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The Reform of EC Competition Law

New Challenges

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Exclusionary Abuses and the Justice of 'Competition on the Merits'

*Philip Marsden**

I INTRODUCTION

My approach will be first to identify the exquisite problem raised by practices that are at once exclusionary and efficient, and the difficulties this presents for

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* Director, The Competition Law Forum, and Senior Research Fellow, British Institute of International and Comparative Law. (Note: this paper was written and delivered prior to the issuance of the Article 82 Guidance on Enforcement Priorities.)

The Ioannii are sly (editors, Ioannis Kokkoris & Ioannis Lianos). Come to Athens, they said. Participate in our conference. But please, try to say something positive. Presumably this was to lift me above my usual critical remarks on reform of Art. 82 [See for instance, P. Marsden, 'Article 82 Review' *Competition Law Insight* (2006); P. Marsden, (with S Bishop), 'Editorial: Intellectual Leaders Still Need Ground to Stand On', *European Competition Journal* 3, no. 2 (2007): 315; P. Marsden, (with S Bishop), 'The Article 82 Discussion Paper: A Missed Opportunity', *European Competition Journal* (2006): 1.] I'll do my best. This is, after all, the first conference of its kind to be held in Greece. We are not in Brussels, amid its dry arguments over the dismal science of assessing fidelity rebates, refusal to deal, or bundling. But I rather like sparking debate in this tinderbox. These are important matters. The leading cases in European law on abuse are in these areas. Large companies' strategies and products are at issue. Michelin. British Airways. Even Microsoft. I thought the odd bit of criticism I may have offered was a positive thing. A contribution even. It was intended to spur DG-COMP on to follow through on their promises. I would just remind them, so gently, that their Discussion Paper on Reform of

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enforcers and advisors. Next, I will examine the resulting different enforcement approaches, and the merits or not of each. Finally, I want to offer some suggestions for analysis and enforcement approaches, based on these grander concepts of merit and justice. As ever, my thinking is evolving in this area.

II THE EXQUISITE PROBLEM

The main aim of competition law is to try to make markets work fairly for consumers. A key problem for those involved in this quest is to identify anti-competitive conduct and address it appropriately, without distorting the market itself. Competition authorities and courts are trying to remove harm, without doing any harm – their Oath might smack of Hippocrates: First, do no harm.

This raises several problems. One perhaps surprising problem is that it is not always easy to identify anti-competitive conduct – in particular whether it is anti-competitive net of any efficiencies it may provide. What is often forgotten is that there is also a problem of identifying whether the conduct at issue is anti-competitive in the first place, or whether it is actually pro-competitive and should not be impeded by too much regulatory scrutiny, let alone prohibited outright. Here terminology and the way the conduct is framed can appear relevant. Bundling sounds cosy; tying harmful. 'Get one free' offers sound like savings; 'all or nothing' offers smack of forcing. We protect freedom of contract but then we might frown when a contractor exercises that freedom by refusing to deal with a long-time customer, or even a newcomer. We think it sounds good to reward the patronage or custom of a buyer by giving her discounts, but in the EU in particular, when a dominant firm rewards such 'fidelity' with rebates it is an abuse. Competition officials favour low pricing, but their view can change entirely if it is 'predatory' or even so different as to be 'discriminatory'. Finally, we are told that it is not a sin to rely on the fruits of our efforts, and in particular our intellectual property rights. However, we must also keep in mind that we are not allowed to rely on them to the extent of stifling future innovation by rivals.

In sum, dominant firms have to tread a careful course among these types of conduct, and oftentimes what a smaller firm can do with impunity a dominant firm dare not even mention in emails or board meetings. What is worse, big firms that operate in many markets can be subject to different rules – when this happens it can bring corporate cultures and regulatory approaches into a real clash of the titans. The tying and refusal to deal at issue in Microsoft was prohibited in Europe but the

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Art. 82 began with the well-meaning aim of enhancing or at least protecting consumer welfare. Not so far later, however, DG-COMP seemed to lose its way, or to be more charitable, it got mired in the case law of old and much-criticised theories of harm, far from its intended path of a 'more economic approach'. Considering all this and the venue, I thought it might be appropriate to link this dry competition law topic to some grander Athenian concepts – namely those of merit and justice. I hope they are still as relevant today and in this context as they were a couple of thousand years ago.

same refusals were only disciplined in the US, and the same form of bundling was even positively encouraged.[1]

To distinguish the good from the bad and the ugly one could just try to see whether the activity is efficient or simply exclusionary. However, this does not help when the conduct is *both* efficient and exclusionary. Obviously asking if the conduct is exclusionary is not enough; you need a framework to identify some broader harm to the efficient operation of the market on behalf of consumers than merely inhibiting the entry or expansion of rivals, or even actively forcing them out. Nevertheless, an almost myopic focus on exclusion is still the approach taken in the EU.[2]

The controversy between the jurisdictions affects the enforcement approach, in particular the degree to which conduct can be assumed to harm rivals or the market itself, or whether that harm needs to be proven. For example, the Bundes-Kartellamt has long taken the view that it can assume that certain conduct is harmful, and step in to stop it, even if the remedy raises price.[3] There are several great debates occurring around the world, on just this subject. The Antitrust Modernization Commission has issued a huge report canvassing the issues and theories of harm[4]; the EC Discussion Paper generated substantial debate[5]; the International Competition Network has a Unilateral Conduct Working Group that continues to contribute thoughtful analysis on a broader international level. It is not too much to say, though, that these issues tend to arise in every case alleging monopolization or abuse of dominance: the complainant inevitably argues that it is being forced out in some way, or otherwise disadvantaged, whether the conduct is efficient or not. In some way any such case involves the authority or court having to decide whether there has been a form of antitrust injury sufficient to merit intervention, and whether it suffices for that injury to just be to the rival, in terms of foreclosure, for example, or that it should involve some harm to the marketplace itself.

The exquisite problem in such cases has been identified at the upper echelons of the judicial system on both sides of the Atlantic. In identifying the types of exclusionary conduct that should be prohibited by section 2 of the Sherman Act, the US Supreme Court has opined that it is conduct which tends to impair the opportunities of rivals, and which does not further 'competition on the merits'.[6] This rhetoric is not altogether clear, of course. Nevertheless, it is echoed in European law, where exclusionary abuse prohibited by Article 82 EC is distinguished from 'normal competition' and 'performance-based competition'[7] and

1. C-T201/04 *Microsoft v. Commission*, judgment 17 Sep. 2007; *United States v. Microsoft Corp.*, 253 F. 3d 34 (D.C. Cir. 2001).
2. C-95/04, *British Airways v. Commission*, unreported; ECJ judgment of 15 Mar. 2007.
3. See 'A Bundeskartellamt/Competition Law Forum Debate on Reform of Art. 82: A "Dialectic" on Competing Approaches', (special issue) *European Competition Journal* 2 (2006): 211.
4. See <www.govinfo.library.unt.edu/amc>.
5. See <www.ec.europa.eu/comm/competition/antitrust/art82/index.html>.
6. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp*. 472 U.S. 585 (1985).
7. Case 85/76 *Hoffman-LaRoche* [1979] ECR 461.

involves 'reinforcing [one's] position by recourse to means other than competition on the merits'.[8]

Fortunately, these grand statements have been brought down to earth, and in the process some important differences of approach can be identified. In the US the *Aspen Skiing* court held that monopolization requires proof of an attempt to exclude rivals on some basis other than efficiency. It viewed competition as a process, leading to greater efficiency, which itself was guided by the touchstone of consumer welfare.[9] In contrast, the DG-COMP Discussion Paper finds that 'Ultimately, the protection of rivalry and the competitive process is given priority over efficiency gains'. This has serious ramifications. It also explains why efficiency-enhancing conduct will always be prohibited in the EU if it can be assumed to harm rivals. Rivalry is obviously part of the competitive process, as the EU courts have found, but they define it as an 'institution', in which rivalry matters so much that governments need to guarantee a particular market structure, which most usually translates as a certain number of competitors. This is why in some of the hardest cases, the EC does not allow the most successful and most efficient rival to prevail, but instead allows it to engage in conduct that might exclude rivals where it can prove that its conduct has compensating cost-based efficiencies.[10]

III THE DIFFERENT ENFORCEMENT APPROACHES

Why are these approaches so different? Is it merely, as the BundesKartellamt (BKartA) seems to be suggesting, based on a pragmatic choice between assumptions of harm, which themselves are based on the relative pressures of evidence gathering and the need to intervene? Perhaps. My view though is that there is a fundamental difference of economic philosophy at the heart of the problem. This sounds terribly grand and difficult, but really it just boils down to how much we feel we can trust the market or the government to correct problems. This is quite an old debate, as far as old debates can go in antitrust. Indeed, antitrust was created because the market could not be relied upon to control the excesses of the powerful. The primary concern of the Anglo-American approach – although this has changed over time – appears to be for efficiency, as represented by consumer welfare (or vice versa even). Its proponents view competition as a process, leading to greater efficiency, which provides us consumers with a greater variety of cheaper, better products. Harm is most often associated with output restrictions, which reduce choice and increase price. Identifying such harms requires careful analysis of likely economic effects, and it is only when such harms are viewed as likely that intervention will be allowed. Under the consumer welfare approach, remedies are almost never price-raising, unless the alternative would be clearly worse.[11]

8. Case T-228/97, *Irish Sugar plc v. Commission* [1995] 5 CMLR, 1300.
9. *Aspen Skiing*, *supra* n. 6.
10. C-95/04, *British Airways v. Commission*, unreported; ECJ judgment of 15 Mar. 2007.
11. 'A Bundeskartellamt/Competition Law Forum Debate on Reform of Article 82: A "Dialectic" on Competing Approaches' above.

The Ordoliberal approach, in contrast, is motivated primarily by a concern for the market order and its structure. There is an eventual concern for consumers, of course, but it is assumed that they will benefit from the interaction of competitors if only the structure of the market is ordered. Competition is seen as an institution, and the paramount concern is with harm to the structure of the market, evidenced through the relative position of rivals. Competition policy exists to guarantee that structure, and through it to guarantee the economic freedom of the rivals. Remedies thus focus on ordering the market so that rivals can flourish and compete. Such remedies may be price-raising, if such is needed to provide the ability and incentive for small, less-efficient rivals to survive and thereby guarantee the appropriate market order.[12]

The two approaches aim generally in the same direction, towards consumer welfare, but they go about it in very different ways. Ordoliberals criticize the consumer welfare approach for spending too much time on economic analysis, only to conclude that intervention is not needed, or if it is, the delay itself means that it is too late to act. As such, Ordoliberals argue that the consumer welfare approach may allow some anti-competitive conduct to continue or that remedies may be too late and the patient (complainant) will be left incurable, or worse, dead.

Ordoliberals get criticized because they tend to apply rigid formalistic approaches without identifying whether the conduct in question does actually harm the rival or competition itself. This may result in too much intervention, and thus some pro-competitive and efficient conduct may be prohibited. This in turn would chill such conduct in the future, which deprives the market of innovative goods or services. Ordoliberals thus end up subsidising competitors at the expense of consumers, to no great gain to competition since inefficient smaller rivals will never be able to discipline an incumbent anyway.

These two approaches have been contrasted quite starkly in the debate on Article 82 Reform in the EC. In an attempt to better understand each approach, I offered to bring members of my 'Anglo-American' Competition Law Forum to Bonn to meet with representatives of the BundesKartellamt.[13] Surprisingly, we were able to agree on quite a number of things.

First, we agreed that a per se formalistic approach to business practices of dominant firms is inappropriate. Economic evidence and analysis should be used to identify whether the conduct is harmful. This need not be a comprehensive and time-consuming review; instead some form of quick look is possible. We also agreed that it is advisable to use safe harbours and rebuttable presumptions to assist in administering the competition laws. We also agreed that *actual* harm need not be proven before intervention would be appropriate. Instead, evidence of *likely* harm is all that should be required.

We had several remaining disagreements, however. One pertained to how we use economic evidence, with the BKartA suggesting that after several decades of enforcement experience it was entitled to make certain assumptions about the kind

12. *Ibid.*
13. *Ibid.*

of harm that certain practices might have on a market. Critics felt that practices should be examined to see if harm is likely in each particular case. The biggest point of contention among us, however, concerned the harm we were trying to prevent. Was it enough to find likely harm to competitors (i.e., the structure of competition) or did we need to see conduct that was likely to harm consumers, for example, through raising price?

This of course brings us full circle, and we find ourselves again at the exquisite problem, a knot we have not yet been able to cut.

IV SOME SUGGESTIONS BASED ON MERIT AND JUSTICE

What I would like to do is attempt to cut through some of these arguments and see if there isn't something deeper and even older going on which might be able to guide us in this thoroughly modern debate.

It seems to me that both sides would agree that competition should be based on performance, or merit. Indeed, recall that the foundation of much of the case law was rhetoric about 'competition on the merits', a point on which both the US and EU agree expressly. They also seem to agree that performance-based competition should be encouraged. But what does this mean?

My view of performance-based competition is that it is supposed to be an ever-upward spiral of innovation, competition and efficiency. Fostering improvements in competitive performance should thus be the primary mode of competition no matter which economy you are in.

If one is focused on promoting improvements in performance, then it should be completely inappropriate, and indeed unjust, to punish more efficient firms – even if they are dominant – for pulling ahead in a race. What should be punished is conduct that is not based on any improvement in performance, or in other words, the product offering. Obviously this would include purely exclusionary conduct.

What is performance-based competition though, and would we know it when we saw it, even if rivals complained about it? My view is that performance-based improvements are based on the merits of the product, and involve making something more attractive and even more valuable to consumers. They involve making something more efficiently, and thus cheaply, or adding improvements in quality or efficiency. Merit of course is an even richer concept than this, and is linked to value, the value in particular of the product to the particular consumer. But what should be obvious is that merit is most certainly a richer concept than mere 'objectively justified cost savings based on efficiencies'. Why is that? Simple. Competition itself is based on more than mere cost savings. Of course cost savings, if passed on to consumers, can lead to reductions in price. But price is not the only way that companies compete. They compete on choice, on tailoring products to their consumers, on getting the right fit between supply and demand.

If performance-based competition is all about building a better product, a better engine, if you will, and thus being able to pull ahead of your rivals, then this is a far cry from exclusionary conduct, even if rivals do see you disappear into

the distance with their customers. This is not pushing rivals out; it is pulling away from them. Of course, from the rivals' perspective they are losing business to the dominant firm and feel aggrieved. Nevertheless, that is how competition works. It is not a participation sport, like the Ordoliberals want. If the dominant firm's conduct can be seen to be truly pro-competitive, and to be an improvement in a competitive offering, on any of the criteria of price, quality, or choice, then this is not true exclusion and should not be condemned no matter what it does to the rivals. After all, so long as everyone has a chance to run in the race, the fact that one person is faster than the rest is not a deprivation of anyone's freedom. Indeed, it is what the race is all about. Dominant firms should be free to introduce better product offerings, and they just need to ensure that their customers are free to 'take it or leave it'. This freedom also allows rivals to compete if they wish. Indeed they never lose the opportunity to compete and the ability to do so as well is – as it should be – up to them.

The point I would like to close with is that an approach that fosters performance-based competition is also a just approach. Rewarding successful conduct accords with justice, just as punishing successful conduct is an injustice. Both aspects have been summed up by Judge Learned Hand in the *Alcoa* case: 'The successful competitor, having been urged to compete, should not be turned upon when he wins'.[14]

How do we 'operationalize' this approach though? Is it possible? Is this sufficient guidance for business people, for authorities and the courts? One possibility is to focus on the unjust aspects of abusive conduct of dominant firms. And what is the defining feature of dominant firms? Their success, of course; but this is not a problem, or a cause for fault. For competition policy purposes, though, their success gives them a degree of power over the market, and over their rivals in particular. So it is their power relative to others that seems important, and this is what clearly exercises the Ordoliberals, who would prefer a more 'even' playing field. I do not agree with that. I think the focus should be on what makes this power so problematic. And what is that? It is that such power allows the dominant firm to *coerce* others, whether rivals or consumers. It is coercion that should be made a key part of any test, not simply in identifying whether the company has market power, but also in identifying whether it has abused that power. If the conduct is coercive, it removes the freedom of others, by definition. What happens, though, if it is just performance-based competition? Is that coercive? Not at all, if anything it should spur rivals on to do better. Indeed it should 'incentivize' them to do so.

So this is where I come down: coercive conduct deprives rivals of their economic freedom; it should be banned under either the economic freedom approach of Ordoliberalism or the consumer welfare approach, because it eliminates the rival's ability to compete. However, if the conduct still leaves the rival free to act, then it is not coercive, and instead it is incentivizing, in the manner of a runner pulling ahead.

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14. *US v. Alcoa*, 148 F2d 416 (2d Cir. 1945).

Every firm can incentivize its rivals, simply by improving its offering and poaching customers. Dominant firms can do this too. But only dominant firms can coerce others. That is the whole problem. Abuse of dominance provisions exist to prevent that.

So what would be a just approach to exclusionary conduct? What would accord with efficiency, with merit, and with justice? In my view it would be an enforcement approach that was based on incentives, or merit-based offers based on improved performance, being presumed legal unless proved likely to harm consumers in the short or medium term. Similarly, coercive conduct, which deprives rivals of their liberty and freedom to act, should be presumed illegal, unless the dominant firm can show that it somehow enhances efficiency.

I welcome the continued discussion on this subject which can only help to build consensus on these important issues.

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