the authorities, as past practice and the consideration of dominance may be relied upon (although the whole circumstances of a case are considered). The CLF, however, questions whether either approach offers greater legal certainty over the other: the economic freedom approach would face difficulties in assessing dominance, companies' costs and pricing, and likely market effects. It assumes that the consumer welfare approach does not really offer any less legal certainty than the economic freedom model. It follows a structured rule-of-reason analysis, for example, to identify likely consumer harm. Under this approach, rebuttable presumptions and safe harbours may still facilitate the decision-making of the authorities, and hence of companies. Where the approaches differ, however, is with respect to the type of harm that these presumptions are designed to identify.

(d) A False Link

While the economic freedom model does not appear to accord with the consumer welfare model, its adherents (including the BKartA) argue that its underlying assumptions are broadly justified where experience with similar cases, or just considering the likely effects, leads one to conclude that dominant firm conduct may have an exclusionary effect that is likely to harm consumer welfare. However, our discussions revealed that the indirect concern about consumer welfare is not the only rationale for the economic freedom approach. Indeed, the BKartA expressly disavowed the need for proving such a link. Consumer welfare will not be the guiding star of an authority which follows an economic freedom model: it will be more concerned with what it sees as a dominant firm putting undue (ie based on dominance) limitations on market participants' rights, freedoms or opportunities. Our discussions also revealed that such an authority may view a consumer welfare model and its implementation as being overly utilitarian, in that it considers the welfare of a group (here, consumers) over that of the rights, freedoms or opportunities of the participants directly affected by the dominant firm's conduct. In any event, the BKartA note that the economic freedom model is based on the belief that in the long run both goals (economic freedom and consumer welfare) are not in conflict as safeguarding of a vivid competition process will enhance consumer welfare.

(e) An Historical Link

An authority which is primarily concerned about ensuring that dominant firm conduct does not unduly limit the rights or freedoms of market participants will be confident that its substantive test for harm is satisfied by evidence of likely or attempted exclusionary behaviour—in particular, dominant firm conduct which

limits the opportunities of rivals—leading also to anti-competitive effects in terms of harm to consumer welfare. Such an approach can also be found in the very roots of antitrust, particularly in the US, where the primary motivation at the time was a concern that the size and relative independence of the larger trusts were limiting the rights or economic freedoms of rivals and customers and thus engaging in a form of private imperialism. The influence of original US antitrust policy on the German Antitrust Law (GWB) has been emphasised frequently in economic and jurisprudential literature.¹²

(f) *Recognising Economics and Incentives*

The CLF recognises the important foundations that the economic freedom model set down for competition law and policy, but notes that it takes insufficient account of developments of economic theories of harm, and may indeed cause harm to the market by chilling pro-competitive behaviour. However, the BKartA notes that one has to recognise that those who prefer the economic freedom model emphasise their concern about the adverse incentives to compete resulting, for example, from a dominant firm's market power. It would hardly be possible to measure those effects of the conduct in question on the entrepreneurial decisions of actual or potential competitors. Firstly, there is a time gap between the effects measured during a certain period of time and the entrepreneurial decisions on which they are based which makes it difficult to prove the causality. Secondly, opportunities cannot be considered, ie the question as to how the market would have developed without the allegedly abusive conduct cannot be answered simply by looking at the past, because in order to guarantee an effective abuse control the assessment of, for example, rebate incentives requires an *ex ante* consideration. In this context, game theory considerations from which investment or competition incentives are derived with or without the conduct under consideration ("likely effects") appear to be more reliable. In response, the CLF believes that the economic freedom model allows authorities to intervene unnecessarily in the market, assisting rivals who have not been (or are not likely to be) harmed by conduct which is deemed to be anti-competitive because of its form. It is also concerned that such intervention (and its risk) will skew market incentives and thus result in less competitive and innovative markets.

¹² See, eg HG Schröter, "Kartellierung und Dekartellierung 1890–1990" (1994) 81 *Vierteljahresschrift für Sozial- und Wirtschaftsgeschichte* 457; L Murach-Brand, *Antitrust auf deutsch. Der Einfluß der amerikanischen Alliierten auf das Gesetz gegen Wettbewerbsbeschränkungen (GWB) nach 1945* (Tübingen, Mohr Siebeck, 2004).

4. Clarifying some Misperceptions

It is impossible to reconcile the approaches as they are depicted above. However, in our meeting in Bonn, we agreed that some aspects of this common depiction contain serious misperceptions.

(a) *The Increasing Role of Economics*

Consumer welfare concerns are a key—if not sole—motivator of analysis in an increasing number of competition authorities around the world. This is mostly due to the recognition of the utility of economic evidence and analysis in competition cases. Economic analysis is also of concern to authorities who employ the economic freedom model. For clarification, two decisions of the BKartA are summarised:

1. *Price squeeze: oil companies (B8-77/00)*. In 2000 the Bundeskartellamt prohibited with immediate effect the major six oil companies in Germany from demanding higher prices (plus a freight surcharge) for supplying independent petrol station operators than they charge final consumers at their own petrol stations. By opening up a price gap and charging small petrol station operators at their refineries higher prices than those charged to consumers at their own petrol stations the large oil companies were unfairly hindering the independent petrol station operators. This pricing policy prevented these operators right from the start from making a profit on fuel sales. Unlike the large vertically integrated six oil companies, small and medium-sized firms did not have the same access to the crude oil market and the financial resources to cushion any losses on the fuel market.
2. *Predatory pricing: Deutsche Lufthansa/Germania (B9-232/02)*. In 2002 the Bundeskartellamt prohibited Deutsche Lufthansa AG (DLH) from demanding a price for a one-way ticket per passenger on the Frankfurt–Berlin route which is not at least €35 above Germania's price, as long as DLH does not have to charge more than €134 as a result. The Bundeskartellamt saw the pricing strategy of DLH as an attempt to squeeze its new competitor Germania out of the market and feared that emerging competition would be substantially impaired as a result. Germania started operating scheduled flight services between Berlin and Frankfurt/Main in November 2001. The company offered tickets at €99 for a one-way, fully flexible and rebookable flight. The conditions essentially corresponded to DLH's economy tariffs suitable for business travellers. DLH reacted by also introducing a fully-flexible economy tariff which offered an immense price reduction (up to €485). In January 2002 DLH raised the price to €105, clearly undercutting Germania's price of €99 as it included services which were not offered by Germania. The

price DLH set was clearly below its average operating costs per passenger. The only rational explanation for this pricing strategy was that DLH was attempting to force Germania from this route and to recoup resulting losses at a later stage by discontinuing this price tariff and resorting to previous ones. The Bundeskartellamt therefore protected the newcomer Germania from being hindered by the dominant DLH. The BKartA consider that proof of the actual harm on consumers resulting from Lufthansa's practices would not have given any actual evidence for an intervention of the authority.¹³

These cases illustrate clearly the use of likely effects based on economic analysis by the BKartA. As a result, one of the BKartA and CLF's clearest conclusions would be that one should consider economic analysis when examining claims of abuse of market power. The CLF is of the opinion that authorities should use that evidence to assess the likely negative and positive effects on the market and thereby identify competitive harm, and in particular likely negative effects on consumers.

(b) Consumer Welfare is Not All About Economics

The CLF is of the view that while many authorities appear to accept the need to be concerned about consumer welfare, none of them undertake a full effects-based analysis when analysing alleged abuses of market power. Instead, most use a structured analysis with tests and filters, where conduct is assumed to be lawful unless harm to competition can be shown to be likely. Under the consumer welfare model, the most frequent guide to whether conduct harms competition is whether a price increase or output restriction is likely. In the CLF's opinion, no authority waits for a full examination of all possible effects of a practice and all are quite willing to act on the basis that harm is *likely*, rather than to wait for it to occur. The CLF is thus of the view that concerns that the use of economic analysis will not allow authorities to act sufficiently quickly enough to prevent anti-competitive conduct appear to be unjustified.¹⁴ In contrast, the BKartA submits that it has already witnessed similar scenarios in the past and states that it is an unsatisfactory result if an administrative abuse procedure is pursued for several years and as a result there is a prohibition/fine decision based on perfect economic assessment but the competitive structures of the market are

¹³ The CLF believes that in both the cases cited by the BKartA, the consumer welfare approach would not have allowed intervention without having undertaken an economic analysis of the likely effects on consumers.

¹⁴ However, the substantive test for harm under the consumer welfare model is indeed still more rigorous than that under the economic freedom model, and thus will lead to less intervention in the market.

destroyed as a result of the abusive conduct and the actual efficient competitors are driven out of the market.

(c) *Economic Freedom is not all about Per Se Rules*

It is obviously true that there are some important European decisions which have taken a per se approach to harm, with little identifiable direct concern for or analysis of dominant firm conduct's economic effects.

One can witness this approach most recently in *Michelin (II) v Commission*¹⁵ and *British Airways v Commission*.¹⁶ As implemented in such cases, such an per se approach involves fitting the dominant firm conduct into a particular category. If that category (eg non-cost-based fidelity rebates or commissions) is one which has been deemed to be inherently likely to foreclose competitors, then it will be deemed to be an abuse and thus prohibited. The only criterion related to economic analysis was whether the rebate programme, for example, could be linked to cost-based savings internal to the dominant firm. No consideration of other economic effects of the practice (such as incentives to grow the market) were identified or proven. In particular, economic evidence regarding the pro-competitive nature of such rebates was not considered.

(d) *Economic Freedom and Economic Analysis*

The approach in *Michelin (II)* and the *British Airways* case is a static per se approach. The CLF recognises that the economic freedom approach advocated by the BKartA is not a strict per se approach as it involves certain rebuttable presumptions, based on a coherent theory of harm derived from several decades of experience with abuse of market power cases. Certain forms of conduct are assumed to (possibly) restrict the economic freedom of efficient or potentially efficient rivals. Economic analysis offers the opportunity to consider and evaluate the conduct examined within an economic context. In this way it can be ascertained whether or not the conduct objected to is objectively justified.

Structured analysis, rebuttable presumptions of harm and safe harbours challenged by economic evidence are also favoured by those employing the consumer welfare model—admittedly employing a different test of harm, and with economic evidence required to prove the likelihood of the allegation, rather than to disprove it; nevertheless, the important point from our perspective is that the system employed is to a large extent similar.

¹⁵ *Supra*, n 6.

¹⁶ *Ibid.*

(e) *Likely-effects-based Approach*

The BKartA notes that it has, in its cases, always considered the market effects of a *prima facie* abusive behaviour. However, the BKartA only considered and assessed the likely effects on the market and did not try to prove actual market effects. The BKartA therefore favours a likely-effects-based approach.

The BKartA emphasises that proving actual effects is generally a very difficult and time-consuming task that weakens the enforceability of abuse control. To the BKartA one of the disadvantages of analysis based on actual effects is the economic rigour required for it. A consideration based on actual facts would have to prove the causality between conduct and actual effect on the market. A comparison would be required between the actual market situation and the market result which would be potentially possible in the absence of the conduct under consideration. However, as such a comparison is hardly possible due to the lack of comparative factors, it has to be replaced by other methods. An actual causality, however, cannot be proved this way, which means that a consideration based on actual effects can almost always be challenged.

The BKartA adds that an effects-based consideration of, for example, rebate systems is an *ex post* consideration. However, it submits that the decisive factor is a rebate system's incentive effect which inevitably can only be established by an *ex ante* consideration. Hence it is not possible to deduce the incentive effect (which is the only relevant effect in examining abusive conduct) on the basis of actual market effects. It is thus well conceivable that a dominant company which is exposed to increased competitive pressure from its competitors will use a rebate system to stabilise its market share. If this rebate system provides a strong incentive for the dominant company's customers to continue to purchase the product from that company, and if its competitors are unable to compete against the rebate system, there will be no effect on the markets. An *ex post* consideration of market shares is thus not appropriate to ascertain the actual effects of a rebate system.

The likely-effects-based approach, in opposition to an actual-effects-based approach, is explicitly endorsed by Advocate General Kokott in her opinion on the British Airways case of 23 February 2006¹⁷ (paragraphs 70ff):

“70. Significantly, BA itself states that it is not necessary in each case to establish actual anti-competitive effects of a rebate or bonus scheme on competitors. The burden of competition authorities, Courts, and, in some cases, private complainants, in even attempting to establish it would in many cases be entirely disproportionate.

71. What is to be proved is, rather, the mere likelihood of the conduct in question hindering the maintenance of development of competition still existing in the market by means other than competition on the merits, thereby prejudicing the goal of effective and undistorted competition in the common market . . .

¹⁷ *Supra*, n 10.

75. [T]he Court . . . was correctly satisfied with proof that the abusive conduct of the dominant undertaking ‘tends to restrict competition, or, in other words, that the conduct is capable of having, or likely to have, such an effect.’”

In response, the CLF states that it does not believe that if a consumer welfare approach required actual evidence of consumer harm it would be completely unadministrable; however, it emphasises that the approach it is advocating focuses on proving likely—not actual—consumer harm. In the *British Airways* case, the Advocate General endorsed the use of likely harm to the structure of the market. The opinion does not address the assessment of harm to consumers as such, as it assumes such harm will follow from harm to the structure of the market.

The *BKartA* and the CLF submit that enforcement or application of Article 82 should not be through a *per se* approach, but should instead employ a system of rebuttable presumptions, and the CLF also advocates the use safe harbours, based on sound and tested economic theory. In particular, enforcers should be encouraged to explain the process of their analysis in their decisions. Finally a likely-effects-based approach is supported.

D. IRRECONCILABLE APPROACHES: RAMIFICATIONS FOR ENFORCEMENT

The discussion of the consumer welfare approach and the economic freedom approach led to the conclusion that one should employ a structured form of analysis of a likely-effects-based approach involving rebuttable presumptions and (the CLF would add) safe harbours. However, one has to recognise that this recommendation does not reconcile the consumer welfare and economic freedom approaches. In particular, it does not say which theory of harm it is best to employ, and in turn which presumptions should be made or safe harbours offered:

1. should certain forms of dominant firm conduct be presumed to be harmful (as they may possibly restrict rivals’ economic freedom) but this presumption be rebuttable by economic evidence or considerations to the contrary; or
2. should all dominant firm conduct be presumed to be harmless (as unlikely to harm consumer welfare) absent evidence of likely price increases.

In the debate it was not attempted to provide a unified structure for evaluating the alternative approaches and choosing between them. However, decision theory tells us to choose the approach that would minimize the sum of the expected costs of error and the costs of implementation. But there is no *passerpartout* as there are important differences from case to case, such as the

characteristics of firms and markets that affect the probabilities of error, the error costs, and the implementation costs of alternative policy approaches.¹⁸

Error costs are usually divided into two different types, “false positive” (Type I) and “false negative” (Type II). Type I errors mean that performance-based and consumer-enhancing competition is prohibited by an authority, with direct short-term costs and a longer-term chilling effect on pro-competitive and innovative conduct. Type II errors refer to cases where abusive practices are not prohibited or are subject to delayed (or inadequate or no) remedies to the structure of the market. This holds the danger that a competitive market structure turns into a lasting non-competitive one due to the exclusion of actual or potentially efficient rivals in the middle or long term, especially in the presence of significant network effects, economies of scale or of scope, significant learning- or reputation effects, or other, eg institutional, barriers to entry to the market in question. We state that both types of error result in harm to the competitiveness of the market. As such, standards should be employed which are carefully conditional and competition authorities should structure their analysis to avoid or minimise both types of error.

To the CLF, the consumer welfare approach does not raise the risk of prohibiting pro-competitive and consumer-enhancing conduct, or of chilling future pro-competitive and innovative conduct. In the CLF’s opinion, those “harms” are likely to be greater, so that competition authorities should in particular seek to avoid Type I “false positive” errors, which are supposed to be more likely when applying the economic freedom approach.

Contrary to the present discussion, which almost neglects the negative impact of Type II “false negative” errors, the BKartA is convinced that these errors harm competition (and hence consumers) as well—at least in the middle term—as the resulting damages to the market structure are long lasting. This is especially true in the presence of important barriers to entry or the market characteristics described above. The BKartA therefore pays careful regard to avoid both Type I and Type II errors, with the latter—due to analytical shortcomings particularly assessing long-term effects—being likely to result from applying the consumer welfare approach.

Performance Matters

The authors submit that both the consumer welfare and the economic freedom approach share a core view of “competition on the merits”. As is often pointed out with respect to the consumer welfare model, merit-based competition operates under the “may the best man win” principle, or “to the victor goes the crown”:

¹⁸ See P Joskow and A Klevorick, “A Framework for Analysing Predatory Pricing Policy” (1979) 89 *Yale Law Journal* 213, 218.

“A single producer may be the survivor out of a group of active competitors, merely by virtue of his *superior skill, foresight and industry*. In such cases a strong argument can be made that, although the result may expose the public to the evils of monopoly, the [Sherman] Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: *Finis Opus Coronat*. The successful competitor having been urged to compete must not be turned upon when he wins.”¹⁹

“Superior competitive performance” is a key limitation of the offence of abuse of dominance in Canada, for example, and not a defence.²⁰ It is so because the conduct itself cannot be anti-competitive in the first place if it is based on superior competitive performance.

Performance-based competition has also been a core element of the economic freedom model in Germany, both historically and through to the current day.²¹ In particular, the concept of

“‘*Leistungswettbewerb*’—competition on the basis of performance ... derived from nineteenth century rules on ‘unfair competition’. It describes competitive conduct that could not be prohibited as unfair, even though it harmed competitors. On this basis, improvements in quality, reductions in price (as long as they are non-discriminatory and non-predatory), or improved after-sales service, were classified as performance-based forms of conduct. Where dominant firms used performance-based methods of competition, they should be free to compete, even if their conduct harmed competitors.”²²

As such, Article 82 should be enforced only to address dominant firm conduct which is not based on “competition on the merits”.²³ Conduct based on performance-based improvements should be presumed compatible with Article 82. This is a richer concept than internal cost-savings based on efficiencies generated within the dominant firm. It is so because the nature of competition is richer itself than a mere focus on cost-savings. A focus on cost-savings alone misses out on a vast range of improvements in performance that result from innovation.

¹⁹ *US v Alcoa*, 148 F2d 416 (2d Cir. 1945) at 430. Emphasis added.

²⁰ Competition Act, s 79 (4).

²¹ See P Ulmer, *Schranken zulässigen Wettbewerbs marktbeherrschender Unternehmen* (1977); WuW/E OLG 1767 “Kombinationstarif” (KG 1977); WuW/E OLG 1983 “Rama-Mädchen” (KG 1978); WuW/E OLG 2148 “Sonntag Aktuell” (KG 1979); WuW/E OLG 2403 “Fertigfutter” (KG 1980). Note by Germany, Competition on the Merits, OECD DAF/COMP/WD(2005)4, 27 May 2005, para 17: German competition law tolerates the emergence or strengthening of a dominant position if it is due to a company’s inner growth. Therefore, the law cannot forbid all the business activities of a dominant company that influence the market structure—which they potentially do in most cases. Otherwise, the competitors of the dominant company would not have to face any competition by the market leader at all and competition would come to a complete standstill.

²² J Kallaugh and B Sher, “Rebates Revisited: Anti-competitive Effects and Exclusionary Abuse under Article 82” [2004] *European Competition Law Review* 263, 270.

²³ A speech to the European Association for Research in Industrial Economics, Berlin by John Vickers, Chairman of the OFT (3 September 2004), available at <http://www.oft.gov.uk/News/Speeches+and+articles/2004/spe03-04.htm>; (2005) 115 *Economic Journal* F244.

The CLF is of the view that those authorities who still wish to prevent conduct which limits economic freedom (even though it is based on performance-driven improvements) should do so through provisions that are separate from European—and indeed national—competition law. National statutes that are concerned primarily with the protection of small and medium-sized enterprises, or which seek to address exclusionary behaviour that does not harm competition itself, are perfectly acceptable within other contexts, and particularly in national-only markets, but are not appropriate in the application and enforcement of Article 82 EC.

Competition policy should not assist rivals even when they are competing with dominant firms except to address anti-competitive, non-merit-based conduct, ie conduct which is not based on their independent improvements in performance.

In our view, this core similarity in the two approaches of consumer welfare and economic freedom contains the seeds for some form of common understanding and hopefully a coherent approach to the reform of Article 82 EC.

As such, this paper closes with an analogy to a race which hopefully will offer some insight into the relationship between “economic liberty” and the “right or opportunity to compete”—and “competition on the merits”:

“Pulling ahead in a race and thereby freeing oneself from competitive discipline is a goal sought by all true competitors. If a company has taken a leading position by pushing its rivals back or out of the race, however, it has expropriated their liberty to its own ends, and should be condemned.”²⁴

“Preventing competitors from pulling ahead in a race—or by too far a lead—undermines every competitor’s incentive to compete in the first place. This is why competition policy only prevents competitors from doing something so harmful to their fellow rivals that it distorts the nature of the competition itself. It stops companies from thwarting the ability of their rivals to compete, or even from denying them access to the race in the first place. Competition policy guarantees competitors nothing more than the opportunity to make a competitive offer. If they already have that opportunity, then there should not be anything for competition policy to do.”²⁵

“Competition policy seeks to protect merit-based competition. This means that those with the ability to compete should have the opportunity to do so. To that end, if an arrangement allows the competitors the *opportunity* to compete, then their *ability* to display their merits is still intact, and no enforcement action is needed. However, if their opportunity to compete has been deprived as a result of anti-competitive activity of a rival, then there is a problem. In tailoring a solution to this problem, competition authorities should restore only the ‘opportunity to compete’.”²⁶

²⁴ P Marsden, *A Competition Policy for the WTO* (London, Cameron May, 2003), 225.

²⁵ *Ibid*, 226.

²⁶ *Ibid*, 227 (emphasis in original).