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Prohibition of the abuse of a dominant position

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TABLE OF CONTENTS

1. INTRODUCTION

Dominance - the analysis of market power and the abuse of market power is an especially challenging area of competition law both for new and mature Competition Authorities because it involves complex economic analysis.

For economies that are in transition to a market based system, competition law will for the first time be fully applied to former legal monopolies. In addition, a real market economy means that State intervention in the economic process should be cut down and companies will have to perform on their own merits. China is facing this challenge.

China's enforcement agencies will inevitably come into a position where they will have to apply Chapter III of the Anti Monopoly Law with respect to difficult cases of monopolies, dominant companies and where they will have to decide whether certain behaviour actually constitutes abuse. It is a great challenge!

Enforcement agencies should be cautious about intervening in the functioning of markets unless there is clear evidence that they are not functioning well. It is far too easy to get the analysis wrong in these types of cases. Therefore we would advice for any new competition regime to approach this type of cases with particular caution; this is what we try to do on our side.

A very challenging area is the application of competition law to the exploitation of IPR and in particular their licensing policy. The legitimate exploitation of IPR must be protected to foster innovation – the abusive exploitation must of course be stopped.

Let me explain how we approach the abuse of dominance issues in the EU.

2. BASIC CONCEPTS

2.1. The concept of dominance

As in the EU, market power is the central criterion in the newly adopted Anti-Monopoly Law for the finding of a dominant market position.

In formal EU terms dominance is described as a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.[1]

What does market dominance imply? What does it mean to properly define dominance?

In principle, dominance is a phenomenon for which the economists would use the term substantial market power - that is to say - the power to profitably influence market variables to the detriment of consumers and for a substantial period of time.

The convenient shorthand term is *"to profitably raise prices above the competitive level"*. However, we should not forget competition is not only about prices, but also about

[1] See Case 27/76 United Brands, paragraph 65, and Case 85/76, Hoffmann-La Roche, paragraph 38.

quality, choice, innovation, or level of output. So there are many parameters to take into account in ascertaining whether somebody possess market power

However, for all practical purposes, and to make a long story short, an undertaking is dominant if it has *substantial and durable market power*.

An investigation into whether a company has *substantial and durable market power* giving it a dominant position in a particular market normally comprises a variety of factors. The main factors which we use in the EU are:

(1) market position of the allegedly dominant firm;

(2) market position of the competitors;

(3) strength of buyers and their ability to sponsor new competition on the market; and

(4) barriers to entry.

These factors guide the market analysis which is required in abuse of dominance cases. At the same time these factors are sufficiently flexible to accommodate the extensive heterogeneity of individual cases. These factors are also sufficiently wide to cover those of the factors that are listed in Article 18 of the Chinese Anti Monopoly Law which are of real relevance for the determination of dominance.

An element that I have not found in the text of the Anti Monopoly Law and which is really important in determining whether a company has market power and whether it is in a dominant position – is the temporal element. Article 17 of the Anti Monopoly Law states: *"Dominant market position" in this Law refers to a market position held by undertakings that can control the price or quantity of products or other transaction conditions in the relevant market or can block or affect the access of other undertakings to the relevant market."*

Although the definition of dominant market position is silent about the temporal element, the Chinese enforcers will have to take this element into account in their work. Otherwise, they are likely to find dominance in respect of undertakings that are not in reality dominant. Market power is the power to influence market prices, output, innovation, the variety or quality of goods and services, or other parameters of competition on the market for a significant period of time.[2] According to EU case law[3] if the undertaking concerned has a high market share compared to other players on the market, it is an indication of dominance, provided that this market share has been held for some time. If market shares have fluctuated significantly over time, it is an indication of effective competition. However, this is only true where fluctuations are caused by rivalry between undertakings on the market. Fluctuations caused, for instance, by mergers are not in themselves indicative of such rivalry.

In addition to the above discussed market status factors, the Anti Monopoly Law also includes market share presumptions for dominance. However, establishing market power is a complex economic assessment – and in our practice, we have found that although market shares do constitute useful first indication in carrying out this assessment, they are not the end of the story. The Commission will interpret them in the light of the

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[2] See § 24 of DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses. December 2005.

[3] See Case 85/76 Hoffmann-La Roche cited in footnote 5, paragraph 41. See § 29 of DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses. December 2005.

specific market conditions, and in particular of the dynamics of the market and of the extent to which products are differentiated. This applies in particular in "new economy" or "knowledge economy" markets, where products are differentiated and dynamic effects are important. So - we believe - the focus in assessing dominance should be more on competitive constraints, *i.e.* the importance of entry and expansion barriers.

Barriers to expansion or entry can take various forms. They may be legal barriers such as tariffs or quotas, or they may take the form of advantages specifically enjoyed by the dominant firm; these may include economies of scale and scope, privileged access to essential inputs or natural resources, important technologies or an established distribution and sales network. They may also include costs faced by customers in switching to a new supplier. The dominant firm's own conduct may also create barriers to entry, for example where it has made significant investments which entrants or competitors would have to match, or where it agrees long term contracts with its customers.

This means that we must use the presumption that high market shares held for some time warrant a presumption of dominance with caution. It is probably only relevant in cases where market share figures are a sufficiently meaningful representation of the competitive dynamic. As mentioned, in some "new economy" markets, for example, this may not be the case.

On the other hand, the Commission considers that low market shares are generally a good proxy for the absence of substantial market power. The Commission's experience suggests that dominance is not likely if the firm's market share is below 40%. However, there may be cases in which another conclusion is reached, for example where competitors face capacity limits making them unable effectively to constrain the dominant firm.

Therefore the thresholds in Article 19 of the Anti Monopoly Law, which is the 50% market share of a single undertaking, should be treated merely as a proxy. The market share presumption should only be applied – or be easily rebutted - when competitors have considerably smaller markets shares and there are significant barriers to entry.

The Anti-Monopoly Law also provides that there is a presumption of (collective) dominance when two undertakings account for more than 2/3 of the market or three undertakings account for more that 3/4 of the market. These presumptions can be problematic as they will far too quickly lead to a finding of collective dominance.

The problem with the market share presumptions becomes apparent when they are coupled with the various forms of abuses listed in the law. For instance, if the prohibition on discrimination is applied to each of three oligopolists with a joint market share of 75% or more, it will facilitate the conclusion that there is collusion in the market since it would prevent the individual companies from deviating from the official price lists, as that could lead to a presumption for discrimination.

I would advice you to handle issues raising allegations on collective dominance merely on the basis of market share with particular care. While we are of course not ignoring market shares as such in Europe, the finding of collective dominance in EU competition law requires that two or more undertakings - that are not dominant individually - from an economic point of view through structural or contractual links present themselves or act together on a particular market as a collective entity.

In the absence of links between the undertakings concerned three conditions must be satisfied before a finding of collective dominance can be made:

- Firstly, each undertaking must be able to monitor whether or not the other undertakings are adhering to the common policy. It is not sufficient for each undertaking to be aware that interdependent market conduct is profitable for all of them, because each undertaking will be tempted to increase his share of the market by deviating from the common strategy. There must, therefore, be sufficient market transparency for all undertakings concerned to be aware, sufficiently precisely and quickly, of the market conduct of the others.

- Secondly, the implementation of the common policy must be sustainable over time, which presupposes the existence of sufficient deterrent mechanisms, which are sufficiently severe to convince all the undertakings concerned that it is in their best interest to adhere to the common policy.

- Finally, it must be established that competitive constraints do not jeopardise the implementation of the common strategy. As in the case of single dominance, it must be analysed what is the market position and strength of rivals that do not form part of the collective entity, what is the market position and strength of buyers and what is the potential for new entry as indicated by the height of entry barriers.

From our experience, a detailed analysis that is going far beyond market shares is required to establish dominance. There is no shortcut for a Competition Authority to establish whether a company is dominant or not.

2.2. Abuse

The abuse of dominant market position is an area of application of competition law where economic analysis plays a central role.

It is consequently very positive that the list of abuses in Article 17 of the Anti Monopoly Law is not meant to be exhaustive. The same is the case with Article 82 EC which only provides four examples of abuse.

The European Court of Justice has held that other forms of abuse are covered than those mentioned in the Treaty and that these are to be determined by the general principles and objectives of the Treaty. The European Court of Justice has held that behaviour which is such as to influence the structure of the market, where, as the result of the very presence of the undertaking the degree of competition is weakened, and which through recourse to methods different from those which condition normal competition (competition on the merits), has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition, constitutes abuse.

Consequently, exclusionary or predatory abuses, *i.e.* abusing market power to eliminate a competitor or restrict or impede its activities, because such conduct imperils the competition remaining in the market, are included in the prohibition.

Exclusionary abuses are characterised by the fact that they target competitors and aim at eliminating them or weakening their position. It is difficult to distinguish exclusionary abuses from legitimate competition.

The general framework of analysis that the Commission intends to use when assessing exclusionary abuses is the following:

(1) the actual or likely effect on competitors and competition *i.e.* whether the allegedly abusive conduct has resulted or is likely to result in consumer harm;

(2) in case of pricing abuses – the Commission will examine whether the abusive conduct hampers competition from competitors which are as efficient as the dominant firm *i.e.* whether a hypothetical competitor that is as efficient as the dominant firm would be likely to be foreclosed by the conduct in question.

(3) the Commission will examine claims put forward by a dominant firm that its conduct is justified. It may do so either by demonstrating that its conduct is objectively necessary or by demonstrating that its conduct produces efficiencies which outweigh any anticompetitive effects on consumers.

Exclusionary abuses are typically:

- Exclusive dealing: A dominant firm may try to foreclose its competitors by hindering them from selling to customers through use of exclusive purchasing obligations or rebates, together referred to as exclusive dealing.

- Tying and Bundling: A dominant firm may try to foreclose its competitors by tying or bundling. *"Tying"* usually refers to situations where customers that purchase one product (the tying product) are required also to purchase another product from the producer (the tied product). *"Bundling"* usually refers to the way products are offered and priced by the firm. In the case of pure bundling the products are only sold jointly in fixed proportions. With mixed bundling the products are also made available separately, but the sum of the stand-alone prices is higher than the bundled price.

- Predation: The Commission considers that a dominant firm predates if it deliberately incurs losses or foregoes profits in the short term, so as to foreclose or be likely to foreclose one or more actual or potential competitors with a view to strengthen or maintain its market power and thereby cause consumer harm.

- Refusal to Supply: Firms, whether or not they are dominant, have a right freely to choose their trading partners, and freely to dispose of their property. Refusals to supply will only be considered abusive by the Commission in very rare circumstances.

  The concept of refusal to supply covers a broad range of practices, such as the termination of an existing commercial relationship, refusal to supply products, to provide interface information or to grant access to an essential facility or a network.

  The Commission considers that a refusal to deal is in principle liable to be abusive if the following cumulative circumstances are present, unless the refusal can be shown to be objectively justified:

  - where the refusal relates to a product or service indispensable to the exercise of a particular activity on the downstream market;

  - where the refusal is of such a kind as to lead, or to be likely to lead, to the elimination of effective competition on that downstream market;

- where the refusal to supply leads, or is likely to lead, to long-lasting consumer harm.

Exploitative abuses: is behaviour which directly affects consumers. The difficulty in dealing with this type of abuse is how a competition agency should determine optimal parameters like price or output. The test for excessive pricing which the European Court of Justice has devised is:

(1) whether the difference between cost and price is excessive, and

(2) whether the price is unfair in itself or in comparison to competing products. What is excessive? What is fair?

As you can see from the inventory of abuses that I have just made abusive conduct can assume many shapes and forms. It is therefore good that under the Chinese Anti Monopoly Law, as is the case under EU law, scope is left for dealing with types of conduct that does not fit into one of the pre-defined categories of abuses in the law text.

As for the various forms of abuses, on the basis of our ongoing reflection in this field we can draw some experiences that are relevant for the Anti Monopoly Law.

First, we consider that the focus should clearly be on protection of competition – and not the competitors - for the ultimate benefit of consumers.

As for the competitive harm, one should take into account not only short term harm, but also medium and long term harm – even though those are inherently more difficult to predict. Often the medium or long term effects are those that ultimately count.

A competition authority needs also to take into account that the same type of conduct can have efficiency-enhancing as well as competition restricting or eliminating effects. Several of the specific provisions of Article 17 refer to the concept of "*'without proper reason'*. It is to be commended that there is scope for taking justifications into account. However, there is a risk that this concept will be interpreted differently from the monopoly agreement exception rule. Two interpretations would appear possible: a narrow interpretation whereby valid reasons would only encompass factors leading to the conclusion that the conduct is devoid of any restrictive object or effect, or a wide interpretation whereby no abuse is found as soon as there is a business justification for the conduct in question even if it also has likely negative effects. Neither approach is satisfactory. An alternative is to consider a similar approach to the one contained with respect to agreements which provides a framework for balancing pro-competitive and anti-competitive effects. This would clearly need more reflection.

I encourage you to provide clear guidance on the meaning of *'without proper reason'* in Article 17 in the future implementation rules. This would help the competition authority to distinguish the normal business practice and the abuse and would also provide guidance to business.

2.3. IPR and the concept of abuse

A particular field of the debate regarding abuse has for decades been IPR. Article 55 makes it clear that the Anti Monopoly Law is not applicable to conducts by undertakings to protect their legitimate intellectual property rights in accordance with IP law. However, the Anti Monopoly Law is applicable to the conduct of undertakings to

eliminate or restrict market competition by abusing intellectual property rights. It is positive that the Anti Monopoly Law applies only to abusive exploitation of IPR. The problem is of course to determine what should be considered as abusive exploitation.

The application of competition law is complex and should be applied in a manner that respect the IPR and which encourages investment in R&D. Under EU law the exercise of intellectual property rights is also subject to the prohibition of restrictive agreements and the prohibition of the abuse of dominance but in the application of the law it is taken into account that licensing is generally efficiency enhancing and that care needs to be taken not to discourage investment in innovation. The EU has a solid case law outlining its policy which provides excellent guidance in this respect and DG Competition has made a study analysing the legal situation for the Chinese authorities which makes excellent reading regarding this difficult but crucially important issue.

A prominent case in this field which has been decided so recently that it is not included in the study I just mentioned, is the Microsoft case. In the *Microsoft* decision[4], the Commission found that interoperability information was needed to allow Microsoft's competitors to compete with it in markets neighbouring the market for personal computer operating systems. It also found that Microsoft's bundling of the Media Player with the PC operating system was abusive.

In its ruling issued on 17 September 2007[5], the Court of First Instance upheld the Commission's decision, finding that Microsoft had abused its virtual monopoly in the market for personal computer operating systems, *inter alia* by seeking to leverage that position into markets for work group operating systems by refusing to give its downstream competitors access to the minimum interoperability information necessary to allow them to effectively compete in those other markets. The Court confirmed that "exceptional circumstances" have to be present before finding an abuse when intellectual property rights are involved.[6] The Court noted in particular that (and I quote) *" the following circumstances, in particular, must be considered to be exceptional: in the first place, the refusal relates to a product or service indispensable to the exercise of a particular activity on a neighbouring market; in the second place, the refusal is of such a kind as to exclude any effective competition on that neighbouring market; in the third place, the refusal prevents the appearance of a new product for which there is potential consumer demand"*.

The Court moreover upheld the Commission's claims that the bundling of the Windows Media Player forecloses competition in the media players market. The Commission observed, in particular, that in classical tying cases both it and the Community Courts 'considered the foreclosure effect for competing vendors to be demonstrated by the bundling of a separate product with the dominant product.

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4 Commission Decision 2007/53/EC of 24.03.2004.

5 Judgment of the CFI of 17.09.2007 in Case T-201/04, *Microsoft v Commission*.

6 *"It follows (…) that the refusal to deal by an undertaking holding a dominant position to licence a third party to use a product covered by an intellectual property right cannot in itself constitute an abuse of dominant position within the meaning of Article 82 EC. It is only in exceptional circumstances that the exercise of the exclusive right by the owner of the intellectual property right may give right to such an abuse".*

3. REVISION OF EU POLICY

As you may know, the European Commission is conducting an internal reflection on the policy underlying our legal provisions on abuse of dominance (Article 82 of the EC Treaty), and the way in which we should enforce that policy.

In December 2005 the Commission published a Staff Discussion Paper which raises various points on exclusionary abuses for discussion with third parties. The Paper was in public consultation until 31st March 2006. We received more than 100 submissions. The next step was a Public Discussion that was held on June 14th 2006. This focused on the most topical issues raised in the submissions.

On the substance, most commentators supported the suggestion in the Discussion Paper to move to a more economic approach with a clear effects based analytical framework – and with a clear objective to protect consumer welfare.

We are taking some time to reflect on the various messages we received last year. Presently, we are in the process of formulating internal conclusions on the basis of the comments received and advancing insights further to internal discussion.

Obviously, the formulation of policy guidance on a legally and economically complicated topic like unilateral conduct is an important step. We therefore need to reflect carefully on issues like the right balance between a more 'case by case analysis' and the formulation of general rules, the relationship between policy guidance and case law, and even the appropriateness of issuing policy guidance. In this matter 'getting it right' has priority over speed. We therefore need to call on those who are waiting for next steps for somewhat more patience until we have finished our internal work.

3.1. EU Effects based approach

I would nevertheless like to share some of the lessons we have learnt from the discussion so far and which I consider to be of high relevance for the future Chinese enforcers of Chapter III of the Anti Monopoly Law.

One of the primary lessons we have learned that comes to my mind is that there is wide agreement on the need to switch from a primarily form based approach to an effects based approach.

This wide consensus may seem surprising in view of the apparent attractiveness of form-based rules: when a given conduct fits the form, it is *a priori* easier to predict the outcome of an assessment of compatibility with the law and it is easier to carry out that assessment. This should in principle strengthen legal certainty and lower enforcement costs at the same time.

But adopting an approach based on *per se* illegality or *per se* legality under competition laws only makes sense when the form of conduct in question is almost always or – conversely – almost never harmful to consumers.

However, most of the types of conduct falling to be assessed under our provision on the abuse of dominance can have both anti-competitive and pro-competitive effects and therefore should not be deemed always legal or illegal. If we agree that such an approach is not always suitable for the application of these provisions, the challenge is then to design a workable and operational approach, which allows timely enforcement decisions

by the competition authority and provides predictability of policy for dominant companies to allow self assessment of their conduct.

A properly defined and structured effects-based analysis will help to ensure that intervention takes place only where necessary. As Commissioner Kroes already noted in Fordham in 2005, we should be cautious about intervening in the functioning of markets *unless* there is clear evidence that they are not functioning well. This means that competition authorities should concentrate on cases that really matter in terms of consumer welfare.

Moreover, we have learned some lessons as to how a more effects-based approach could or even should be properly established.

The first element in this is that having an effects-based approach does not mean embarking on an in-depth assessment on every case. Indeed, it is not in any way incompatible with the establishment of *ex-ante* rules and presumptions, providing the rules are empirically based.

The second element is that the aim of our policy must be clear. We believe that, in the context of exclusionary conduct, the ultimate objective of on the abuse of dominance is to increase consumer welfare by protecting competition.

A third element is that, in order to properly protect consumers, it is necessary to intervene not only when there are actual negative effects, but also when there are likely negative effects. Consumers are not optimally protected if we have always to wait until they are actually harmed. In order to identify likely consumer welfare effects we should therefore look at the likelihood of an increase in market power compared to a properly defined counterfactual.

A fourth element is that conduct that increases market power may at the same time have beneficial effects for competition and consumers. These efficiencies or pro-competitive effects that can be brought about by the dominant undertaking will have to be weighed against the negative effects to competition caused by the increase in market power. This will moreover render the analytical approach which we adopt consistent with the approach we take in applying Article 81 EC and in merger control.

In short, this means that we would apply to the unilateral conduct of dominant firms the same assessment as we already apply under our rules on restrictive agreements and in merger control, namely a balancing of the negative and positive effects on consumer harm. This does not mean that some specific tests can not and will not play a useful role, in particular when it comes to establishing that particular forms of conduct are anti-competitive in a given case.

4. CONCLUSION

Let me conclude with one final observation on my part. It seems to me that, while Europe may not always be the fastest in adapting its policy to new economic thinking, the process of change that we have witnessed over the years, of introducing a more effects-based approach, of applying a consumer harm test in all areas of antitrust, is nonetheless a robust one. One advantage of this slowly-but-steadily process of change is perhaps that the pendulum has less swing. I hope that means that, in the end, this will help to guarantee greater durability and predictability of our policy.

Ladies and gentleman, this was about the European Union experience. This Symposium, as so many others that the Chinese authorities have organised since they started working on the Anti Monopoly Law, shows their willingness to reach out and learn from others' experiences. But each country is different and of course China needs to take into account its specificities and today I can only give China one real advice– do as Europe: take your time to found your own policy approach in this area.

Thanks for your attention!

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