

**Conference on "Pricing and the Dominant Company"**

**"The Commission's current thinking on Article 82"**

**Philip Lowe  
Director General  
DG Competition**

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## ***Introduction***

Thank you for inviting me here today to start the discussions on pricing and the dominant company. I note that the subtitle of the conference is, in the first place, "The Commission's next moves on Article 82" and, in the second place, "the implications of Microsoft". Although there is a lot to say on both - and there is obviously a connection between the two - you won't be surprised to hear that I will have to exercise some self-restraint not to let the latter take over this talk altogether.

What I will do today is to give you some insight into the Commission's current thinking on Article 82, and specifically on pricing issues. The debate on Article 82 has generated a lot of heat over the last few years. Internally, we have done a lot of thinking and we have had a lot of very valuable discussions with a wide range of stakeholders. There have also been some very significant judgments by the European courts, not least in the Microsoft case. These necessarily have an impact on our approach. The most helpful thing I can do today is probably to take you through some of the Article 82 cases that have recently been keeping DG Competition busy.

I'll discuss cases in the high tech and telecommunications sectors - which are extremely important to consumers. These cases are good examples of our current enforcement priorities under Article 82, both in terms of the type of infringement at issue, and of how we can make a difference by taking action.

## ***General conditions for applying Article 82***

Before I go into any detail, it is useful to recall some of the general preconditions for action by the Commission under Article 82.

First, the firm under investigation must have durable and significant market power, not simply by reference to its market share but also by taking account of the full range of constraints which it faces, and in particular the ease with which its position may be challenged by existing or potential competitors.

Second, the particular conduct which is the focus of the Commission's concerns must lead to consumer harm, either through hampering or eliminating competitors' access to a market to such an extent that they no longer have the ability or incentive to compete with the dominant firm, or by exploiting customers or consumers directly. The effects on consumer harm may be direct and immediate on price, or they can be longer term, for example on the process of innovation.

However, we are unlikely to act against conduct which may have the effect of restricting the ability of competitors to succeed in the market-place, if that behaviour can be justified by the dominant company's superior efficiency, higher quality, or innovation.

## ***Telecommunications sector***

A decision we took in July 2007 provides a good illustration of the Commission's approach. We found that the Spanish telecoms provider Telefonica had infringed

Article 82 by charging a wholesale broadband access price to its competitors which did not allow them to compete effectively in the retail broadband access market: the margin between this wholesale price and the retail price charged by Telefonica made it impossible for the other providers to operate profitably, despite being at least as cost-efficient as the dominant firm. As a result of Telefonica's practices broadband prices in Spain were higher than average in the EU old Member States and broadband less widespread than average.

This decision follows on from the Wanadoo and Deutsche Telekom cases in 2003, which respectively involved predation and margin squeeze by the incumbent telecoms operators in the broadband markets in France and Germany. I am convinced that the Commission's decisions in this field have helped to ensure that the telecoms sector in France, Germany and Spain is more competitive, bringing down prices, and stimulating investment and innovation, with clear benefits for consumers.

### ***High tech sector***

We often have to confront issues of market power and dominant firm pricing in the high tech sector. Obviously this can be a fast-moving area, and some people argue that we risk playing catch-up with our enforcement action – i.e. the market moves on before we get a chance to take action and our eventual decision and remedies are useless by the time they are in place. This is always a risk associated with *ex post* enforcement, and a competition authority needs to do everything that it can to take timely enforcement action.

However, I do not think these concerns are well founded: if markets are truly fast moving there is likely to be innovation and market entry, and there is unlikely to be enduring market power.

It is in the markets in which one company has so entrenched its dominant position that it is able to commit abuses which affect consumer welfare, that we need to do something. And I believe that such markets exist in the high tech sector, particularly when you bear in mind that there can be market power without a complete stagnation of the market.

The markets at issue in the Commission's **Microsoft** decision are a case in point. The Decision, confirmed by the Court of First Instance, requires Microsoft to provide the relevant interoperability information on reasonable terms. The principle which we applied as regards pricing was that for Microsoft to be able to charge a price, there had to be innovation in the interoperability information. This is because the very essence of the abuse had been the refusal to disclose interface information, which industry players usually provide to each other, often at no cost, and so Microsoft should not be rewarded for providing mundane interface information necessary simply to connect to its Windows monopoly.

Microsoft's potential competitors summed up the situation very well: the interoperability information was not kept secret because it was valuable, it was valuable because it was secret. Microsoft failed to show any real innovation in the vast majority of the information that it eventually disclosed; it was simply keeping the interoperability information secret to allow it to leverage into other markets. Requiring disclosure could not undermine innovation, because there was none to undermine.

Putting an end to this abuse meant that Microsoft offered the interoperability information that is not covered by patents for a one-off nominal fee, whilst for the patented information, a running royalty of 0.4% of licensee product revenues applies. This solution protects any genuine innovation by Microsoft, while at the same time ensuring that the main potential competitor to Microsoft - the open source movement - can access the interoperability information.

As a result of the Commission's intervention, open source developers have been able to license the information, development work has started, and new, innovative products can be expected to come to market.

The remedy does not mandate outcomes. Rather it creates the opportunity for competition.

It is up to competitors to make the most of this opportunity. It is also up to Microsoft to innovate and build new and better products without artificial protection from its failure to disclose interoperability information. We are keeping up the pressure on Microsoft to comply with the competition rules: as you will know, we have recently opened proceedings against Microsoft following complaints by ECIS concerning interoperability and by Opera, a rival internet browser vendor, concerning tying.

Moving on from Microsoft, market power and pricing disputes are relatively frequent consequences of standardisation work in the high-tech sector. If standardisation processes are open and transparent, then standards can bring significant benefits to the consumer by ensuring compatibility between products, and thus allowing competition to unfold on the basis of price and innovation. But

under certain circumstances, standardisation can confer on a particular technology a degree of market power that it would otherwise not have had. Standardisation means that companies will be locked in as regards a certain technology and will have to come to agreement with the IPR holders of patents included in the standard.

This is well known, which is why many standards organisations require both disclosure of potentially relevant IPRs, and a commitment to license those IPRs on fair reasonable and non-discriminatory – FRAND - terms.

These requirements do not necessarily end all problems. What if IPRs are not disclosed? What if one person's FRAND terms are another person's exploitative abuse? If the problems only manifest themselves once the standard has been established or even widely adopted, it may be too late to start the standardisation process again, choosing another technology.

We are currently looking at two cases that illustrate these issues.

The Commission's Rambus case involves a company's alleged failure to disclose relevant IPRs during the standard creation process and the alleged exploitation of a monopoly position it would not have had without those IPRs' inclusion in a standard.

I cannot say much on this since the case is still pending, but the Commission's provisional concern, set out in last July's Statement of Objections was that Rambus carried out a "patent ambush" and is consequently claiming unreasonable royalties for the use of patents relating to a standard for "Dynamic Random Access

Memory" chips (DRAMS) used notably in computers. A "patent ambush" is essentially the deceptive capture of a standard through intentional non-disclosure of essential intellectual property rights during the standards development process. The Commission's preliminary view is that without its "patent ambush", Rambus would not have been able to charge the royalty rates it currently does, and potentially would not have been able to charge any royalty rates at all as its technology would not have been selected. Arguably then, the "patent ambush" has had the effect of driving up prices for DRAMS, which are a component of computer systems, and are also used in a wide variety of consumer electronic and communications products. There are important issues to consider here, such as whether Rambus has market power, whether it failed to disclose essential IPRs, whether alternatives to the Rambus technology were available at the time of the standardisation, and whether the prices charged by Rambus are greater than they would have been absent the standard.

Another pending case turns not on whether IPRs were disclosed, but on whether the commitment to license essential technology included in the standard on fair, reasonable and non-discriminatory (FRAND) terms is respected – and of course whether a failure to respect a FRAND commitment can breach the competition rules.

We recently opened formal anti-trust proceedings against **Qualcomm**, a chipset manufacturer which holds IP rights in the 3G standard for European mobile phone technology.

The non-disclosure of essential patents resulting in the ability to charge certain royalty rates as well as licensing on non-FRAND terms can hold up the whole



industry and are, I believe, dangerous.

Charging non-FRAND royalties on the technology included in the 3G standard could lead to final consumers paying higher handset prices. In addition, charging non-FRAND royalties could lead to a slower adoption of the 3G standard, and possibly also a slower development of the future 4G standard.

I cannot say at this stage whether either of these cases will lead to enforcement action, but it is clear that ex post control of pricing is not always easy.

It is therefore sensible for a competition authority to look at ways that markets can be made to operate better, avoiding the need for ex post control. So are ex ante mechanisms possible? Imagine the following scenario. At the point at which a standard is under discussion, there are four viable, roughly comparable alternative technologies each competing to be selected as the essential technology for the standard. If the selection is made on the basis of both the price and quality of the relevant technologies, then the price is competed down to the market level *ex ante*. Broadly speaking, the mechanism is similar to an auction. One potential essential technology holder declares his rights before the standard is set, and at the same time, specifies the maximum royalty he would charge if he is selected for the standard. Then, another potential essential technology holder may declare his rights and the associated maximum royalty that he would charge. And so on. There is therefore a virtuous cycle of competition on the basis of technology **and** price before the standard is selected where the price is competed down to the market level.

There have been increasing calls for standardisation bodies to allow and implement *ex ante* selection of the kind that I describe here. There is no reason, as some claim,

that this is in itself anti-competitive because it risks leading to some kind of inappropriate price collusion, at least where the standard-setting process picks one solution over others.

In these circumstances it is difficult to precisely envisage what kind of collusion there might be. If such *ex ante* schemes are merely some kind of artificial front for illegal price-fixing, then that would of course be a problem. But in and of themselves, such schemes are not anti-competitive, and indeed, as I have outlined, have the potential to bring strong pro-competitive benefits by competing the price down to the market level before the standard is set.

In addition to ex ante arrangements such as this, potential problems could also be mitigated by avoiding proprietary technologies in standard setting. Of course this will often not be possible as many very successful European standards demonstrate.

All that being said, I do not believe that it is the role of a competition regulator to prescribe actively what rules standards bodies must adopt. Different rules may be appropriate for different bodies and sectors, and industry will generally know best what works. However, we can give guidance as to what may or may not be problematic from an anti-trust perspective to ensure that industry can make the most informed choices.

Finally as regards the high-tech sector, I would like to say a few words on another price-based case - **Intel**. Again, I cannot say much on this since the case is pending, but the Commission's main allegation in last July's Statement of Objections relates to conditional rebates. Here, the Commission's provisional finding is that Intel has provided substantial rebates to various PC manufacturers which are conditional on

them obtaining all or the great majority of their chip requirements from Intel. Among the factors which need to be considered when examining the effect of such rebates on competition are the size of the rebates, their scope, and the effect on rivals that having to compensate customers for the loss of the rebates has. Our Statement of Objections alleges that this conduct is part of a broader Intel strategy which is targeted at preventing AMD from expanding, and which would have the effect of denying or delaying consumers the choice of new and innovative products.

This is a classical Article 82 pricing case, but one which is informed by economic thinking as to the potential for consumer harm. Again, it is an area where an enforcement authority must be cautious – lower prices are *prima facie* good for consumer welfare. It is only if the prices are so low as to damage the competitive process and thus to damage consumer welfare that we should intervene.

### ***Conclusion***

As you can tell, we have some interesting issues currently on the table. I think that the message for you to take away is that we are drawing the lessons from past cases such as Microsoft, and that although pricing cases are inherently difficult, we are actively pursuing several, covering both exploitative and exclusionary conduct by potentially dominant firms. We are looking at cases in key sectors of the economy and we are looking at key types of abuse. In all cases, of course, our aim is to focus our enforcement action where it can make a real difference to consumers.