SPEECH

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Remarks on Unilateral Conduct

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I would like to thank Chairman Debbie Majoras and Assistant Attorney General Tom Barnett for giving me this opportunity to speak at the joint FTC/DoJ hearings on Section 2 of the Sherman Act. These hearings reflect a strong interest throughout the world over the last few years in what you call "single-firm conduct". At the international level, the International Competition Network (ICN) at its 5th Annual Conference in Cape Town in May launched a new Working Group on Unilateral Conduct. The OECD has arranged Roundtables on issues related to single-firm conduct. And numerous conferences have had single-firm conduct figuring prominently on the agenda.

In the European Commission we began reflecting on our enforcement policy of Article 82 of the EC Treaty a few years ago. Article 82 is the Treaty article prohibiting abuses of dominant positions, so broadly equivalent to your Section 2. We thought this was a logical step after having "modernised" the application of Article 81 – the article dealing with agreements - and the merger control regime in the years before. This modernisation had brought in a more effects based approach to both Article 81 and merger control. It was now time to review Article 82 in a similar way.

The application of Article 82 was criticized for being fragmented without clear guiding principles and for applying in some instances general form based criteria whose meaning was not always clear in specific cases. To the extent that this would cause Article 82 to be applied in cases where there would not be a sufficient likely or actual restrictive effect on the market, this would clearly be wrong. There was much concern from the business community about these false positives, so-called Type I errors. Likewise, it would be a mistake if a form based approach caused Article 82 not to be applied to cases in which there was a likely or actual harm to the market – false negatives, or Type II errors. The vocal parts of business were perhaps less concerned about these errors, but as an authority charged with protecting consumer welfare, I believe we need be concerned about both. These were the reasons for us to review our application of Article 82.

After some initial internal debate, we involved our colleagues in the National Competition Authorities in the EU Member States in our discussions. Then in December 2005 we published a Discussion Paper on the application of Article 82 to exclusionary abuses. The Discussion Paper suggested a framework for the continued rigorous enforcement of Article 82, building on the economic effects based analysis carried out in recent cases. It described a consistent methodology

for the assessment of some of the most common abusive practices, such as predatory pricing, single branding and rebates, tying and bundling, and refusals to supply.

The Discussion Paper did not go through all of the aspects of Article 82, and in the short time we have today I cannot go through all aspects of the Discussion Paper. What I would like to do instead is to emphasize some of the principles that we set out in a section in the Paper called "Framework for Analysis of Exclusionary Abuses". I will then give you a flavour of where we are after reflecting on the reactions we have had during the public consultation.

The Paper makes clear that the main objective of Article 82 is to protect consumer welfare by protecting competition. We want to protect competition on the market, not individual competitors. The basic assumption is that competition will benefit consumers and that limits on competition will hurt consumers. Limits on competition should therefore, in principle, be prohibited unless it can be shown that efficiencies outweigh the loss of competition for consumers.

The Discussion Paper states that we are concerned about likely and actual effects on consumer welfare in the short, medium and long term. Obviously, the longer the conduct has been going on, the more we will concentrate on actual effects.

Consumer welfare is therefore the anchoring principle for our competitive analysis. We do not enter much into what Chairman Majoras in her opening remarks at these hearings called a search for the "Holy Grail" test. I agree entirely with her that this debate runs the danger of becoming too academic to be of much practical significance. Though rather than the Holy Grail, I see it more as the search for the Grand Unified Theory: just as physicists strive to find the theory that unifies Newtonian physics and quantum mechanics, so economists strive to find the theory that unifies the various aspects of anti-competitive unilateral conduct. And the economists, just as the physicists, have not yet found it.

Some have read the Discussion Paper as attempting to set out such a Grand Unified Theory of abuse. That was not and, particularly after the robust public comments, will not, be our intention. The Discussion Paper was intended to be the Commission's first contribution to the discussion, not the Commission's last word.

The Paper argues that two central questions have to be asked:

The first question is: does the conduct have the 'capacity' to foreclose? This depends in good part on the form and nature of the conduct. Sometimes the answer is fairly obvious, as for exclusive dealing contracts. Sometimes it is much less obvious – think for example of rebates. I will come back to this in a moment.

The second is: does the conduct have a likely or actual market distorting effect?

Likely effects are effects which, in a specific market context, are predictable on the basis of experience and/or a solid theory of economic harm. The likelihood and significance of foreclosure depends on factors such as pre-existing market power and barriers to expansion or entry, the market coverage of the conduct, and, in case of selective foreclosure, the importance of the targeted customers or competitors.

Actual effects are established on the basis of evidence of market evolution in the past. This does not necessarily involve complicated economic studies but can be facts as presented to or obtained by the authority.

Let me now come back to rebates. As I mentioned earlier, it is not immediately obvious whether a certain rebate scheme has the "capacity to exclude". To answer that question we first need to ask: exclude who? In the paper we propose that for rebates - as well as for other types of price based conduct –the exclusion of "as efficient competitors" is abusive. Though this is not the only test which can be used to show abuse, it is a useful one, as it allows dominant firms to assess their conduct based on their own costs. A failed price-cost test is of course not the end of the analysis. We would still have to show a likely market foreclosure effect.

The Paper also states that if conduct clearly creates no efficiencies and only raises obstacles to residual competition there is no need to carry out a full effects analysis. Such conduct can be presumed to be abusive. However, as with any presumption, the dominant company can of course rebut it by providing evidence that the conduct will create efficiencies or is objectively justified.

Exclusionary conduct may escape the prohibition of Article 82 if the dominant undertaking can provide an objective justification for its behaviour or if it can demonstrate that its conduct produces efficiencies which outweigh the negative effect on competition.

There is an objective justification where the dominant company is able to show that the otherwise abusive conduct is actually necessary on the basis of objective factors external to the parties involved - and in particular external to the dominant company ("objective necessity defence"). The dominant company may, for example, be able to show that the conduct concerned is objectively necessary because of reasons of safety or health related to the dangerous nature of the product in question. Such necessity must be based on objective factors that apply in general for all undertakings in the market.

Now I come to the question of efficiencies. The same conduct can of course have effects which enhance efficiency, and effects which restrict competition. In the Paper we propose a weighing or balancing approach where efficiencies are balanced against the negative effects on competition, and that balancing exercise determines whether or not the conduct is abusive.

This balancing test is important, and notwithstanding all of the discussions about how efficiencies should be assessed, and upon whom the burden of proof should lie, the one core element that I cannot see us moving away from is that fundamentally there should be this balancing. The purpose of competition law is to maximise consumer welfare. Of course consumer welfare can be harmed by inappropriate intervention by a regulatory body in the market. But it can also be harmed by inappropriate reluctance to intervene as well. As I mentioned earlier, in working to maximise consumer welfare, we need be as concerned by Type II errors (under-enforcement) as by Type I errors (over-enforcement). And we need be as concerned by not giving enough emphasis to efficiencies (by focussing on the harm, regardless of the benefits) as we are by giving too much emphasis to efficiencies (by ignoring the harm, regardless of the net impact on the market).

As to how we carry out this analysis in practice, EC law already provides us with a framework. Certain types of conduct can be analysed both under Article 81 and under Article 82. Consistency requires that the conditions for assessing efficiencies defence under Article 82 be similar to those of Article 81(3), which exempts restrictive agreements if certain conditions are met. These conditions are:

- Efficiencies are realised or likely to be realised by the conduct (conduct-specific)
- The conduct is indispensable to realise the efficiencies
- Overall consumers should benefit from the efficiencies ('consumer pass on')
- Competition should not be eliminated in respect of a substantial part of the products concerned. In the Paper we interpret this as a level of dominance above which protecting the competitive process normally will outweigh possible efficiencies. We suggest that this might be a dominant position with a market share above 75%, and no meaningful competitive pressure left from either residual or potential competitors.

The burden of proving a capability to foreclose and a likely or actual foreclosure effect falls on the authority or plaintiff. However, the burden of proving an objective justification or efficiencies should be on the dominant company. It should be for the company invoking countervailing factors to the negative effects to demonstrate these factors to the required legal standard of proof.

Let me now turn to where we are after a first analysis of the reactions to the Discussion Paper as reflected in the more than 100 submissions we received during the public consultation phase.

Let me first describe what I see as areas of reasonable consensus:

- There is a broad welcome for the overall aim of clarifying the application of Article 82 and for an effects based approach;
- There is a broad welcome for the clarification that the ultimate objective of Article 82 enforcement is to protect consumers (even though the extent to which an authority ought to show the impact on consumers is disputed);
- There is also broad consensus on the aim to protect competition and not competitors;
- An authority must be free to act where harm remains likely, but has not yet come to pass. We do not have to wait until the patient is dead before we try to revive him;
- Safe harbours and presumptions, both for legality and illegality, are necessary to ensure practicality of the effects based approach – but of course they have to be based on sound economic principles.

However, there are also some difficult open questions:

As I said earlier, we consider that conduct that clearly creates no efficiencies and only raises obstacles to competition can be presumed to be abusive. But what are the classes of conduct which are so nakedly abusive that we can have a per se rule prohibiting them? Similarly, conduct which is clearly competition on the merits should always be legal. But what are the classes of conduct which are so clearly competition on the merits that we can assume per se legality?

When it comes to price-based conduct, how far should we rely on price-cost tests? What are the alternatives to price-cost tests? And how exactly should they be formulated? For example, we need to show profit sacrifice to prove predation. Is profit sacrifice also an appropriate test for other price based abuses, for instance for rebates?

The role of the so-called meeting competition defence is most clear when it comes to price discrimination. In the US you even have it stated explicitly in the Clayton Act. It makes perfect sense that a company can argue that the reason it charges different prices to different customers is that the competition forces it to do so. However, it is much less clear what role the meeting-competition defence should have beyond price discrimination. For example, I am not sure it should be a defence in itself that a company argues that it is losing money on particular sales by charging prices below avoidable costs because competition forces it to do so. That begs the question why the company wants to make those sales at all. It may have a good reason for doing so, but it seems to me that that reason then should be the "defence", not the meeting-competition argument in itself. So what is the role of a meeting-competition defence outside price discrimination? Under which conditions would it be applicable?

The reactions to our Discussion Paper showed general support for efficiencies playing a role in the analysis, but differing opinions as to whether it is correct to apply the same conditions as Article 81(3) - and in particular whether the burden of proof should be on the dominant company. There are other issues to consider with respect to efficiencies. For example, what can we say about which efficiencies should be admitted in respect of which type of conduct? A related question is how the innovation incentives of a dominant firm can be balanced against the incentives for rivals' follow on innovation.

These are only some of the difficult policy questions which we need to answer if we want to issue guidelines on Article 82. Back in Brussels we are reflecting on all these issues. At the same time the debate is continuing around us and around the world. These hearings are of course one of the fora we are following with particular interest.

We are all in search for the right policy. Let there not only be global competition for the best practices, but also global cooperation and discussion to improve our rules. In the end I don't think we should expect too much divergence in view of the broad consensus on many basic principles. However, we should probably not expect total convergence either. Differences in legal systems and different stages of economic integration and liberalisation of markets will in all likelihood continue to shape the way competition policies are applied in various parts of the world.