

ARTICLE 82 EXCLUSIONARY CONDUCT DISCUSSION PAPER: AN INTERVIEW WITH MICHAEL ALBERS AND LUC PEEPERKORN, DIRECTORATE GENERAL – COMPETITION OF THE EUROPEAN COMMISSION

In December 2005, the Directorate General – Competition of the European Commission (“DG Competition”) released for public comment a discussion paper on the application of Article 82 of the EC Treaty to exclusionary abuses (the “Discussion Paper”). To explore the issues raised by the Discussion Paper, Jay Modrall, Courtney Schaberg and Julie Soloway of the Section 2 Committee interviewed Messrs. Michael Albers and Luc Peepkorn of DG Competition, respectively head of the DG Competition unit responsible for the Discussion Paper and one of the main authors of the Discussion Paper. The following is subject to the caveat that the views expressed by Messrs. Albers and Peepkorn are individual and are not necessarily shared by DG Competition.

Section 2 Committee (“S2C”): As you know, the U.S. antitrust agencies have declined to publish guidelines on the application of Section 2 of the Sherman Act. Could you describe briefly why the Commission decided to undertake the huge effort leading to publication of the Discussion Paper?

ALBERS: There are a number of reasons, but I will limit myself to the most important ones. The first reason is that we have already done a similar exercise for other provisions of European competition law, in particular for Article 81, which is comparable to Section 1, and for the Merger Regulation. This all started in the late nineties, and actually Article 82 is the last provision left, so to speak, that needs to be reviewed in order to align our enforcement policy to an effects-based approach. Another reason that is pertinent to the exercise right now is that we have been building what we call the European Competition Network. Community competition law is not only applied by the Commission; since the adoption of Regulation 1/2003, it is compulsory for national authorities to apply Community law where trade between Member States is affected. In order to ensure coherence of enforcement, we need to have very clear rules, so that everybody can enforce the rules similarly. Thirdly, the Discussion Paper is also a potentially important document for national courts, because national courts are also expected to apply EC competition law more than ever before. In case the Discussion Paper leads to the adoption of guidelines, these guidelines will be an important

document for the application of EC competition law in Europe by many more actors than ever before.

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S2C: The Commission has said that the Discussion Paper is not intended to call into question any existing case law. While some of the Discussion Paper clearly summarizes existing practice, the Discussion Paper also introduces long, detailed sections that appear to be new and potentially to change the current approach. Can you identify any areas in which DG Competition is trying to use the Discussion Paper to change the way companies analyze proposed conduct, or the way the Commission and national

authorities and courts themselves look at alleged violations, under Article 82?

ALBERS: I think the approach that we have taken is evolutionary. Commissioner Kroes has said that she is not in favor of a radical change or shift in policy. The Discussion Paper therefore builds on the jurisprudence, but this doesn't mean that we are not proposing relatively new things. In all five areas of exclusionary abuses which are covered by the Discussion Paper, you will find something new. To highlight the most important changes from my point of view: The attempt to develop a general analytical framework has never been made before and is an important step. We want to ensure coherent application of the law to different types of abuse in order to avoid a bias in our enforcement policy and to treat similarly all conduct that has an equivalent effect.

Apart from introducing a general framework, I think the approach to dealing with price-based abuses is very new by European standards. Certainly another highlight is the introduction of an “efficiency defense”. For me, these three are the most important and striking innovations on the basis of an evolutionary concept.

S2C: When you say that you see the approach to price-based abuses as an area of novelty in the Discussion Paper, are you talking principally about the introduction of more economics-based analysis and concepts?

ALBERS: Yes, I think that we now propose a more consistent economic approach for all abuses treated in the Discussion Paper.

S2C: When you were developing the Discussion Paper, were you influenced by other jurisdictions? Which jurisdictions in particular have you found helpful or informative?

ALBERS: Oh yes, the Discussion Paper certainly also builds on the work done by other jurisdictions. We did not even try to develop something completely homegrown - a Brussels greenhouse plant. We rather tried to integrate in our own analysis and thinking all the materials that we could get, but, of course, there is a limit to what a team of basically two economists and two lawyers can do within a given period of time. While we attempted to learn as much as we could from various sources, I certainly would not claim that we have read everything.

In terms of particular jurisdictions, the U.S. and Canadian experiences are of great interest. But if I start identifying countries, I also have to mention that we have been talking to our national authorities in the 25 Member States of the EU. Indeed, we have had an exchange with them about what you might call "best practices" they have been developing. In a number of meetings here in Brussels, we have been going through various types of abuses and comparing approaches.

S2C: The introduction of detailed economic analysis in some areas where case law suggested an almost per se prohibition is a striking and welcome innovation. But some of the analysis described will be difficult if not impossible for companies to perform, especially ex ante in their internal analysis of whether proposed conduct is permitted. How has DG Competition tried to balance the goals of taking a more economics-based approach to Article 82, while still setting out workable rules that can be applied by companies?

ALBERS: You are touching on a very important point. For us it was a very important issue to be taken into account at every step, how to combine economic- and effects-based analysis with predictability and certainty. I don't know whether we have succeeded, but we have certainly tried to satisfy both requirements, partly by basing ourselves on concepts and approaches that are already there in other Commission guidelines. To combine an effects-based approach with a reasonable degree of predictability, we use three main tools: one is to describe the methods of analysis that we propose for different types of conduct. Another way to provide predictability is to formulate safe harbors, which we tried to develop in the Discussion Paper. Finally, we use presumptions to indicate under what conditions we think the burden of proof should shift to the defendant in a given case. We do not want to end up with a perfect effects-based approach, in which every case finds its perfect outcome, if the approach is not operational and has the consequence that Article 82 can no longer be enforced.

PEEPERKORN: I think it is also important to stress that it is an effects-based approach and not so much an economics-based approach. The purpose is not to apply economics; the purpose is to assess whether there are effects. The way to do this for price-based abuses or conduct is somehow to draw the line between pro-competitive pricing, which may hurt some competitors, but which would not hurt competition, and, on the other hand, pricing which hurts competition. What we have basically done, by introducing the as-efficient competitor test and therewith applying a price-cost test, is to take the most applicable or enforceable rule, because it is based on information or data which a company normally has available, such as data on its own costs and pricing. If you want to have an effects-based approach and a degree of predictability, you have to define the type of tests or rules that you will use. The question is one of alternatives; which alternative would be less of an imposition, less complex, but still make it possible to assess the same effects? As you said, some of the analysis may be complex or difficult at times, but we have not yet found better alternatives.

S2C: What will be the legal effect of the final product for national competition authorities and courts?

ALBERS: The Discussion Paper as such has no effect. We are very keen to try to develop a space for ourselves to think publicly, so to speak, with everyone being involved in this thinking and reflection process. The document that could have an effect for companies would be Commission guidelines, and even then they would only bind the Commission. Of course, we are not doing this only to bind ourselves, we are also doing it, as I have indicated before, in conjunction with our colleagues at the national level. We expect the process to have a knock-on effect, certainly on what the national competition authorities do, but also on what the national courts do. But there is an ultimate judge and that judge is in Luxemburg. The European Court of Justice will tell us in the end whether whatever approach the Commission might adopt is the right one under Community law.

S2C: Further to your comments about possible future guidelines, do you envisage publishing a separate Discussion Paper on non-exclusionary abuses before publishing guidelines? When would you expect the final guidelines to come out?

ALBERS: Our intention at this point is to use the consultation period to improve what is now on the table with the Discussion Paper and potentially come out with a more definitive product. We think that exclusionary conduct is the most important and controversial area of abuse control. We should therefore, not only in enforcement, but also in policy terms, give priority to exclusionary abuses. However,

should the Commission decide to come out with draft guidelines, we will also try to add sections on exploitative and discriminatory conduct. Everybody would then have the possibility to comment on our approach to all types of abuses of dominant positions.

The plan is to have draft guidelines, if we go in that direction, by the end of the year, or, because we have a lot more translation to do than for the Discussion Paper, early in 2007. As regards the adoption of the final guidelines, it is difficult to give an answer; I would expect adoption in the course of 2007, but it is impossible to be more specific at this moment.

S2C: There is a widespread view in the U.S. antitrust bar that Article 82 is applied much more aggressively than Section 2, to prohibit conduct that would be viewed as legal, and even pro-competitive, in the United States. Do you agree with that view, and do you see the Discussion Paper as representing a trend towards convergence in this area?

ALBERS: I do not regard myself as an expert on U.S. antitrust law, so treat what I'm going to say with caution. Looking at the U.S., I'm not sure when we talk about convergence with whom and with what I should compare the Discussion Paper. To give you an example, if you compare what currently is U.S. practice or at least U.S. case law with regard to tying, then I would say that our Discussion Paper goes further towards an effects-based approach. On the other hand, if you look at the Discussion Paper approach to predatory pricing standards, I think there is certainly convergence. But again I have to emphasize that one needs to be careful about any comparison, because you have different actors in the U.S., as we have in Europe, and they have different views. So I would say the general direction is convergence, yes, but in detail I think you have to be careful with whom and what you compare.

PEEPRKORN: At least overall, although that is not the goal of the whole process, I think one can say that there is in the Discussion Paper a certain convergence with the U.S. approach.

ALBERS: We regard convergence not as negative, but rather as positive. But you have to understand that we are not doing the review for the purpose of convergence. We have our own reasons for doing the review. If there is a positive side-effect of convergence, this is all the more welcome, certainly.

S2C: The Discussion Paper discusses the concept of dominance in very general terms. While the Discussion

Paper acknowledges that market shares are not determinative of dominance, it suggests that a company may be found dominant with market shares below 40%, or even below 25%. This is counterintuitive in the United States, where much higher market shares are typically

required for a Section 2 violation. Would the Commission consider including safe harbors, or at least a positive statement that dominance will be presumed not to exist with market shares below 40% in the absence of special circumstances?

ALBERS: I would say that we are also more likely to find dominance above 40% than below. The Discussion Paper does not change this; however, it proposes to remove

the dominance presumption that the courts have created for a firm with a 50% market share. It is true that our wording seems to have given rise to some misunderstandings. We will review that chapter and see whether we cannot improve it in order to make very clear what we think the direction should be. However, the negative presumption linked to a 25% market share is something which is for us difficult to change. It derives from a recital in the European Merger Regulation. The Regulation contains the presumption that dominance is unlikely until the market share of 25% has been reached. We cannot easily change a presumption which the European legislator has created, nor can we easily go beyond it in a Discussion Paper or in any guidelines.

PEEPRKORN: The only really new point in that whole chapter is, as Michael said, that we have moved away from the presumption which you find in the case law that there is dominance above the 50% market share threshold. We now only talk about this being an indication, but all the attention seems to have been drawn to what is merely a repetition of what has already been decided elsewhere concerning the possibility of a dominant position below this threshold.

S2C: On a related point, the Discussion Paper refers in various paragraphs to the notion of "degrees of dominance," but this concept is not fleshed out in the discussion of dominance. Can you elaborate on the notion of "degrees of dominance" and how it is or might be taken into account in the Commission's analysis of exclusionary conduct?

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ALBERS: Yes. I think what we are trying to say is that realistically market power is not a uniform concept. There is not only one degree of market power and that is it. There exist different degrees of market power, and therefore there are also different degrees of dominance. It makes a difference in real life terms whether a firm in a market with high entry barriers has a 50% market share with 50% of the market still held by competitors or whether it has an 89% market share, as we had in one case, with only 11% of the market still held by competitors. When you look at conduct under Article 82, such as single branding, it makes a difference for switching possibilities whether a customer faces a single branding obligation from a supplier that has a 50% market share or from one that has an 89% market share. This is what we wanted to say. I would thus not exclude that particular conduct may still be allowed for one dominant firm, but not be allowed for another dominant firm, depending on the degree of dominance.

S2C: Do you think this concept can be worked into the presumptions or the allocation of the burden of proof in the analysis of specific abuses?

ALBERS: This request would lead us to take general and therefore arbitrary decisions on possible thresholds. I do not think that this is such a good idea. It is something we can discuss, of course, but I think it is better to deal with the degree of dominance issue when we deal with the abuse in an actual case.

PEEPERKORN: It will not affect the burden of proof issue, which is governed by the application of our general rules. It would also probably not be very wise to try to create market-share-based indications of degrees of dominance. Neither is it advisable to create safe harbors based on a combination of market share and coverage ratio, i.e. the part of the market affected by the conduct in question. In this area, we are talking about dominant companies, and any general applicable safe harbors will be so low that they will not be very helpful. What we may do, but that is again a “may”, if we get to the stage of guidelines, is to think about using examples. In examples, of course, one can filter in more factors, like whether or not this is a market characterized by network effects, whether there are high or low entry barriers and to what extent potential competitors have an influence.

S2C: U.S. readers of the Discussion Paper may also be perplexed by the analysis of abuses of “collective dominant positions.” Section 4.3 of the Discussion Paper explains that for collective dominance to exist two or more companies

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must present themselves or act together as a collective entity on the relevant market. Section 5.4 on “abuse of collective dominance” seems to set a lower standard, however, since an abuse may apparently be found from completely tacit conduct. Section 5.4 notes that the case law “so far” has involved companies with strong structural links. The notion that an abuse may be found without any evidence of express conduct, and even without strong structural links between the companies involved, will be troubling to many. Could you clarify this issue?

ALBERS: In our jurisprudence so far, we haven’t had many of these cases, and we are trying here to elaborate some guidance on the basis of the scarce case law that exists. It is important to point out that it clearly is not enough to find collective dominance. It is also necessary for applying Article 82 that we establish some kind of common action as regards the conduct in question. There must be a common policy of the collectively dominant firms that finds its expression in the abuse. Collective dominance is not an area where we think we should encourage enforcement in the future. We thought, however, that we should cover this notion in the Discussion Paper because it is expressly in our statute.

PEEPERKORN: It is certainly not the intention to go after every tight oligopoly where you see similar behavior by the oligopolists. There has to be more to it than that.

ALBERS: We understand the concern being voiced that all of a sudden we could find firms with low market shares abusing a dominant position without providing much evidence that there exists in fact a group that is enjoying market power and acting collectively. We understand the concern, and maybe we should re-visit this chapter in order to deal with this concern.

S2C: The Discussion Paper does not define the elements of an exclusionary abuse, but uses a number of expressions to describe the elements of an abuse and the degree of foreclosure required. If conduct is “clearly not competition on the merits,” the Discussion Paper says a presumption of abuse arises, but a dominant company can rebut the assessment of a likely or actual exclusionary effect or show that the conduct is objectively justified. Would it be fair to summarize the Commission’s view of the elements of an exclusionary abuse as follows: (i) exclusionary conduct, which may be price-based or non-priced based, defined as conduct that is not “on the merits”; (ii) a significant actual or

likely foreclosure effect harmful to consumers; and (iii) the absence of a defense such as objective necessity, meeting competition, or creation of efficiencies?

ALBERS: We agree with the three steps. However, in the first part of your question you relate exclusionary conduct to the notion of “competition on the merits.” We would always add the analysis of foreclosure and defenses before determining whether or not conduct is competition on the merits. It is not single branding as such, or tying as such, that is already not competition on the merits. You have to add the other steps of the analysis, if you want to conclude whether certain conduct constitutes competition on the merits.

S2C: Would it be accurate to say that competition on the merits can never be an exclusionary abuse?

ALBERS: Yes.

PEEPERKORN: I think that the term “competition on the merits” has been used in very different manners in the case law and is rather vague. It is more interesting to see what the Discussion Paper proposes as a general scheme, which is similar to the three steps that you have described but not exactly the same. We are indeed proposing three steps. The first step is to show whether or not the company is capable of excluding a competitor from a particular customer. The second step is to show whether this also applies to such a high number of customers that it will have an effect of excluding companies from the market. These are two elements to get to an effects-based approach. The burden of proof of this is on us. Then the third step is whether or not there are countervailing efficiencies that are enough to outweigh the negative effects of the first two steps. Whether conduct is price-based or not price-based is only relevant to the question of which test to apply to assess whether or not conduct is capable of having an effect, or whether it will have an effect or not. If conduct is price-based, then we may apply a particular test such as the as-efficient-competitor test, but the general approach is that we have to show exclusionary effect, first by capability, secondly by effect on the market, and that thereafter there is room for a defense.

S2C: The Discussion Paper innovation that has attracted perhaps the greatest level of interest in the United States is the introduction of an “efficiency defense” in Article 82 analysis. The elements of this defense -- that the efficiencies are or are likely to be realized from the conduct concerned; that the conduct is indispensable to realize the efficiencies; that the efficiencies benefit consumers; and that competition will not be eliminated for a substantial part of the products concerned -- are analogous to those set out in Article 81(3) and the Commission’s Horizontal Merger

Guidelines. Although the acknowledgment that efficiencies should be taken into account in Article 82 analysis is welcome, many have commented that if the burden of proof is borne by the companies concerned the defense may be difficult if not impossible to meet.

ALBERS: What we are trying to do here may be striking, given that we have not had an explicit efficiency defense in Article 82 in the past. However, what we are saying in the Discussion Paper about an efficiency defense is actually fairly common stuff. We are basically repeating what is already the legal standard under Article 81. We are using the conditions under Article 81(3) in order to outline the conditions on which a dominant firm would be able to justify conduct which is *prima facie* foreclosing. Since 2004, we have a notice that explains in quite some detail how an efficiency defense can be brought forward in an Article 81 case. Not surprisingly, we have a similar approach under the Merger Regulation, where again in the Horizontal Merger Guidelines we also use the same conditions. It does therefore make sense to apply similar standards in an Article 82 context, in particular if we are dealing with an agreement which is at the same time subject to scrutiny under Articles 81 and 82. The same logic applies to unilateral conduct, where it has the same effects as contractual conduct. Ultimately the two provisions should be in harmony, rather than creating different standards when applied to conduct having similar impact on competition and consumers.

PEEPERKORN: This consistency is required, as Michael said, because Articles 81 and 82 often apply to the same conduct, so one should have a consistent approach. Secondly, it would seem very strange to have a burden of proof which is lighter for dominant companies than we apply under Article 81 for non-dominant companies. One could think of something in the reverse way, but not making the burden lighter for dominant companies. So as this is the normal approach under Article 81 for the same type of conduct, then of course we can only look at efficiencies in the same light under Article 82.

S2C: Another innovation in the Discussion Paper is the adoption of an “as-efficient-competitor” test to assess whether particular conduct can be exclusionary. But we were struck by the statement that protecting consumers may require protection of competitors that are “not (yet) as efficient” as the defendant (para 67). Doesn’t this open the door to inefficient competitors using Article 82 to protect themselves from competition? Can you explain the circumstances in which the Commission would view a less-efficient competitor as entitled to protection, and for how long? How will the Commission determine whether the less-efficient competitor is likely to (prospectively) or actually has (retrospectively) become “as efficient” as the defendant?

Can you give us a specific example of how the Commission would treat a complaint by a less-efficient competitor? For planning purposes, how can a dominant company anticipate which of its competitors is less efficient, and whether that competitor is entitled to protection?

ALBERS: I think this is one of the examples where our approach can be criticized with regard to the tradeoff that necessarily exists between an effects-based approach striving to achieve a correct outcome and predictability. The price-cost benchmark is a sort of static "snapshot" criterion. When in other areas we use these kind of criteria we are always asked to apply a more dynamic assessment. This time we try to indicate that we want to use a price-cost test, yes, but we have to use it in a way that captures the dynamics of the market, and we are again criticized. But we acknowledge that this is a slippery slope, and the questions you are asking are very pertinent. We will give further thought as to how we can improve this section. Maybe in the consultation, other people will come up with a better idea than we have been trying to develop here.

PEEPERKORN: I would add that the as-efficient-competitor test, which is basically a price-cost test, is of course not the aim of the analysis. The problem is that there is no single test that applies in all circumstances and always gives the right outcome. The end aim of competition policy is to protect consumers, and it is easy to find an example where it is good for consumers to protect an inefficient competitor because it has a price lowering effect on the market. On the other hand, a price-cost test does give a certain way to look at cases, it may create relative safe harbors, it may help companies to self-assess their conduct, and therefore it plays a very useful role. What we are doing here is acknowledging on the one hand that sometimes it may be good for consumers to also protect companies that are not as efficient, not yet, or not ever, because there are non-replicable advantages on the side of the dominant company, and at the same time to try to limit these exceptional circumstances, because we ourselves, as Michael said, very much acknowledge it is a slippery slope. I think it is too easy to say that there can never be a case where it is good for consumers to intervene although the conduct only hurts less efficient competitors.

S2C: Although we don't have time to discuss the Discussion Paper's treatment of specific abuses in detail, we would like to touch briefly on rebates and tying and bundling. The treatment of rebates under Article 82 has been widely criticized as unduly complex and restrictive. The Discussion Paper seems to move away from the per se condemnation of prior cases, it still takes a more restrictive approach to rebates than is typical in U.S. law. Since rebates result in lower prices, shouldn't these schemes be presumed legal

unless they can be shown to be predatory? The Discussion Paper's approach, while more flexible than the current approach, still requires a complex analysis that will be difficult for companies to use to assess proposed behavior.

ALBERS: It is not necessarily true that rebates granted by dominant suppliers are beneficial for consumers. We often see that rebates do not really lead to price reductions for the next level and the final consumers. It is true, however, that compared with the current jurisprudence, we are proposing a significant change for the analysis of rebates on the basis of an effects-based approach. This requires a different type of analysis. Admittedly, it is complex, but we are proposing various means which should facilitate companies assessing whether their conduct is risky under Article 82.

PEEPERKORN: In your question it is assumed that a rebate is always giving a lower price. This may be true if you look at companies and markets in general. But here you are looking at dominant companies. Our experience in a number of cases, for example in Michelin, has been that the pre-rebate price, the list price, was even above the retail price. In other words, the list price was not in any way a realistic price on which one then got a rebate. The rebate was bringing the price down to more realistic levels. What economists call the non-contestable part of the demand of the customers was being used to leverage the market power into the more contestable part. You can say this is complex, but I think we all agree that in rebate cases if you want to apply an effects-based approach you have to develop some idea of the part of demand over which you want to calculate the effect of the rebate over which you assess the effect of the rebate on the effective price. It's not the last unit that is being bought, it's not all demand, and that is what we are trying to do. I think there are no alternatives, at least not any we have seen in the literature. We have done some example calculations, and it may not be as complex as you think.

S2C: Treating tying and bundling under the same heading strikes many readers as unfounded. By definition, if the sale of one product is tied to the sale of another, customers have no choice whether they wish to purchase only the tying product. If products are offered a bundle of products, regardless of the price differential, customers do have a choice. Since other frameworks are available for analyzing the price treatment of the two products -- predatory pricing or excessive pricing -- why does the Commission treat bundling as a form of tie?

ALBERS: I think this is probably one of the instances where it is difficult for American lawyers to understand our way of analyzing conduct. For us Europeans, there exists a clear parallel between tying and bundling, on the one hand, and single branding obligations and loyalty rebates, on the other,

certainly as regards possible foreclosure effects. You are correct, that if bundles are offered, a buyer still has the contractual freedom to buy the components separately instead of the bundle. However, if it is cheaper to purchase the bundle instead of the components, it often is rational economic behavior to buy the bundle. Under certain circumstances, bundling may therefore have the same foreclosure effect as contractual tying. Consequently, we do not see the kind of distinction that you see between tying and bundling.

PEEPERKORN: If you look at tying and mixed bundling, the question for both, in terms of effects, is whether they foreclose the tied market? We have to go through the same steps, which means is there dominance in the tied market. Are there distinct products? Will there be a market-distorting foreclosure effect on this tied market? Is there an efficiency defense? In the U.S., for tying you have a rather strict type of analysis, which you do not have for mixed bundling. If you put them in the same box, you would have to apply to mixed bundling a similarly strict approach as your semi per se approach to tying. We have the same effects-based analysis for both. If we look at mixed bundling, we propose to ask ourselves the question, is it or is it not leading to a price below cost for the "tied" product? So we add another test in order to make sure that we look at something which has the capability to exclude an as-efficient competitor, but in all other aspects, as I said, dominance in a tying market, etc., the analysis is the same.