The Reform of EC Competition Law

New Challenges

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Section B
Concurrent Proceedings in National and EC Competition Law

Chapter 4
Case Allocation in Antitrust and Collaboration between the National Competition Authorities and the European Commission
Alexandra Mikroulea

Chapter 5
The Role of Arbitration in Competition Disputes
Laurence Idot

Chapter 6
Modernization and the Role of National Courts: Institutional Choices, Power Relations, and Substantive Implications
Kosmas Boskovits

Section C
Optimal Sanctions and Their Limitations

Chapter 7
Optimal Antitrust Enforcement: From Theory to Policy Options
Frederic Jenny

Chapter 8
Eric David

Chapter 9
Protecting Human Rights in the Context of European Antitrust Criminalization
Peter Whelan

Part II
The Challenges of Economic Evidence

Chapter 10
‘Judging’ Economists: Economic Expertise in Competition Law Litigation
A European View
Ioannis Lianos
Summary of Contents

Part III
Vertical Aspects 323

Section A
Competition Law Policy in Markets with Non-conventional Price-Formation Mechanisms 325

Chapter 11
Antitrust Issues in Dynamic Markets 327
Federico Etro

Chapter 12
Antitrust Issues in Network Industries 343
Nicholas Economides

Chapter 13
EC Competition Law and Parallel Trade in Pharmaceutical Products 377
Assimakis Komninou & Anthony Dawes

Section B
Abuse of a Dominant Position 409

Chapter 14
Exclusionary Abuses and the Justice of ‘Competition on the Merits’ 411
Philip Marsden

Chapter 15
The Implementation of an Effects-Based Approach under Article 82: Principles and Application 419
Penelope Papandropoulos

Section C
Mergers 435

Chapter 16
Critical Analysis of the ECMR Reform 437
Ioannis Kokkoris & Krisztian Katona

Chapter 17
On the Economics of Non-horizontal Mergers 477
Nikolaos Vettas & Frago Kourandi

Section D
Cartels 495
Chapter 18
An Optimal Enforcement System against Cartels 497
Maria Luisa Tierno Centella

Chapter 19
The ECN and the Model Leniency Programme 505
Kris Dekeyser & Fabio Polverino

Section E
State Action and EC Competition Law 519

Chapter 20
The Community State Aid Action Plan and the Challenge of
Developing an Optimal Enforcement System 521
Alena Zemplinerova

Chapter 21
EU Competition Policy for Rescuing and Restructuring Companies 537
Nikolaos E. Farantouris

Chapter 22
State Aid Law Claims in Merger Control 559
Alexandros Stratakis & Luca Crocco

List of Contributors 577
# Table of Contents

**Foreword**  
The Reform of EC Competition Law: The Challenge of an Optimal Enforcement System  
*Valentine Korah*  
xxiii

**Preface**  
xxix

**List of Abbreviations**  
xxxix

**Part I**  
Institutional Aspects  
1

**Section A**  
The Design of an Optimal Competition Law Enforcement Regime  
3

**Chapter 1**  
Welfare-Based Optimal Legal Standards: A Brief Review of Theory and Applications  
*Yannis S. Katsoulacos & David Ulph*  
5

I Introduction  
5
   A Decision Errors of Legal Rules  
7
   B Indirect (Deterrence) Effects of Legal Rules  
7
   C Procedural Effects of Decision Rules  
8

II Choosing Legal Standards: Some Limitations of Existing Analyses  
8

III Choosing Legal Standards: A Welfare-Based Approach  
9

IV An Application to Refusals to License IPs and *Microsoft*  
11

V Concluding Remarks  
14
Chapter 2
Private Enforcement: Current Situation and Methods of Improvement
Denis Waelbroeck

I Introduction
II The Basis for Damages Actions in EC Law
III The Situation in the Member States
IV Determining the forum
V Establishing the Claim
   A Discovery
   B Making Prior Decisions Binding
VI Fault
VII Damages
   A Punitive Damages
   B The Passing-on Defence
VIII Collective Actions
IX Costs
X Conclusion

Chapter 3
An EU Competition Court: The Continuing Debate
Christopher Bellamy

I The Last Twenty Years: How We Got Here
   A Setting up of the CFI
   B The Increasing Workload
   C Changes to the Rules of Procedure
   D Structural Reform: Judicial Panels and the European CST
   E The House of Lords Report 2007
II Where Are We Now?
III Where Should We Go from Here?
   A The House of Lords Report
   B Specialized Chambers?
IV The Wider Picture
   A Increasing Workload, Delay, Dilution?
   B Judicial Review and Fundamental Rights
   C Modernization: No Coherent Appellate Structure
V Looking Ahead: A Tentative Conclusion

Section B
Concurrent Proceedings in National and EC Competition Law
# Table of Contents

## Chapter 4
**Case Allocation in Antitrust and Collaboration between the National Competition Authorities and the European Commission**

Alexandra Mikroulea

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Introduction</td>
<td>55</td>
</tr>
<tr>
<td>II Case Allocation within the Network</td>
<td>57</td>
</tr>
<tr>
<td>A Lack of Binding Allocation Rules</td>
<td>58</td>
</tr>
<tr>
<td>1 Centre of Gravity</td>
<td>58</td>
</tr>
<tr>
<td>2 Best-Placed v. Well-Placed Authority</td>
<td>59</td>
</tr>
<tr>
<td>B Initial Allocation Period</td>
<td>60</td>
</tr>
<tr>
<td>C Exchange of Information</td>
<td>61</td>
</tr>
<tr>
<td>III Conflicts of Jurisdiction under the Allocation System</td>
<td>62</td>
</tr>
<tr>
<td>A Positive and Negative Conflicts</td>
<td>62</td>
</tr>
<tr>
<td>B Unpredictability of Penalties</td>
<td>64</td>
</tr>
<tr>
<td>IV Procedural Rights of the Parties</td>
<td>64</td>
</tr>
<tr>
<td>A The Right to a Fair Hearing</td>
<td>65</td>
</tr>
<tr>
<td>B The Right to a Fair Administrative Procedure</td>
<td>66</td>
</tr>
<tr>
<td>C The Right to a Fair Trial</td>
<td>67</td>
</tr>
<tr>
<td>1 Review of Article 11, Paragraph 6 Decisions</td>
<td>67</td>
</tr>
<tr>
<td>2 Review of Article 13 Decisions</td>
<td>68</td>
</tr>
<tr>
<td>3 Review of Other Decisions</td>
<td>68</td>
</tr>
<tr>
<td>D Access to the File</td>
<td>69</td>
</tr>
<tr>
<td>E Legal Representation and the Protection of the Confidentiality of Lawyer-Client Communications</td>
<td>69</td>
</tr>
<tr>
<td>F The Protection Against Self-Incrination</td>
<td>71</td>
</tr>
<tr>
<td>G The Principle of 'ne bis in idem'</td>
<td>72</td>
</tr>
<tr>
<td>V Conclusion</td>
<td>72</td>
</tr>
</tbody>
</table>

## Chapter 5
**The Role of Arbitration in Competition Disputes**

Laurence Idot

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Introduction</td>
<td>75</td>
</tr>
<tr>
<td>II Competition between the Arbitrator and the National Judge</td>
<td>78</td>
</tr>
<tr>
<td>A Evolution in Law</td>
<td>78</td>
</tr>
<tr>
<td>1 Stability of the Conditions Required by National Arbitration Law</td>
<td>78</td>
</tr>
<tr>
<td>2 Amendment of the Limits Imposed by Competition Law</td>
<td>79</td>
</tr>
</tbody>
</table>
Chapter 8
Eric David

I Introduction 139

II Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No. 1/2003 142
A The Need for Transparency Countered by the Retention of Wide Discretion 142
1 The Need for Transparency 142
2 The Commission’s Intention to Strengthen Its Discretion 143
3 The CFI and The ECJ’s Position: Discretion v. Consistent Policy 144
B Uncertainties Resulting from the 2006 Guidelines 148
1 Methodology to Set the Fines 148
2 The Uncertainties Surrounding the Methodology of the 2006 Guidelines and Its Application 149
a Uncertainty Regarding Whether Application of the Methodology of the 2006 Guidelines is Appropriate 149
b Uncertainties Surrounding the Methodology Set Down by the 2006 Guidelines 150

III The Commission’s Commitment Proceedings Policy 154
A The Commitment Proceedings Before the Commission: Theoretical Aspects 154
1 The Commitment Proceedings within the System of Community Proceedings 154
2 The Inherent Risks in the Commitment Proceedings 155
B The Commission’s Jurisprudence 157

IV Conclusion 159

Chapter 9
Protecting Human Rights in the Context of European Antitrust Criminalization 161
Peter Whelan

I Introduction 161

A Background 161
B Aims and Layout 162

II The Normative Position of Human Rights in the Context of European Antitrust Criminalization 163
A Accommodating Human Rights within a Theoretical Model of Antitrust Criminalization 163
### Part II

#### The Challenges of Economic Evidence

**Chapter 10**

*‘Judging’ Economists: Economic Expertise in Competition Law Litigation*

*Ioannis Lianos*

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Introduction</td>
<td>185</td>
</tr>
<tr>
<td>II</td>
<td>Expert Evidence in the Courtroom: Origins and Problems</td>
<td>190</td>
</tr>
<tr>
<td></td>
<td>A The Origins of Expertise: Informational Asymmetry and Epistemic Competence</td>
<td>191</td>
</tr>
<tr>
<td></td>
<td>B Science, Objectivity, and the Specific Nature of Economic Expertise</td>
<td>200</td>
</tr>
<tr>
<td></td>
<td>1 The Evolution of Acceptable Methods of Observation as a Limit to the Demarcation Criterion of Empiricism</td>
<td>203</td>
</tr>
<tr>
<td></td>
<td>2 The Possibility of Deductive Science as a Criticism to the Demarcation Criterion of Induction</td>
<td>206</td>
</tr>
<tr>
<td></td>
<td>3 The Elusive Demarcation Criterion of Facts-Based Reasoning Versus Theory/Abstract Reasoning</td>
<td>212</td>
</tr>
<tr>
<td></td>
<td>4 Scientific Practice as a Limit to the Demarcation Criterion of Scientific Consensus</td>
<td>217</td>
</tr>
<tr>
<td></td>
<td>5 Pragmatism as a Limit to the Demarcation Criterion of Objectivity</td>
<td>224</td>
</tr>
</tbody>
</table>
Table of Contents

C The Development of an Economic Science for Litigation: Implications for the Evolution of Research in Antitrust Economics 227

III Economic Expertise in Competition Law: Scope and Implications 234
A The Legal Relevance of Economic Expertise in EC Competition Law 234
B The Many Faces of Economic Evidence in Competition Law 237
   1 Economic ‘Facts’ 238
   2 Economic Transplants 239
   3 Economic Authority 243
   4 Economic ‘Laws’ 246

IV Points of Entry of Economic Expertise in the Courtroom: 247
A Comparative Institutional Analysis 247
   A Expert Witnesses 248
   B Court-Appointed Experts 254
   C Hybrid Options 261
      1 Assessors and Special Juries 261
      2 Amicus curiae or Advice from the Competition Authorities 262
      3 Internal Economic Expertise (Clerks, Research, and Documentation Units in Courts Formed by Economists) 262
      4 Specialized or Trans-Disciplinary Courts 263

V Substantive Assessment of Economic Expertise 263
A Admissibility of Economic Expertise: The Exclusionary Ethos 265
   1 The Emergence of the Gatekeeping Role of the Judge 265
   2 The Application of the Daubert Rules in Competition Law Litigation 271
   3 A Critical Assessment of the Daubert Test 274
B Assessment and Sufficiency of Economic Expertise: The Discursive Ethos 287
   1 Attaching Weight to Economic Evidence as a Filter for a More Extensive Competition Law Assessment 288
      a The Development of Procedures Requiring the Weighing of Economic Evidence: Summary Judgments and the Expansion of the Plausible Economics Inquiry 288
      b How to Determine the Evidential Weight of Economic Evidence? 293
   2 The Determination of the Standard of Proof 304
      a A Probabilistic Account of Standards of Proof (Persuasion) for Economic Evidence 305
      b Relative Plausibility Theory and Standards of Proof (Persuasion) 315

VI Conclusion 319
## Part III

**Vertical Aspects** 323

### Section A

**Competition Law Policy in Markets with Non-conventional Price-Formation Mechanisms** 325

### Chapter 11

**Antitrust Issues in Dynamic Markets** 327

*Federico Eiro*

1. Introduction 327
2. Endogenous Market Structures and Competition Policy 328
3. Toward a Reform of Antitrust Policy for Dynamic Markets 331
4. Predatory Pricing 332
5. Intellectual Property Rights Policy 334
6. An Application: The Dynamic Market for Online Advertising 337
7. Conclusions 341

### Chapter 12

**Antitrust Issues in Network Industries** 343

*Nicholas Economides*

1. Introduction 343
2. The Logic of Competition Law in the United States and the European Union 344
3. Markets with Network Effects
   - A Sources of Network Effects and the Reversal of the Law of Demand 345
   - B Critical Mass 351
4. Features of Markets with Network Effects
   - A Ability to Charge Prices on Both Sides of a Network 351
   - B Network Effects may or may not be Internalized 352
   - C Fast Network Expansion 353
   - D Perfect Competition is Inefficient 353
   - E Incompatibility as a Strategic Weapon 354
   - F Inequality of Market Shares and Profits 357
   - G Monopoly may Maximize Total Surplus 361
   - H In Networks, Market Inequality can Exist without Anti-competitive Acts 361
   - I In Network Industries, Free Entry Does Not Lead to Perfect Competition 362
   - J Imposing an Egalitarian Market Structure Is Likely to be Counterproductive 362
   - K Nature of Competition is Different in Network Industries 363
   - L Path-Dependence 363
Table of Contents

V Competition Policy Issues in Network Industries 364
   A Interconnection Issues in One-Sided Bottlenecks 364
   B Interconnection Issues in Two-Sided Bottlenecks 367
   C Market Power Creation Specific to Networks:
      The Importance of Technical Standards 369
   D Vertical Integration and Vertical Control Issues in Network
      Industries 371
   E Dynamic Efficiency Issues 372
   F Innovation Issues 372
   G Criteria to Be Used for Antitrust Intervention in Network
      Industries 372
   H Criteria to Be Used for Remedies 373
VI Concluding Remarks 375

Chapter 13
EC Competition Law and Parallel Trade in Pharmaceutical Products 377
Assimakis Komninos & Anthony Dawes

I Introduction 377
II The Factual Background: The Greek Example 381
III The Specific Legal and Economic Context of the
   Pharmaceutical Sector Sets it Apart from Other Industries 383
      A State Regulation and Public Service Obligations 383
      B The Benefits of Parallel Trade cannot be Presumed to
         Accrue to Customers and End Consumers 386
IV The GSK Cases 389
      A Article 81 EC 389
      B Article 82 EC 393
V Comment 398
      A Article 81 EC 398
      B Article 82 EC 403
         1 The Definition of the Relevant Market and Dominance 403
         2 Abuse 404
VI Conclusion 408

Section B
Abuse of a Dominant Position 409

Chapter 14
Exclusionary Abuses and the Justice of ‘Competition on the Merits’ 411
Philip Marsden

I Introduction 411
II The Exquisite Problem 412
III The Different Enforcement Approaches 414
IV Some Suggestions Based on Merit and Justice 416
<table>
<thead>
<tr>
<th>Chapter 15</th>
<th>The Implementation of an Effects-Based Approach under Article 82: Principles and Application</th>
</tr>
</thead>
<tbody>
<tr>
<td>Penelope Papandropoulos</td>
<td></td>
</tr>
<tr>
<td>I Introduction</td>
<td>419</td>
</tr>
<tr>
<td>II Different Approaches to Designing Rules for the Analysis of Exclusionary Conduct</td>
<td>420</td>
</tr>
<tr>
<td>III An Effects-Based Approach to Analyse Unilateral Conduct by Dominant Firms</td>
<td>424</td>
</tr>
<tr>
<td>IV Predation: The American Airlines Case</td>
<td>426</td>
</tr>
<tr>
<td>V Input Foreclosure</td>
<td>429</td>
</tr>
<tr>
<td>VI Rebates</td>
<td>430</td>
</tr>
<tr>
<td>VII Conclusion</td>
<td>433</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Section C</th>
<th>Mergers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter 16</td>
<td>Critical Analysis of the ECMR Reform</td>
</tr>
<tr>
<td>Ioannis Kokkoris &amp; Krisztian Katona</td>
<td></td>
</tr>
<tr>
<td>I Introduction</td>
<td>437</td>
</tr>
<tr>
<td>II Jurisdictional Reform</td>
<td>438</td>
</tr>
<tr>
<td>A Member State Referrals to the Commission</td>
<td>439</td>
</tr>
<tr>
<td>B Referrals to Member States</td>
<td>440</td>
</tr>
<tr>
<td>C Article 9 ECMR, Post-Notification Referrals upon Request by Member States</td>
<td>441</td>
</tr>
<tr>
<td>D Pre-Notification Referrals upon Request by the Merging Parties</td>
<td>442</td>
</tr>
<tr>
<td>E Company Requests for Pre-Notification Referral to the Commission</td>
<td>443</td>
</tr>
<tr>
<td>III Procedural Reform</td>
<td>445</td>
</tr>
<tr>
<td>A Pre-Notification Consultations</td>
<td>445</td>
</tr>
<tr>
<td>B State of Play and Triangular Meetings</td>
<td>446</td>
</tr>
<tr>
<td>C Discussion of Remedies</td>
<td>447</td>
</tr>
<tr>
<td>D Other Procedural Innovations</td>
<td>448</td>
</tr>
<tr>
<td>IV Substantive Reform</td>
<td>448</td>
</tr>
<tr>
<td>V Case Law Analysis</td>
<td>452</td>
</tr>
<tr>
<td>A Oracle/PeopleSoft</td>
<td>452</td>
</tr>
<tr>
<td>1 Analysis of the Case</td>
<td>452</td>
</tr>
<tr>
<td>2 A Gap Case?</td>
<td>457</td>
</tr>
<tr>
<td>B Sony/BMG</td>
<td>463</td>
</tr>
<tr>
<td>1 Analysis of the Case</td>
<td>463</td>
</tr>
<tr>
<td>2 A Gap Case?</td>
<td>467</td>
</tr>
</tbody>
</table>
Table of Contents

VI Market Structure Conducive to ‘Gap’ Cases 472
VII Conclusion 474
Annex 1 475

Chapter 17
On the Economics of Non-horizontal Mergers 477
Nikolaos Vettas & Frago Kourandi

I Introduction 477
II Vertically-Related Firms and Markets 480
   A Vertical Chains 480
   B Pre- and Post-Chicago Views 481
III Main Economic Effects in Vertical Structures 482
   A Double Marginalization: The Basic Vertical Externality and Solutions 482
   B Equilibrium Pricing Incentives with Strategic Pricing 484
   C Quality and Specific Investments 487
   D Dynamics 489
   E General Lessons from the Theoretical and Empirical Analyses 490
IV Non-horizontal and Non-vertical Cases 491
V Economic Analysis Behind Non-horizontal Merger Guidelines 491
VI The Possible Roles of the Non-horizontal Merger Guidelines 493
VII Conclusion 494

Section D
Cartels 495

Chapter 18
An Optimal Enforcement System against Cartels 497
María Luisa Tierno Centella

I What is Special About Cartels? 497
II What is Special About the Enforcement of Cartel Rules? 498
III Detecting and Proving Secret Cartels 499
IV Timely Punishment: Sanctions 502
V Is There Such a Thing as an Optimal System to Enforce the Cartel Prohibition? 503

Chapter 19
The ECN and the Model Leniency Programme 505
Kris Dekeyser & Fabio Polverino

I Introduction: Antitrust Enforcement in the Pre-modernization Era 505
II The European Competition Network and Its Functioning 506
   A An Integrated and Flexible Enforcement System 507
   B Exchange of Information 508
Table of Contents

C Work Sharing 509
D Coherent Application of Antitrust Rules 510
E Achievements of the ECN Network 511

III The Model Leniency Programme 512
A The Implications of ECN Cooperation for National Leniency Programs 512
B Remedies Adopted in the Network Notice 513
C The Adoption of the Model Leniency Programme 514
D The Principles of Leniency Harmonization 515
E The Summary Application System 515
F The Results of the MLP 516

IV Conclusion 517

Section E
State Action and EC Competition Law 519

Chapter 20
The Community State Aid Action Plan and the Challenge of Developing an Optimal Enforcement System 521
Alena Zemplinerova

I Introduction 521
II Enforcement of EU State Aid Control 523
A Less and Better Targeted State Aid 523
B Effective Procedures, Better Enforcement, Higher Predictability and Transparency 525
C Shared Responsibility between the Commission and the Member States 526
D Greater Emphasis on Economic Analysis 527

III State Aid Under the EU Treaty 528
A Transfer of State Resources 528
B Economic Advantage 529
C Selectivity 530
D Effects on Trade Between Member States 530

IV Assessment of State Aid Compatibility with the EU Market 531
A Negative Effects of State Aid 532
B Positive Effects of State Aid 533

V Concluding Remarks 535

Chapter 21
EU Competition Policy for Rescuing and Restructuring Companies 537
Nikolaos E. Farantouris

I Introduction 537
II Meaning of ‘a Firm in Difficulty’ 540
III Rescue or Restructuring?
Chapter 22
State Aid Law Claims in Merger Control

I Introduction 559
II EC Case-Law 560
A The Matra Doctrine: Origins and Recent Developments 560
B The RJB Mining Case: The Matra Doctrine in a Merger Control Context 563
C The BaByliss Judgment: A Step Back from RJB Mining? 566
III Commission Practice Post-RJB Mining 568
A RAG II 568
B The Hellenic Shipyard Cases 569
C Metronet/Infraco 570
D Deutsche Post/DHL(II) and Deutsche Post/Exel 571
E Iberdrola/Scottish Power 573
F ENEL/EMS 573
IV Concluding Remarks 574

List of Contributors 577
Chapter 14

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...
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

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 harm⁴; the EC Discussion Paper generated substantial debate⁵; 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

⁴. See <www.govinfo.library.unt.edu/amc>.
involves ‘reinforcing [one’s] position by recourse to means other than competition on the merits’.  

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. 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.

III THE DIFFERENT ENFORCEMENT APPROACHES

Why are these approaches so different? Is it merely, as the BundesKartellamt (B KartA) 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.

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.\footnote{Ibid.}

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.\footnote{Ibid.} 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 \textit{actual} harm need not be proven before intervention would be appropriate. Instead, evidence of \textit{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
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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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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